

Thomas Bruce Hart

Appellant

v.

Joseph O'Connor
Paul Michael O'Connor
Francis Joseph O'Connor

Respondents

FROM
THE COURT OF APPEAL OF NEW ZEALAND

REASONS FOR REPORT OF THE LORDS OF THE JUDICIAL COMMITTEE
OF THE PRIVY COUNCIL OF THE 22ND APRIL 1985,
DELIVERED THE 22ND MAY 1985

Present at the Hearing:

LORD SCARMAN
LORD BRIDGE OF HARWICH
LORD BRIGHTMAN
SIR DENYS BUCKLEY

[Delivered by Lord Brightman]

This appeal from a decision of the Court of Appeal of New Zealand concerns the validity of an agreement for sale of three blocks of farmland near Waimate, South Canterbury. The agreement was made between the respondents' predecessor in title as vendor, and the appellant Mr. Hart as purchaser. At the conclusion of the hearing their Lordships indicated that they would humbly advise Her Majesty that the appeal should be allowed for reasons which they would give later. This course was taken in order to mitigate problems which would arise out of a third change in the possession of the land.

The land comprised in the agreement for sale was the subject matter of a testamentary settlement of which at the date of the contract Mr. Jack O'Connor, the testator's eldest son, was the sole trustee. According to findings of fact which are not now challenged, Mr. Jack O'Connor was not of a sufficient mental capacity to enable him to enter into such an agreement, but this was not known to Mr. Hart. Mr. Jack O'Connor has since died and the respondents are the present trustees of the trust estate. The trustees maintain that the contract should be set

aside on the ground of its alleged "unfairness" to the respondents and the beneficiaries whom they represent, and also on the ground that it was an "unconscionable bargain".

The testator who made the settlement of the farmland died in 1911. The trust estate became distributable in 1950 when the testator's widow died. Mr. Jack O'Connor then became the sole trustee. The beneficiaries were the testator's nine children. With the consent of the interested parties a distribution of the trust estate was deferred, and the land instead was farmed by Mr. Jack O'Connor in partnership with his brothers Mr. Dennis O'Connor and Mr. Joseph O'Connor for their own account. It will be convenient to follow the courts below and refer to the three brothers as Jack, Dennis and Joe. The partners lived in houses on the land; Jack and his wife lived in one house and Dennis who was a bachelor lived in another house with Joe and his wife. Mr. Hart farmed neighbouring land. By 1976 when Jack was 83, Dennis 82 and Joe 71, it had become apparent that the brothers were too old to continue farming. It followed that the farm would have to be sold or possibly leased. A lease would however have the effect of further postponing a distribution of the trust estate which was already much overdue. A sale to Joe's sons Paul and Frank, or a sale to an outsider, were the only feasible alternatives. In circumstances which their Lordships will relate, the land was ultimately sold to Mr. Hart.

It is important to appreciate that no imputations whatever are made by the respondents against the integrity of Mr. Hart, and rightly so. Mr Hart's conduct leading up to the sale was above reproach, as the opening sequences of the story will make abundantly clear. The initiative for the disposal of the land came from the trust solicitor and members of the O'Connor family. Although it was going to suit Mr. Hart to become the proprietor of the land, and this was known to those concerned on the O'Connor side, he was content to wait in the wings until a suitable opportunity to buy should arise.

For fifty years the solicitor who had acted for the O'Connor estate was a Mr. Wilson, of the firm of Wilson Watters and Co. He retired in 1970. His partner Mr. Henderson succeeded him as the estate solicitor. By 1977 Mr. Henderson and others were becoming increasingly worried over the future of the land and a solution had to be found. So on 4th March 1977 Mr. Henderson wrote to Jack saying, "I understand that your health has not improved as you would have liked and of course this leads us to think that the worry of running the farm may now possibly be taking its toll. It is obvious that something must be done ...". A few days later Mr. Henderson

attended on Jack in an attempt to persuade him that it was time to give up farming. Jack was reluctant to let Joe's sons take over the farm, but above all he did not want to give up his home. In the upshot Mr. Henderson advised Jack to talk the matter over with his two brothers, and he suggested that the three of them should then come and discuss things with him. Mr. Wilson agreed to be present at such a discussion to assist if at all possible, and it was also arranged that Mr. Laing, the estate accountant, should be there. When nothing happened, Mr. Henderson wrote to Jack again towards the end of the month and to Dennis and Joe as well. Finally a meeting was arranged for 27th April. Mr. Henderson made a note of the conclusions reached at this meeting; it was not feasible for the partnership to continue farming; a sale to a person outside the family was not agreed; a lease, whether to Joe's sons or to a person outside the family, would only be a stop-gap; a sale to Joe's sons seemed the likely possibility, although Mr. Henderson added in his note that previous discussions with Jack and his wife led him to doubt whether Jack would be prepared to sell to them.

On the next day Mr. Henderson wrote to Joe's elder son Paul putting the suggestion to him that he and his brother "should in some manner or other take over the farming interests". There was some urgency because the new lambing season was due to start at the beginning of September. After a delay due to difficulty in getting in touch with Joe's sons, a meeting with them was held in the middle of June; Paul and Frank were keen to take on the farm, but there would be a number of problems, including agreement on price, financing the price, and the provision of a home on the land for at least one of the brothers. Despite his efforts, Mr. Henderson found shortly afterwards that Jack was still in a state of indecision, and he was particularly worried in case he and his wife should have to leave their house. Mr. Henderson wrote to Jack on 1st July to assure him that there was no suggestion that he would have to give up his home even though a sale took place.

