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MEDIUM PRIORITY

NZLR

IN THE HIGH COURT OF NEW ZEALAND
AUCKLAND REGISTRY

10/6

M.541/94

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BETWEEN	IVAN KELVIN HARLICK and PEGGY JOAN HARLICK	
	Plaintiffs	
AND	ASB BANK LIMITED	
	Defendant	

Hearing: 1 June 1994

Counsel: M. A. McClennan for Plaintiffs
R. B. Stewart for Defendant

Judgment: 1 June 1994

ORAL JUDGMENT OF BLANCHARD, J.

Solicitors: Harkness Henry & Co., Hamilton for Plaintiffs

Simpson Grierson Butler White, Auckland for Defendant

The plaintiffs are seeking an interlocutory injunction restraining ASB Bank from exercising rights against them under an overdraft loan agreement, a guarantee and indemnity, a further loan agreement and guarantee and a mortgage over their home.

Mr Harlick is 61. His wife is 54. Prior to his retirement he was a truck driver. Mrs Harlick has always been a housewife. Neither of them has any business or investment experience. They live on their National Superannuation. Their only asset is their home and contents.

They have owned their home at Port Waikato, which is the subject of the mortgage in respect of which the bank wishes to exercise power of sale, for ten years. They paid cash for it and there was no mortgage registered against the title until after, in May 1989, they granted to the bank the mortgage to which these proceedings relate. The Government Valuation of the house is $62,000 so it is a modest home.

The loan agreement and securities arise out of a loan made by the bank to Mr and Mrs Harlick's son-in-law and daughter, the Lawsons, who borrowed the money in order to expand a bread run business. Unfortunately, they have now experienced a financial failure and, whilst I understand that they are able to make payments to the bank at the rate of about $150 per week, it is insufficient to meet the commitments incurred under the mortgage. Property Law Act notices have been served and these injunction proceedings have been brought at a stage when the bank is preparing to sell up the security.

The amount which was, eventually, borrowed by the Lawsons was $55,000. The loan was increased to that figure from $50,000 in July 1990. The plaintiffs however say that the Lawsons told them that the loan was only to be for $30,000 and for no more than a three month term. Mr Harlick's affidavit records that they were more than happy to help the Lawsons. They thought that the Lawsons had "lots of money" because a year or so earlier they had won a first division Lotto prize of about $300,000:

> *"They were driving around in a flash car at the time, and had recently had a trip overseas, and a new truck. We did not think there was any risk to our house, or to our own financial position."*

The Lawsons' bank manager was Mr King. In his affidavit he says that in late April 1989 the Lawsons sought a $50,000 overdraft facility and he explained to them that it would have to be fully secured. He says that "after some discussion with them" they told him that Mr and Mrs Harlick would "be able to offer their house as security". Shortly after that meeting Mr Lawson provided Mr King with the full names of the Harlicks and the address of their property and also the name of the solicitor to whom mortgage documentation was to be sent. The name supplied was that of Mr McLeod of Sturrock Monteith & Co., in Pukekohe. He was the Lawsons' solicitor. Mr and Mrs Harlick had had little need to deal with lawyers, though when purchasing their house many years before they had used the Tuakau Office of Sturrock Monteith & Co.

The security department of the bank prepared the loan and security documentation and Mr King then contacted Mr Lawson to arrange for all parties to come in and execute the documents. On 2 May 1989 Mr and Mrs Lawson and Mr and Mrs Harlick came into Mr King's office and signed the

overdraft loan agreement and the form of guarantee. Mr King deposes that, although he cannot recall what was said at the meeting, he would have followed his invariable practice of going through the documents and referring to the main terms. In particular, he thinks he would have referred to the amount of the loan and that the security was to be a first mortgage over the Harlicks' property. He says that he thinks he would also have explained to them that by signing the guarantee the Harlicks were responsible for the debt and were putting their house up as security for their obligations in terms of the guarantee. Mr King also thinks that he would have given copies of the documents to the Harlicks.