Mr. Hart's solicitor was Mr. MacGeorge. He was a member of the same firm as Mr. Henderson. There is no suggestion that there was anything improper in Mr. Hart's continuing to employ his own solicitor although Mr. MacGeorge was a partner of the solicitor acting for the trust estate. On 27th July Mr. Hart saw Mr. MacGeorge and asked him to take up with Mr. Henderson the possibility of his leasing the land with an option to purchase. Mr. MacGeorge set out his proposals in a memorandum for Mr. Henderson, which the latter discussed with Jack on 29th July. Jack had in the meantime become adamant that he would

not sell to Joe's sons, ostensibly because he did not think that they could make an economic living having regard to the burden of the necessary loan, and of development and replacement expenditure. In letters of 3rd August Mr. Henderson so informed Paul and Frank. On the next day Mr. Henderson wrote to Dennis and Joe to say that Jack had agreed to lease the land to Mr. Hart, with an option to purchase, but that the existing residential arrangements would not be disturbed.

In August Mr. MacGeorge was away from his office for a short holiday. On or about 26th August Mr. Hart happened to be in the offices of Wilson Watters and Co. to pay an account when he ran into Mr. Henderson by chance. He told Mr. Henderson that he was not happy with the lease arrangement, and he asked him to see whether Jack would be willing to sell instead. The next thing Mr. Hart knew was when Mr. Henderson telephoned him and asked him to call at his office. He was then told that Jack had agreed to sell and that an independent valuer would be appointed. Mr. Hart asked Mr. Henderson whether Dennis and Joe were agreeable to a sale, and he was told that they were. Mr. Henderson drew up a purchase agreement, submitted it to Mr. MacGeorge and also took it to Jack for signature. All the terms of the agreement, including provision for a valuation and the nomination of the valuer, stemmed from Mr. Henderson. In due course Mr. Hart signed under the advice of Mr. MacGeorge.

The agreement is dated 1st September 1977. It was expressed to be made between Jack as trustee of the estate of John O'Connor deceased of the one part and Mr. Hart "as agent" (but nothing turns on that description) of the other part. The material clauses were as follows:-

- "1. The purchase price is the market value [of the land] as determined as at 1st September 1977 by Donn Armstrong registered valuer of Timaru. The purchase price shall be paid ... in cash on or before 1st September 1979.
3. Possession shall be given and taken upon 1st September 1977 ...
22. Pending payment of the purchase moneys due under clause 1 hereof the purchaser shall pay the vendor interest on so much thereof as shall remain owing from time to time at the rate of 11% p.a. payable quarterly in arrears.
24. The vendor and his brothers Joseph O'Connor and Dennis O'Connor and their wives shall have the right to remain in possession of the houses (and immediate surrounds) so long as they wish free of charge except whilst in possession of such houses they shall be responsible at their expense for the proper maintenance repair and upkeep thereof."

There was appended a separate agreement for the sale of the stock at a valuation.

On 30th August Mr. Henderson wrote to Joe and Dennis to tell them that "Jack has now signed up the sale of the properties to Bruce Hart ... The leasing arrangement would have been a very cumbersome matter and all manner of confusion would have arisen when a final valuation was arrived at. We have protected your position as far as occupation of the homesteads is concerned, and you have the right to live in the house for life". The information that the land had been sold came as a great shock to Joe. On 9th November Mr. Armstrong valued the land at \$179,780, which the parties agreed to treat as \$180,000. This figure may be compared with \$197,500 at which the trustees' valuer later valued the land encumbered with the life interests, as at 1st September 1977.

Towards the end of 1977 Dennis and Joe consulted a solicitor, but no action was taken until the respondents' present solicitors took over in October 1979. In May 1980 Joe and his two sons issued proceedings against Jack as trustee and Mr. Hart as purchaser to set aside the sale. In March 1981 Joe and his two sons were appointed by the court to be trustees in place of Jack. Jack died shortly thereafter. The action was then reconstituted as, in effect, a suit by Joe and his two sons as trustees and beneficiaries against Mr. Hart as the sole defendant, the sons being by then derivative beneficiaries. By their amended statement of claim the plaintiffs sought to have the contract set aside on the following four alternative grounds:-

- (a) that Jack was of unsound mind when he entered into the agreement, and that Mr. Hart knew this or ought to have known it;
- (b) that irrespective of Mr. Hart's knowledge of Jack's incapacity, the agreement was unfair to the trust estate;
- (c) that the agreement represented an unconscionable bargain in favour of Mr. Hart; and
- (d) that Jack acted without proper deliberation, not in conformity with his position as a trustee and without consulting the beneficiaries as to the terms of the agreement.

The action came to trial before Cook J. and occupied 14 days. The learned judge delivered a reserved judgment, dismissing the action. He first considered Jack's capacity to contract, and found on a balance of probabilities that Jack did not have contractual ability to enter into the agreement, and would not have had a proper understanding of the matters for decision even if (contrary to the judge's view) they had been adequately explained to him. He

then considered the circumstances in which a contract made by a person who lacked mental capacity was liable to be set aside. The traditional view in English law was that it must be proved that the other contracting party knew of or ought to have appreciated such incapacity. Otherwise the contract stood, assuming it was not voidable on equitable principles as an unconscionable bargain. But in *Archer v. Cutler* [1980] 1 NZLR 386 it had been decided that a contract made by a person of insufficient mental capacity was voidable at his option not only if the other party knew of or ought to have appreciated his unsoundness of mind, but also if the contract "was unfair to the person of unsound mind". *Archer v. Cutler*, to which their Lordships will have to refer in detail later, was accepted by both sides and by the learned judge as a correct statement of the law, and there was no argument upon it; in a court of first instance this was almost inevitable.

Turning to the question of Mr. Hart's knowledge, the learned judge expressed himself as unable to find that Mr. Hart had such knowledge of Jack's incapacity in August 1977 as would enable the agreement to be avoided. There remained accordingly the question of "fairness". He considered this in the context of five matters. First, he considered the nature of the advice available to Jack. He was satisfied that there was a lack of effective advice and this was an indication of an element of unfairness in the bargain. Secondly, he considered the relative bargaining positions of the parties. Jack was old; his physical health was not good; he had to find "some solution to the problem of carrying on the farm", i.e. some solution which would enable the partners to cease farming having particular regard to the matter uppermost in Jack's mind, which was the need to retain his home. By contrast, Mr. Hart was a very much younger and more vigorous man, a property owner with experience both as a county councillor and as a farmer. "They were by no means on an equal footing and this operated notwithstanding that the terms of the arrangement come to were conveyed - one could not say that they were negotiated - by the two solicitors as their intermediaries. While this is not a factor which, of itself, demonstrates that the bargain was unfair, it is to be borne in mind when considering the terms of the agreement". Thirdly, he rejected, as a factor relevant to fairness, the position of Paul and Frank as beneficiaries, and a denial to them of the chance of ascertaining whether they would be able to buy. Fourthly, he rejected as a relevant factor a form of consent signed by Joe and Dennis on 25th September 1977, to which their Lordships have not found it necessary to refer. Lastly, he considered the terms of the contract itself, and said this:-

"The object is not to determine at what sum a valuer should have assessed the market value of the property as at the 1st September 1977; it is to decide whether the contract entered into at that time was unfair to the estate. There are many factors which might have had a bearing on the price; the trend of sales, particularly in respect of the Willowbridge land at that time; the fact that no-one other than the Harts had any opportunity to show interest; that no attempt was made to see how high a price Mr. Hart would have paid; then there are the particularly favourable conditions which were offered; two years before any payment, so that a purchaser could expect not only an increase in land value over the period but the benefit of such improvements as he might make in that time before he had to use the land as security for borrowed moneys; the fact that, if he already owned land, that land also was likely to have been increasing in value, further easing the task of financing. No-one can accurately assess what the result might have been had two or more competed keenly for the land. Taking these matters into consideration I can only conclude that a substantially higher price might well have been obtained and that, in any event, the chance to obtain the best price was thrown away. Consequently, I find that the contract was an unfair one."

In short, the learned judge found that the terms of the agreement were "unfair" viewed against the background of the absence of any effective advice for Jack and the unequal bargaining positions of the contracting parties. Therefore, founding upon *Archer v. Cutler*, the learned judge held that the agreement was not enforceable (at law) against the party of unsound mind though his impairment was not apparent.

This conclusion would have led to the rescission of the agreement but for the defence of *laches* raised by Mr. Hart. The learned judge decided with reluctance that this defence was made out, and consequently he gave judgment in favour of Mr. Hart with costs. In the circumstances it was not necessary for the judge to deal with the separate allegation (the claim in equity) that the agreement represented an unconscionable bargain in favour of Mr. Hart.

The trustees appealed against the finding of *laches*. Mr. Hart cross-appealed against the finding of lack of mental capacity and the finding that the agreement was unfair. Mr. Hart's counsel now challenged the decision in *Archer v. Cutler*. While accepting that it was correctly decided on its facts, he submitted that, for a contract to be unfair where there was no knowledge of the other parties' lack of capacity, there must have been "over-reaching

behaviour" on the part of the one who sought to retain the bargain.

The Court of Appeal found that there was ample evidence to support the finding of fact that Jack lacked the requisite contractual capacity. They upheld the trial judge's finding that the bargain was "unfair". They also said that the decision in *Archer v. Cutler* correctly represented the law, and rejected the submission that there must be over-reaching behaviour before a bargain can be set aside by an incompetent (whose incapacity is not known) on the ground of unfairness. Finally the Court reversed the trial judge on the finding of *laches*, and thus allowed the appeal. The action was then remitted to the High Court to determine the compensation payable to Mr. Hart. This was claimed on the basis of improvements made to the farmland and the increase in the value of the land caused by currency inflation during the intermediate period. The compensation claimed was in excess of \$291,000. It was allowed at about \$58,000 in respect only of improvements. Mr. Hart appealed, and that appeal was dismissed.

Mr. Hart now appeals to Her Majesty in Council. He does not challenge the finding of Jack's mental incapacity, nor the Court of Appeal's finding on the question of *laches*. The respondent trustees for their part do not contend that Mr. Hart knew or ought reasonably to have known of Jack's incapacity. Apart from questions arising out of Mr. Hart's claim for compensation, the issues raised by the parties on this appeal are as follows:-

(A) Whether *Archer v. Cutler* was rightly decided; that is to say, whether a contract by a person of unsound mind, whose incapacity is unknown to the other contracting party, can be avoided (at law) on the ground that it is "unfair" to the party lacking capacity (or those whom he represents), there being no imputations against the conduct of the other contracting party (reflecting paragraph 7A(ii) of the respondents' case).

(B) If *Archer v. Cutler* was rightly decided, whether the High Court and the Court of Appeal were correct in finding that the sale agreement was "unfair" to Jack, (reflecting paragraph 7C of the respondents' case).

(C) If *Archer v. Cutler* was wrongly decided, whether the respondent trustees were entitled to have the contract set aside (in equity) as an "unconscionable bargain" notwithstanding the complete innocence of Mr. Hart (reflecting paragraph 7D of the respondents' case).

(D) If *Archer v. Cutler* was rightly decided, and the courts below correctly found that the sale agreement was "unfair", whether the sale agreement would escape

rescission because it was impossible to achieve *restitutio in integrum* (reflecting paragraph 7E of the respondents' case).

In order to avoid unnecessary prolongation of the hearing and with a view to saving the parties expense, their Lordships invited counsel to confine their submissions to issues (A) and (C), leaving issues (B) and (D) for subsequent argument if necessary.