Mr King further says that neither Mr or Mrs Harlick said or did anything which caused him to believe or suspect that they did not understand that they were guaranteeing the loan and were offering their home as security. Mr King considered Mr and Mrs Harlick to be "normal people" who gave no appearance of being confused, reluctant or in any way uncertain about what they were doing. He says that they were both alert and appeared relaxed and agreeable.

In contrast, it is Mr Harlick's testimony in his affidavit that he is "absolutely sure" that Mr King did not explain the documents, that they thought the loan was for $30,000 only and that it was not explained that the loan would have "any effect beyond the three months that [the Lawsons] told us it was for". They did not appreciate, he says, that they were putting their house at risk and they were not told to obtain independent advice from their own lawyer before signing up the documents.

Mr Harlick also says that Mr King was a "family friend" of the Lawsons and they knew him also. Mr King agrees that he knew Mr and Mrs

Lawson but says it is not correct to describe him as a family friend. He knew the Lawsons well enough to "say hello and have a chat to" in the street, but they were not friends.

After the meeting at the bank on 2 May the bank's security department sent the standard form mortgage to Mr McLeod. Mr King had no involvement with the execution of the mortgage nor any contact with Sturrock Monteith & Co. Evidently the lawyers dealt directly with ASB's security department. Mr Harlick says, concerning the mortgage, that the Lawsons made an appointment for them with Sturrock Monteith at the Pukekohe Branch. They had never previously been to that branch nor met any lawyers from it. They travelled to the lawyers' office and met the Lawsons outside. Then all four of them went in and spoke to Mr McLeod. He had some documents ready which they were asked to sign. Mr Harlick says that there was no discussion about the documents and no explanation given. They were there for only a "matter of minutes".

I return again to the affidavit of Mr King. He deposes that in June 1990 the Lawsons applied for a loan of $55,000 in order to repay the $50,000 overdraft and clear another small loan of about $5,000. The loan application again recorded that the security was to be the personal guarantee of the Harlicks supported by the existing mortgage over their home. That mortgage was an "all obligations" form of security. It had in the meantime been registered by the bank. The loan application showed an apparently substantial surplus of assets over liabilities, including the bread run business at $198,000 and a Mercedes Benz truck at $100,000. Mr King says that on 23 July 1990 the Lawsons and the Harlicks again came to the bank's office in Tuakau and the four parties signed the loan agreement and guarantee in his presence. As before, he witnessed the signatures. He

says that immediately before the execution of documents he explained the terms of the loan agreement. Clearly, however, he is relying upon his usual practice when he says he "would have pointed to and read out" certain provisions, which include the amount of the loan, the interest rate and the monthly payments. He says he would also have pointed out that the security was the first mortgage over the Harlicks' home. Mr King deposes that he gave Mr and Mrs Harlick a copy of the guarantee and explained it to them.

Mr King says that he specifically recalls the meeting because the Lawsons arrived first and had to wait with him for some time for the Harlicks to arrive. He also recalls noticing and discussing with Mr Harlick the fact that he had lost one of his fingers. "Again Mr and Mrs Harlick appeared relaxed and friendly. They gave no indication of being unaware of what they were doing or what I was telling them."

Mr Harlick's affidavit about the events in July 1990 is to the effect that he has no recollection of signing the second guarantee and loan agreement. He is "sure we did not go into the bank at this time, or meet with Mr King". He has no recollection of being given copies of documents on any occasion.

Mr Harlick also says:

> *"We did not really understand any of the documents we signed. We relied on [the Lawsons], Mr King and Mr McLeod. We trusted them and never knew anything like this could happen. Both my wife and I cannot read without glasses. We never take our glasses anywhere, and could not have read the documents, even if we were given the chance to do so."*

Mr King admits in his affidavit that he did not tell the Harlicks that the guarantee executed in May 1989 would cover other moneys which Mr and Mrs Lawson might owe in the future and he did not tell them that they should obtain independent advice from their own lawyers before signing the documents. It seems clear also from Mr King's silence on the point that no suggestion was made in July 1990 that independent advice be obtained.