Their Lordships turn first to a consideration of *Archer v. Cutler*. Their Lordships attach importance to three factors. First, this decision was accepted by both sides as correct when the case was argued at first instance. Secondly, the Court of Appeal in a strong judgment affirmed without hesitation that the law there set out was the law of New Zealand. Thirdly the Court of Appeal, when they gave judgment on the compensation appeal, underlined their previous statement of the law in the following important passage:-

"In that case [*Archer v. Cutler*] it was held that there were no considerations of policy or principle precluding the court from holding that a contract entered into by a person of unsound mind is voidable at his option if it is proved either that the other party knew of his unsoundness of mind or, whether or not he had that knowledge, the bargain was unfair. On the basis that this principle should be adopted for New Zealand this court expressly approved *Archer v. Cutler*. In the result it made a declaration that the agreement for sale and purchase was rescinded."

If *Archer v. Cutler* is properly to be regarded as a decision based on considerations peculiar to New Zealand, it is highly improbable that their Lordships would think it right to impose their own interpretation of the law, thereby contradicting the unanimous conclusions of the High Court and the Court of Appeal of New Zealand on a matter of local significance. If however the principle of *Archer v. Cutler*, if it be correct, must be regarded as having general application throughout all jurisdictions based on the common law, because it does not depend on local considerations, their Lordships could not properly treat the unanimous view of the courts of New Zealand as being necessarily decisive. In their Lordships' opinion the latter is the correct view of the decision.

Archer v. Cutler was a purchaser's action for specific performance of a contract for the sale of land. By way of defence the vendor pleaded first that she was of unsound mind to the knowledge of the

purchaser, secondly that she was induced to enter into the agreement by the undue influence of the purchaser, and thirdly "that the contract should be set aside as a catching and unconscientious bargain". The facts were briefly as follows. The vendor and the purchaser were adjoining land owners. The purchaser had a problem over access to his land, which would be solved if he acquired the vendor's land. He knew the vendor had already given a purchase option to a friend, but he made known to the vendor his interest in acquiring her land should the opportunity occur. At some later time the vendor got in touch with the purchaser, and inquired if he was still interested in buying, as her friend had decided not to exercise her option. He called on her next day to discuss the matter. The vendor suggested a price of \$15,000. The purchaser thought that \$17,000 would be a fairer figure and he offered to pay it subject to his being able to arrange finance. He put his offer in writing, and she wrote out her acceptance. A week later he told her that he had arranged finance and that the sale was therefore unconditional. The learned judge held that an informed vendor would have expected to receive at least \$24,000; that there was however no evidence that the purchaser knew the true value of the land, and that it was understandable that two persons with no professional expertise should fix a value of \$17,000 as being a fair price. He also found that the vendor was suffering from advanced senile dementia at the time of the agreement which rendered her incapable of understanding the bargain, but that the purchaser was unaware of this. The agreement represented a sale at a substantial undervalue. It was held that contractual incapacity was established; that a contract entered into by a person of unsound mind was voidable at that person's option if the other party knew of the incapacity or, whether or not he knew, if the contract was "unfair" to the person of unsound mind; and that the contract was unfair, the *indicia* of unfairness being (i) a price significantly below the true value, (ii) the absence of independent legal advice for the vendor, and (iii) the difference in bargaining positions resulting from the disparity in their respective mental capacities.

If a contract is stigmatised as "unfair", it may be unfair in one of two ways. It may be unfair by reason of the unfair manner in which it was brought into existence; a contract induced by undue influence is unfair in this sense. It will be convenient to call this "procedural unfairness". It may also, in some contexts, be described (accurately or inaccurately) as "unfair" by reason of the fact that the terms of the contract are more favourable to one party than to the other. In order to distinguish this "unfairness" from procedural unfairness, it will be convenient to call it "contractual imbalance".

The two concepts may overlap. Contractual imbalance may be so extreme as to raise a presumption of procedural unfairness, such as undue influence or some other form of victimisation. Equity will relieve a party from a contract which he has been induced to make as a result of victimisation. Equity will not relieve a party from a contract on the ground only that there is contractual imbalance not amounting to unconscionable dealing. Of the three *indicia* of unfairness relied upon by the learned judge in *Archer v. Cutler* (assuming unfairness to have existed) the first was contractual imbalance and the second and third were procedural unfairness.

The judgment in *Archer v. Cutler* contains, if their Lordships may be permitted to say so, a most scholarly and erudite review by the trial judge of the textbook authorities and reported cases on the avoidance of a contract made by a person of unsound mind. For present purposes the key passages in the judgment are these (page 400, line 44):-

"From these authorities, it would seem that the English law on the subject is ill-defined. The case of *Imperial Loan Company v. Stone* [1892] 1 Q.B. 599 widely accepted as being a statement of the law on avoidance of contracts made with persons of unsound mind would, save in the judgment of Lopes LJ, seem to regard unfairness of the contract as being of no moment. Proof of unsoundness of mind and the other party's knowledge of that unsoundness alone will avoid the contract. But the passage cited from the judgment of Lopes LJ. and the dicta of Pollock CB. in *Molton v. Camroux* (1848) 2 Exch 487 of Patteson J. on appeal in the same case, of Sir Ernest Pollock MR. in *York Glass Company v. Jubbs* [1924] 131 L.T. Rep. 559 and of Sargant LJ. in the same case would suggest that proof of unfairness of a bargain entered into by a person of unsound mind, even though that unsoundness be not known to the other party, will suffice to avoid it."

and (page 401, line 45):-

"I find nothing in policy or principle to prevent me from holding that a contract entered into by a person of unsound mind is voidable at his option if it is proved either that the other party knew of his unsoundness of mind or, whether or not he had that knowledge, the contract was unfair to the person of unsound mind."

Their Lordships apprehend that in these passages the learned judge is dealing indifferently with procedural unfairness and contractual imbalance, either of which, or both of which in combination, may enable the contract to be avoided against a

contracting party ignorant of the mental incapacity of the other.

The original rule at law, and still the rule in Scotland, was that a contract with a person of unsound mind was void, because there could be no *consensus ad idem*. This was later qualified by a rule that a person could not plead his own unsoundness of mind in order to avoid a contract he had made. This in turn gave way to a further rule that such a plea was permissible if it could be shown that the other contracting party knew of the insanity.

Their Lordships turn to the three cases mentioned in the first citation from *Archer v. Cutler*. The starting point for a consideration of the modern rule is *Molton v. Camroux* (1848) 2 Exch 487, and on appeal 4 Exch 17, which was heard first in the Court of Exchequer, and later in the Court of Exchequer Chamber. It arose out of the purchase by a person of unsound mind of annuities from a life assurance society. The society had granted the annuities in the ordinary course of its business. After referring to earlier authorities that a plea of insanity would not prevail unless the other contracting party knew of it, the court said this at page 502:-

"We are not disposed to lay down so general a proposition, as that all executed contracts *bona fide* entered into must be taken as valid, though one of the parties be of unsound mind; we think, however, that we may safely conclude, that when a person, apparently of sound mind, and not known to be otherwise, enters into a contract for the purchase of property which is fair and *bona fide*, and which is executed and completed, and the property, the subject-matter of the contract, has been paid for and fully enjoyed, and cannot be restored so as to put the parties in *statu quo*, such contract cannot afterwards be set aside, either by the alleged lunatic, or those who represent him."

The case was then heard by the Court of Exchequer Chamber. The Court identified the issue as (page 19):-

"... whether the mere fact of unsoundness of mind, which was not apparent, is sufficient to vacate a fair contract executed by the grantee, by payment of the consideration money, and intended *bona fide* to be executed by the grantor, by payment of the annuity."

The answer was that:-

"... the modern cases show, that when that state of mind was unknown to the other contracting

party, and no advantage was taken of the lunatic, the defence cannot prevail, especially where the contract is not merely executory, but executed in whole or in part, and the parties cannot be restored altogether to their original position."

In the foregoing passages and in certain other citations from the authorities, their Lordships find it convenient to underline references to "fairness" and "not taking advantage" and the like.

The learned judge in *Archer v. Cutler* read these passages from *Molton v. Camroux* as emphasising the importance of fairness as an ingredient in an enforceable contract with a lunatic whose condition of mind is unknown to the other party; see pages 396 and 397. However their Lordships respectfully think that *Molton v. Camroux* is not an authority for the proposition that contractual imbalance, or procedural unfairness short of unconscionable conduct or equitable fraud, enables a person of unsound mind to escape from the contract.

In *Molton v. Camroux* Pollock C.B. listed the circumstances which would enable the courts safely to conclude that a contract with a lunatic apparently of sound mind should be upheld. One such circumstance was that the contract was "fair and *bona fide*". This was an appropriate qualification for the purpose of excluding cases where the other contracting party, though ignorant of the insanity, was guilty of fraud. It does not, their Lordships respectfully think, support the proposition that the court is entitled to embark on a balancing exercise before upholding such a contract, in order to see where the balance of advantage lies; and if it is thought that the advantage lies, or at the time of the contract lay, substantially in favour of the innocent party of sound mind, then the contract can be set aside. This seems apparent from the earlier passages in the judgment of the Chief Baron. He equated "fairness" with "made in good faith" when discussing counsel's distinction between the executed and the executory contract of a lunatic; see page 502 line 1. In the quotations he selected from *Browne v. Joddrell* (1827) 1 M. and M. 105 and *Dane v. Viscountess Kirkwall* (1838) 8 CAR. and P. 679 the person of unsound mind can have the contract set aside if the other party "imposed" upon him, or "took advantage of" his unsoundness of mind. These references seem to their Lordships to demonstrate that it was procedural unfairness to which the Chief Baron was directing his mind and not contractual imbalance. The same is to be said of the judgment of the Court of Exchequer Chamber. Their Lordships find nothing in *Molton v. Camroux* to suggest that contractual imbalance, falling short of some species of fraud, entitles a person of unsound mind, whose mental impairment is not apparent, to have the contract avoided.

In *Imperial Loan Co. Ltd. v. Stone* [1892] 1 Q.B. 599, a person of unsound mind was sued on a promissory note which he had signed as surety. The jury found that he was insane when he signed the note but there was no finding as to the creditor's knowledge of such insanity. Nevertheless the judge entered a verdict against the creditor. On appeal it was submitted that there was no authority that a man could be sued and made liable on an executory contract which he had made when of unsound mind, except in the case of a contract for necessaries. This submission was rejected, and a new trial was directed. Lord Esher MR. said this (at page 601):-

"When a person enters into a contract, and afterwards alleges that he was so insane at the time that he did not know what he was doing, and proves the allegation, the contract is as binding on him in every respect, whether it is executory or executed, as if he had been sane when he made it, unless he can prove further that the person with whom he contracted knew him to be so insane as not to be capable of understanding what he was about."

Fry LJ. said (page 602):-

"It thus appears that there has been grafted on the old rule the exception that the contracts of a person who is *non compos mentis* may be avoided when his condition can be shown to have been known to the plaintiff. So far as I know, that is the only exception."

Lopes LJ. introduced the word "fair" into his statement of the rule (page 603):-

"In order to avoid a fair contract on the ground of insanity, the mental incapacity of the one must be known to the other of the contracting parties. A defendant who seeks to avoid a contract on the ground of his insanity, must plead and prove, not merely his incapacity, but also the plaintiff's knowledge of that fact, and unless he proves these two things he cannot succeed."