Mrs Harlick in a short affidavit confirms the accuracy of Mr Harlick's affidavit in so far as she was involved in the matters referred to. In particular, she confirms that she is certain that they did not go to the bank to sign documents in the presence of Mr King after May 1989 and that they certainly did not see Mr King in July 1990. Of the earlier events she says that Mr McLeod did not give them any explanation of the documents they were signing (the mortgage) and did not tell them "we could or should get our own lawyer".

The only question which has to be determined today is whether there is a serious question to be tried. Mr Stewart conceded that if there was such a question to be tried the balance of convenience clearly lay with the *status quo* and it would be appropriate for an interim injunction to be issued.

The plaintiffs' case is that the Lawsons have exercised undue influence over them in procuring them to give the guarantee and mortgage and that either the Lawsons had become the agents of the bank so that their improper conduct towards the plaintiffs is to be imputed to the bank, or the bank had actual or constructive knowledge of the Lawsons' undue influence upon the plaintiffs.

To demonstrate undue influence the plaintiffs must show that

(a) the other party to the transaction (or someone who induced the transaction for his or her own benefit) had the capacity to influence the complainant

(b) the influence was exercised

(c) its exercise was undue

(d) its exercise brought about the transaction.

I take those ingredients from the judgment of Richardson, J. in *Contractors Bonding Ltd v Snee* [1992] 2 NZLR 157, 166. The House of Lords in *CIBC Mortgages plc v Pitt* [1993] 4 All ER 433 has lately said that it is unnecessary to show that the transaction was manifestly disadvantageous. On the facts of the present case the elimination of that ingredient is of academic interest only.

Earlier in Richardson, J's, judgment at p.165 he said that u ndue influence "consists in the gaining of an unfair advantage by an unconscientious use of power by a stronger party against a weaker in the form of some unfair and improper conduct, some coercion from outside, some overreaching, some form of cheating, and generally, though not always, some personal advantage obtained by the stronger party." He also said that it is "directed at conduct within a relationship which justifies the conclusion that the disposition or agreement was not the result of a free exercise of the disponer's will. The doctrine is founded on the principle that equity will protect the party who is subject to the influence of another from victimisation."

The undue influence here alleged is that the Lawsons took advantage of the Harlicks' trust in them and lack of any business experience and of the Harlicks' willingness to acquiesce in anything proposed by the Lawsons. It is said that the Lawsons misrepresented the nature of the transaction both as to amount of liability and its duration and that they exploited their relationship with the plaintiffs, thereby producing a situation which has made the Harlicks' home available to satisfy the Lawsons' debts. It is submitted for the plaintiffs that the bank manager, Mr King, had such notice of the circumstances that he must have been aware that the Harlicks were being exploited by their relatives. The suggestion that the house should be used as security arose as a result of a meeting between Mr King and the Lawsons. It is said that it can be inferred from the affidavit of Mr King that this suggestion had not previously been discussed with the Harlicks. It is further said that the bank, through Mr King, knew that the Lawsons intended to procure the plaintiffs to execute the guarantee and mortgage over their house and that it must have been obvious to Mr King that the Harlicks were reliant upon the Lawsons, naive in relation to commercial matters and lacking any capacity to assess the proposal independently of the Lawsons. The point is also taken that there may have been a friendship between the Lawsons and Mr King, though I have recorded Mr King's denial.

The affidavits reveal substantial factual differences between the plaintiffs and the defendant. The Court cannot at this stage make findings of fact and ought to assume that the plaintiffs' factual contentions will be sustained. However, evidence from the bank which is not contradicted must be given its full weight: *Bowkett v Action Finance Ltd* [1992] 1 NZLR 449 at 452. I note, also, the statement of Thorp, J. in ***Neate v Peerless***

Carpets Ltd (unreported, High Court, Auckland 10 October 1990, CP 1793/90):

> *"While of course the Court must be careful not to determine factual controversy on the affidavits, there must be shown a sufficient basis in the affidavits to regard the factual conflict as one seriously requiring consideration and resolution by the usual tests of examination and cross-examination."*

The subject of undue influence has recently been considered by the House of Lords in ***Barclays Bank plc v O'Brien*** [1993] 4 All ER 417. That was a case about a guarantee given by a wife for the debts of a husband. The wife said that the husband had put undue pressure on her to sign and had misrepresented the effect of a charge which she had executed. Like the Harlicks, according to their affidavit evidence, the wife believed that the security was limited to a certain amount (much less than the actual overdraft run up by the husband) and would last only a short period.