The learned judge in *Archer v. Cutler* relied on the statement of Lopes LJ. that the mental incapacity of a lunatic must be known to the other contracting party "in order to avoid a fair contract on the ground of insanity", as implying that such knowledge is unnecessary in order to avoid a contract which is unfair in the sense of contractual imbalance. But in their Lordships' view "fair" was quite appropriately used by Lopes LJ. so as to except the case of the apparently sane person who is imposed upon in a manner which equity regards as unconscionable, and was not intended to permit an inquiry into the

balance of the terms of the contract. The quotation from Lopes LJ. which the learned judge in *Archer v. Cutler* relied upon omits (page 398, line 51) the succeeding sentence where the Lord Justice repeats the rule without any reference to "fairness" and says in unqualified terms, that "a defendant who seeks to avoid a contract on the ground of his insanity, must plead and prove, not merely his incapacity, but also the plaintiff's knowledge of that fact, and unless he proves these two things he cannot succeed". In the face of that statement of the rule, it seems to their Lordships impossible to suppose that Lopes LJ. regarded proof of contractual imbalance as a permissible alternative to knowledge of insanity where a person of unsound mind seeks to set aside an agreement which was made in good faith. (Indeed, how is one to judge a contract of suretyship in terms of contractual balance?) This approach is in line with two cases which shortly followed *Molton v. Camroux*, namely *Beavan v. M'Donnell* (1854) 9 Exch 309 at page 314 "... The contract was entered into by the defendant, and the money received, fairly and in good faith"; and *Campbell v. Hooper* (1855) 3 Sm. and G. 153 at page 159, "... the money was honestly paid, and no advantage taken by the plaintiff, nor any knowledge by him of the lunacy ...".

The *Imperial Loan* case was considered and accepted as correct by the High Court of Australia in *McLaughlin v. Daily Telegraph Newspaper Co. Ltd* [1904] 1 C.L.R. 243, where Griffith CJ. delivering the judgment of the Court said this of the *Imperial Loan* case and its predecessor *Molton v. Camroux* (at page 272):-

"The principle of the decision seems, however, to be the same in both cases, which, in our judgment, establish that a contract made by a person actually of unsound, but apparently of sound mind with another who deals with him directly, and who has no knowledge of the unsoundness of mind, is as valid as if the unsoundness of mind had not existed. If the man dealing with the person of unsound mind is aware of his insanity, the contract is voidable at the option of the latter, but the party who takes advantage of the other cannot himself set up the incapacity. In this respect the matter is treated on the same footing as cases of fraud inducing a contract. There is, indeed, authority for saying that the equitable doctrines governing the validity or invalidity of a contract made with an insane person are only a particular instance of the general doctrines relating to fraudulent contracts. In the cases last mentioned no unfairness of dealing could be imputed to the persons who sought to take advantage of the contract, which was, in fact,

made, in each case, with an apparently sane person. The principle appears to be that the validity of a contract made with an apparently sane person is to be determined by the application of the same rules as are applied in ordinary cases."

The third case mentioned by the learned judge in the key passage which their Lordships have quoted from his judgment in *Archer v. Cutler* was *York Glass Co. Ltd. v. Jubb* [1924] 131 L.T. Rep. 559, and on appeal (1925) 134 L.T. Rep. 36. This was a vendor's action for breach of contract against the committee of the estate of a person of unsound mind. The purchaser pleaded first that he was of unsound mind to the knowledge of the defendant, secondly (by a late amendment) that the vendor knew that he was infirm of mind and body and incapable of managing his affairs reasonably and properly, that the price was excessive, that he had no legal advice and that there was no reasonable degree of equality between the contracting parties. The first plea was a plea at law. The second plea was relied upon as raising a case in equity for the rescission of the contract upon the grounds alleged, that is to say, on the assumption that at law there was a valid and binding contract but that it was one which a court of equity under the old practice, when the two courts were separate, would have rescinded and set aside and would have granted an injunction and restrained the plaintiff from enforcing at law; see the manner in which these two pleas were distinguished by Sir Ernest Pollock at page 37, Warrington LJ. at page 41 and Sargant LJ. at page 43. Issues (A) and (C) in the instant appeal reflect the same differentiation between the plea at law and the plea in equity.

The trial judge had no doubt as to the rule at law (at page 561):-

"It is well settled that where the defendant in an action of contract sets up the defence of his insanity at the date of the contract he must, in order to succeed, show that the plaintiff knew of his insanity."

That plea failed, because the judge held that the company did not know of the unsoundness of mind. When, throughout his judgment, the judge refers to "fairness", it is plain that he was doing so in the context of the second plea, the plea in equity, as is apparent from the following passage (also at page 561):-

"In the result, after having carefully considered the whole of the evidence in support of this part of the case, I have come to the conclusion and hold as a fact that there was no want of fairness either in the terms of the contract itself or in

the circumstances under which it was made, and I acquit all the persons concerned in the transaction on behalf of the plaintiff company from the charge made against them of having overreached or exercised any undue influence over the defendant."

He held that the contract was accordingly valid.

This decision was upheld on appeal; the contract was valid at law because the vendor was unaware of the unsoundness of mind. The contract was not impeachable in equity because the purchaser failed to establish any of the four circumstances on which he relied in order to establish the plea in equity. It is however necessary to look a little closely at the judgment of Sargant LJ. He identified three issues (page 43); first, whether there was a concluded contract apart from lunacy; if so, secondly, was that contract enforceable at law; "thirdly, if it was enforceable at law, was there any case for saying that equity would restrain the enforcement of the contract that is to say, is the case one in which, prior to the Judicature Act, a bill would have lain for an injunction to prevent the plaintiff from enforcing his remedies at law?" There was plainly a concluded contract. In dealing with the second question, whether the contract was enforceable at law, which he held it was, he added:-

"It is possible a question may arise in some future case, with which we have not to deal at present, whether, in the case of a contract which is not a reasonable one and which is made by an insane person that contract can be enforced, the other person not knowing of the insanity. I have looked through a number of cases and I have not found a single case in which a contract has in fact been binding except where the contract was an ordinary reasonable contract. I do not in any way want to attempt to express my own view on that point because the point has not been argued before us ... I only want to guard myself by saying that my mind is entirely open on the question whether the fairness of the bargain is an essential element to the enforceability of the bargain against a person who was in fact a lunatic although not known to be such by the other contracting party."

He then turned to the third point, the plea in equity, and held that it failed.