The judgment of Lord Browne-Wilkinson (with which the other Law Lords concurred) concludes at p.431-432 with a summary of the views of their Lordships. It is expressed in terms of cohabitees but immediately before this passage Lord Browne-Wilkinson approved the decision of the Court of Appeal in ***Avon Finance Co. Ltd v Bridge*** [1985] 2 All ER 281. In that case a son, by means of misrepresentation, had persuaded his elderly parents to stand surety for his debts. The surety obligation was held to be unenforceable by the creditor *inter alia* because, to the bank's knowledge, the parents trusted the son in their financial dealings. Lord Browne-Wilkinson said that in his judgment that case was rightly decided:

> *"In a case where the creditor is aware that the surety reposes trust and confidence in the principal debtor in relation to his financial affairs, the creditor is put on inquiry in just the same way as it is in relation to husband and wife."*

Then turning to husband and wife (or cohabitees) the judgment continues:

> *"Where one cohabitee has entered into an obligation to stand as surety for the debts of the other cohabitee and the creditor is aware that they are cohabitees: (1) the surety obligation will be valid and enforceable by the creditor unless the suretyship was procured by the undue influence, misrepresentation or other legal wrong of the principal debtor; (2) if there has been undue influence, misrepresentation or other legal wrong by the principal debtor, unless the creditor has taken reasonable steps to satisfy himself that the surety entered into the obligation freely and in knowledge of the true facts, the creditor will be unable to enforce the surety obligation because he will be fixed with constructive notice of the surety's right to set aside the transaction; (3) unless there are special exceptional circumstances, a creditor will have taken such reasonable steps to avoid being fixed with constructive notice if the creditor warns the surety (at a meeting not attended by the principal debtor) of the amount of her potential liability and of the risks involved and advises the surety to take independent legal advice."*

The first step is to see whether the transaction would be set aside as between plaintiff (complainant) and wrongdoer. Earlier at p.423 His Lordship said that if a complainant proves the *de facto* existence of a relationship under which the complainant generally reposed trust and confidence in the wrongdoer, the existence of that relationship raises the presumption of undue influence. In such a case, in the absence of evidence disproving undue influence, the complainant will succeed in setting aside the impugned transaction as against the wrongdoer "merely by proof that the complainant reposed trust and confidence in the wrongdoer without having to prove that the wrongdoer exerted actual undue influence or otherwise abused such trust and confidence, in relation to the particular transaction impugned."

The next step is to see whether the creditor (bank) is implicated in that transaction. Mr McClennan argued that the Lawsons could be seen to be acting as the the bank's agents when they dealt with the plaintiffs but I think that it is artificial to depict what occurred in that way. As Lord Browne-Wilkinson said at p.428, such cases of agency will be of "very rare occurrence". Lord Browne-Wilkinson said that the key to the problem is "to identify the circumstances in which the creditor will be taken to have had notice of the [plaintiff's] equity to set aside the transaction".

For a party in the position of the bank to be affected by constructive notice of presumed undue influence it must actually know of the circumstances which give rise to the presumption of undue influence. But knowledge of the existence of the risk that a relationship of trust and confidence exists and is being abused is sufficient to put the creditor on inquiry. As Lord Browne-Wilkinson said at p.430, "if the known facts are such as to indicate the possibility of an adverse claim that is sufficient to put a third party on inquiry." If inquiry ought to have been made, but was not, and if it is not disproved undue influence was practised upon the plaintiff, then the creditor is implicated and the transaction may be avoided as against the creditor.