York Glass then was a case in which the court considered a lunatic's contract from the point of view of the position at law and separately from the point of view of equity; but Sargant LJ. also posed, but did not answer (because it did not arise and was

not argued) the question whether on the first aspect a court of common law would have enforced a contract by a person of unsound but apparently sound mind, the terms of which were not "reasonable" or "fair".

In the opinion of their Lordships it is perfectly plain that historically a court of equity did not restrain a suit at law on the ground of "unfairness" unless the conscience of the plaintiff was in some way affected. This might be because of actual fraud (which the courts of common law would equally have remedied) or constructive fraud, i.e. conduct which falls below the standards demanded by equity, traditionally considered under its more common manifestations of undue influence, abuse of confidence, unconscionable bargains and frauds on a power. (Cf. Snell's Principles of Equity, 27th edn., pages 545 et seq.) An unconscionable bargain in this context would be a bargain of an improvident character made by a poor or ignorant person acting without independent advice which cannot be shown to be a fair and reasonable transaction. "Fraud" in its equitable context does not mean, or is not confined to, deceit; "it means an unconscientious use of the power arising out of the circumstances and conditions of the contracting parties"; *Earl of Aylesford v. Morris* [1873] 8 Ch. App 484, 490. It is victimisation, which can consist either of the active extortion of a benefit or the passive acceptance of a benefit in unconscionable circumstances.

Their Lordships have not been referred to any authority that a court of equity would restrain a suit at law where there was no victimisation, no taking advantage of another's weakness, and the sole allegation was contractual imbalance with no undertones of constructive fraud. It seems to their Lordships quite illogical to suppose that the courts of common law would have held that a person of unsound mind, whose affliction was not apparent, was nevertheless free of his bargain if a contractual imbalance could be demonstrated which would have been of no avail to him in equity. Nor do their Lordships see a sufficient foundation in the authorities brought to their attention to support any such proposition. It is not supported by anything said in *Wilson v. The King* [1938] 3 D.L.R. 433, to which the learned judge in *Archer v. Cutler* referred, because in that case the immediate contracting party of sound mind was fully aware of the other's insanity. The full quotation from *Hardman v. Falk* [1955] 3 D.L.R. 129, of which the learned judge at page 401 cites only the third sentence, reads as follows:-

"The contract of a lunatic is voidable not void: see *York Glass Co. v. Jubb*. Courts of equity will not interfere if a contract with a lunatic is made in good faith without any knowledge of

the incapacity of the lunatic and no advantage is taken. If the contract is fair and the respondent had no knowledge that the appellant was a lunatic, the appellant is without a remedy: see *Wilson v. The King*."

The learned Justice of Appeal in that case was dealing with the circumstances in which equity would not interfere, that is to say, in the absence of bad faith or taking advantage or other unconscionable conduct. Their Lordships do not think that in the whole context the last sentence of the quotation can be read as any foundation at all for the proposition that despite the absence of equitable fraud, the court will weigh the terms of a lunatic's contract and determine whether they are appreciably more favourable to the other contracting party, and if so, set the contract aside.

Their Lordships must also refer to *Tremills v. Benton* (1892) 18 V.L.R. 607 which the learned judge in *Archer v. Cutler* mentioned as an Australian case "where lack of fairness has been held to be a material element" in a contract entered into with a lunatic who was ostensibly sane; (page 401, line 11). The action was by the personal representative of Tremills to set aside deeds whereby Tremills had granted land and buildings to Mr. and Mrs. Benton, reserving to himself a life interest, in return for his keep. He was 86 years of age, in bad health and died 12 days later. The administrator sought to set aside the deeds on the ground that their execution was obtained by undue influence, and secondly on the ground that Tremills was, to the knowledge of the Bentons, of unsound mind. The trial judge found that although Tremills was in full possession of his faculties, he suffered from delusions; he was not however acting in subjection to any undue influence. The Full Court upheld these findings. The Chief Justice said (at page 620):-

"Was the contract itself, which was entered into by the parties, a fair and *bona fide* contract? If it was, this case is clearly within the legal and the equitable rule by which such a contract, if executed and completed, is to be upheld, although it has been made by a person of unsound mind with another person who has no knowledge that he is contracting with a lunatic. In determining whether a contract is or is not unfair, the adequacy of the consideration is, as the learned primary judge observed, one of the elements to be regarded; but it should be added that it is only one element, and that in order to justify the avoidance of a contract on this ground, the inadequacy of the consideration must be so great as to be unconscionable, and to amount in itself to conclusive and decisive evidence of over-reaching or fraud."

The Chief Justice accepted the trial judge's finding that the consideration given by the defendants was "altogether inadequate", and that neither the deceased nor the defendants regarded the matter as a bargain in which the former expected to receive or the latter supposed they were giving full value. He concluded (page 621):-

"Holding, as we are bound to do, that proof of undue influence on the part of the defendants has failed, and that the deceased had full possession of his faculties, and perfectly comprehended what he was doing, I cannot find any evidence whatever that the transaction between these parties was in itself wanting in fairness and *bona fides*. The deceased, who was advised by his solicitor, had a single, definite object in view. Under the influence of an insane delusion, he wished to deprive his son of his property after his own death, while at the same time he sanely and prudently desired to retain full possession of it during the remainder of his life, and also to secure for himself the benefits and comforts of a home. He bargained for this as a condition of his gift, and the defendants complied with his wish, and covenanted to carry it into effect. The burden of the covenant was in the event small in proportion to the money value of the gift, but the disparity was not caused by the act or demand or undue influence of the defendants. They gave the consideration they were asked to give, and that was all that the deceased in his insane delusion, and in his prudent regard for himself, thought of requiring. The bargain was made a legal and binding bargain by the act of the deceased, and apart from the suspicion, which we must hold to be unfounded, of undue influence having been employed to bring it about, presents no trace of fraud or over-reaching on the part of the defendants, although they undoubtedly reaped the larger share of the benefit of the bargain. I think that we should be departing from the principles on which courts of equity have acted in similar cases if these deeds should now be set aside at the instance of the administrator."