Turning back to the facts of this case, and bearing in mind that all that is necessary for the plaintiffs to show at this stage is that there is a serious question to be tried, I observe that the bank here was aware of the respective ages and the relationship of the parties. It knew that the plaintiffs were of limited means. It seems reasonable to assume that Mr King must have appreciated from his observation of the plaintiffs that they had no business background. It is arguable that the Harlicks entered into the transaction trusting and relying on the Lawsons and that Mr King

appreciated or ought to have appreciated from his knowledge of the situation that this is what was occurring. Most importantly, the bank must have realised that the plaintiffs were allowing their home to be used as security for a comparatively large sum of money (nearly equal to the Government valuation of the home), without receiving any apparent benefit nor any protection by way of corresponding security over other assets of the Lawsons. It must have been obvious to Mr King that the transaction was fraught with risk for the Harlicks if the Lawsons encountered financial difficulties.

Mr Stewart has argued that the plaintiffs' own affidavits show that they understood (without anyone having to tell them) that the Lawsons were well off at the time. He argues that the plaintiffs cannot point to any actual undue influence because the Lawsons were wealthy people in 1989 (their financial difficulties apparently occurred at a later date). Mr Stewart agrees that Mr King did not in 1989 or 1990 take the precautionary steps which wise bankers take in like circumstances in 1994 in response to the third point in Lord Browne-Wilkinson's summary. He did not have a discussion with the Harlicks in the absence of the Lawsons. He did not suggest that independent legal advice be given in relation to the guarantees either in 1989 or in 1990.

I think it is, at the very least, arguable that the fact that the alleged wrongdoer may at the time of the wrongdoing have been wealthy or apparently wealthy does not dispense with the need for inquiry on the part of the bank where other circumstances show that undue influence may be present. As the events of the last decade have dramatically shown, large fortunes can shrink very quickly. The crucial point here is that the bank well knew that an elderly couple were giving security over their home (their

only substantial asset) for the liabilities of their daughter and son-in-law. There was very plainly the potential for extreme prejudice to the plaintiffs.

I have come to the conclusion that the plaintiffs have demonstrated that there is a serious issue to be tried concerning the existence of undue influence and concerning the bank's state of knowledge of the the relationship between the Harlicks and the Lawsons. On the facts before the Court the plaintiffs may be able to establish at trial that the Lawsons were in a position to exercise undue influence over them and that the bank's state of knowledge about this situation was such as to put it on inquiry. The plaintiffs may at trial be able to establish that the bank was thereby fixed with constructive notice of the plaintiffs' right to set aside the transaction with the Lawsons and therefore that they may avoid it against the bank..

Having so found, it is unnecessary for me to consider the significance of the visit which the Harlicks paid to Sturrock Monteith & Co. That related only to the mortgage. There seems to be no suggestion that any legal advice was given during that visit in relation to the guarantee given in May 1989. Equally, there is no suggestion of legal advice having been given (independently or otherwise) when the further guarantee was given in 1990. The mortgage in itself, unless coupled to a guarantee, created no enforceable obligation against the Harlicks or their property. It is the guarantee which creates the liability.

Neither is it necessary to consider the second ground relied upon by the plaintiffs, namely an allegation that the transaction is void because of unconscionability. I content myself only with the observation that the decision in ***Bowkett v Action Finance Ltd*** may be distinguishable on its facts because there the wrongdoer (the son) was, to the knowledge of the

finance company, either bankrupt or about to go bankrupt. In the present case the financial position of the Lawsons appeared, so far as the bank was concerned, to be quite strong even in July 1990. The need for the guarantee was because the Lawsons' assets were not of a nature in respect of which the bank felt comfortable in holding security.

There is a serious question to be tried. The defendant has conceded that the balance of convenience lies in the *status quo* being preserved. Accordingly there will be an injunction as sought in the plaintiff's notice of application pending further order of the Court. Costs are reserved.

With the consent of counsel I make the following timetable orders:

(a) Statement of defence to be filed and served and discovery to be made by defendant by 15 June 1994.

(b) Discovery to be made by plaintiff by 15 June 1994.

(c) Any amended statement of claim to be filed within seven days of completion of discovery.