Holroyd J. said this (at page 621):-

"After much hesitation, and examining carefully all the authorities that were cited, I have come to the conclusion that a contract entered into with a lunatic by a person who does not know him to be, or suspect him to be, a lunatic, cannot be avoided by the lunatic or by his representatives after his death on the ground merely of the insufficiency of the consideration; but that some fraud or imposition must have been practised by the party who desires to uphold the contract, or something done by him which would render it

unconscientious on his part to take advantage of the bargain, to afford a ground for setting it aside. For that reason only I differ from the learned primary judge."

Finally Hodges J. (at page 622):-

"The learned judge has found, and in my opinion has so found on sufficient evidence, that there was not undue influence, that there was *bona fides* on the part of the defendants, and that the defendants did not know that H. Tremills was insane; but he has declared the deeds void on the ground that H. Tremills was insane at the time that he executed them, and that they were not 'fair' within the meaning of that word as used in the judgment in *Hassard v. Smith*, Ir. Rep. 6 Eq. 433 and it is against this decision that the defendants have appealed. The learned judge appears to have acted on the following passage, which he quoted from the case of *Hassard v. Smith*:- 'The rule which now prevails, both at law and in equity, in reference to contracts entered into by a person of apparently sound mind, and not known by the other contracting party to be insane, is, that such contracts, if executed and completed, and if fair and *bona fide*, will not be held void or set aside'. This, I think, correctly states the law if the word 'fair' be understood in the sense in which the Vice-Chancellor must be taken from the context to have intended that it should be understood. And by 'fair' I understand him to mean not unfair, not unconscientious, not over-reaching. I think it refers to a contract not obtained by imposition, but I do not think that it would correctly give the Vice-Chancellor's meaning to substitute for the word 'fair' the words 'for full consideration'."

(The words "if executed and completed" should of course now be disregarded). Then, picking up the word 'fairly' in *Beavan v. M'Donnell*, he said:-

"There the word 'fairly' could not, I think, be referring to a perfect equality of the consideration given by each party to the contract. Again, a little further on, the Vice-Chancellor quotes with approval the following passage from Story:- 'The ground upon which courts of equity now interfere to set aside the contracts and other acts, however solemn, of persons who are idiots, lunatics, and otherwise *non compotes mentis*, is fraud'. The Vice-Chancellor could not quote, with approval, Story's opinion that the ground on which courts of equity set aside these contracts is fraud, if he was deciding that inequality of consideration was a sufficient ground for setting aside such

contracts. Again, the Vice-Chancellor a little further on again quotes with approval Story's view that 'If a purchase is made without any knowledge of the incapacity, and no advantage has been taken, courts of equity will not interfere to set aside the contract etc'. Here again the Vice-Chancellor shows that what invalidates these contracts is not mere inequality of consideration, but the taking of an advantage. If an advantage is taken, the contract is not 'fair'."

This case appears to their Lordships to be directly contrary to the proposition adopted in *Archer v. Cutler*, because it plainly recognises that a contract with an unsuspected lunatic will not be set aside short of equitable fraud.

In the opinion of their Lordships, to accept the proposition enunciated in *Archer v. Cutler* that a contract with a person ostensibly sane but actually of unsound mind can be set aside because it is "unfair" to the person of unsound mind in the sense of contractual imbalance, is unsupported by authority, is illogical and would distinguish the law of New Zealand from the law of Australia, as exemplified in *McLaughlin's* case and *Tremills'* case, for no good reason, as well as from the law of England from which the law of Australia and New Zealand and other "common law" countries has stemmed. In so saying their Lordships differ with profound respect from the contrary view so strongly expressed by the New Zealand courts.

To sum the matter up, in the opinion of their Lordships, the validity of a contract entered into by a lunatic who is ostensibly sane is to be judged by the same standards as a contract by a person of sound mind, and is not voidable by the lunatic or his representatives by reason of "unfairness" unless such unfairness amounts to equitable fraud which would have enabled the complaining party to avoid the contract even if he had been sane.

Their Lordships turn finally to issue (C), whether the respondent trustees are entitled to have the contract set aside as an "unconscionable bargain". This issue must also be answered in the negative, because Mr. Hart was guilty of no unconscionable conduct. Indeed, as is conceded, he acted with complete innocence throughout. He was unaware of Jack's unsoundness of mind. Jack was ostensibly advised by his own solicitor. Mr. Hart had no means of knowing or cause to suspect that Jack was not in receipt of and acting in accordance with the most full and careful advice. The terms of the bargain were the terms proposed by Jack's solicitor, not terms imposed by Mr. Hart or his solicitor. There

was no equitable fraud, no victimisation, no taking advantage, no over-reaching or other description of unconscionable doings which might have justified the intervention of equity to restrain an action by Mr. Hart at law. The respondent trustees have in the opinion of their Lordships failed to make out any case for denying to Mr. Hart the benefit of a bargain which was struck with complete propriety on his side.

For these reasons their Lordships have tendered to Her Majesty their humble advice that the appeal should be allowed; that the declaration of the New Zealand Court of Appeal rescinding the contract of 1st September 1977 for incapacity and unfairness should be set aside; that the respondents should give possession in terms of the contract to the appellant on 1st June 1985 on condition that the net compensation money of \$58,201.92 be repaid by the appellant to the respondents on that day; and that leave should be reserved to either party to apply to the High Court for directions on all other matters which may arise; and that the appellant should have the costs of the hearings below and before the Board, including the costs of the compensation hearings at first instance and on appeal.

Their Lordships desire to record their great appreciation of the skill with which this difficult case was presented and argued by counsel on both sides; they could not have had more assistance than that which they were so fortunate as to receive.



