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"OPPRESSIVE" CONTRACTS - THE CASE FOR CHANGE

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The focus of this paper is to examine the law giving relief from "unfair" contracts in New Zealand. This involves the equitable doctrines of unconscionability and undue influence and the Credit Contracts Act 1981. The aim of the paper is to assess problems with the existing law and suggest workable solutions - whether legislative or judicial. In doing this, the paper looks initially at some of the recent case law in New Zealand, the United Kingdom and Australia. This unveils an unacceptable degree of uncertainty as to when a court will strike down a contract and the basis upon which such a decision will be made.

The paper goes on to examine two different developments suggested in the area - rationalisation of the common law and legislative codification. The Credit Contracts Act 1981 is then critiqued to assess its performance against its aims. Suggestions for reform are mooted with a consumer credit law focus. Finally the paper considers an alternative avenue for practical accessibility to the law for the consumer.

The paper argues that legislative reform is necessary for the consumer as the Act is not giving the necessary protection. For other groups in society the paper contends the common law gives sufficient protection and legislative interference gives rise to too much uncertainty. However developments for the common law to aid clarity and certainty are also mooted.

The text of this paper (excluding contents page, footnotes and bibliography comprises approximately 15,612 words.

I. INTRODUCTION

> The Court must balance the desirability of protecting vulnerable persons from loss of their assets, particularly their homes, against the undesirability of economically sterilising those assets. Sympathy for a victim of undue influence or misrepresentation [or unconscionability or "oppressive" conduct] should not lead a Court into the error of imposing upon lenders an unrealistic standard.[1]

Relief from "unfair" contracts in New Zealand connotes three primary areas of law: the equitable doctrines of unconscionability and undue influence and the Credit Contracts Act 1981 ("the Act"). There is a great deal of overlap between these concepts. All seek to prevent impropriety, both in the conduct of the stronger party and in the terms of the transaction itself which, in the traditional phrase, 'shocks the conscience of the court'.

There are some indications that the doctrine of giving relief to unfair contracts originated in the 17th century: *Ardglasse (Earl of) v. Muschamp* (1683) 1 Vern. 238; *Wieman v. Beake* (1690) 2 Vern. 121. But the doctrine was developed mainly in the 19th century. Its most common application was in cases where moneylenders lent money on exorbitant terms to reversionists and remaindermen against their expectations. In *Barret v. Hartley* (1866) L.R. 2 Eq. 789, 795 Stuart V.C. said that the courts would give a borrower relief against harsh and unconscionable terms or an oppressive bargain extracted by a lender. His Lordship emphasised that this doctrine became of increased importance after the repeal of the usury laws (which prevented the charging of interest).[2]

The Credit Contracts Act has been part of the New Zealand financing environment for some 17 years. The Act was clearly a consumerist measure. The then Minister of Justice explained to Parliament that the Bill would protect consumers in two ways: by improving the information in the market and by prohibiting consumer abuse.[3] This philosophy is reflected in the long title of the Act, which details the following primary objectives of the legislation:

> (a) Prevent oppressive contracts and conduct;

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[1] *Wilkinson v. ASB Bank Ltd* (1998) 6 NZBLC 102,427 (CA), 102,440 per Blanchard J. [*"Wilkinson"*]
[2] *Report of the Contract and Commercial Law Reform Committee; Credit Contracts* (1977) para 7.01 [*"Report"*]
[3] Hon. J. K. McLay, MP (25 September 1980) 433 NZPD 3686-3687

(b) Ensure that all the terms of contracts are disclosed to debtors before they become irrevocably committed to them;

(c) Ensure that the cost of credit is disclosed on a uniform basis in order to prevent deception and encourage competition; and

(d) Prevent misleading credit advertisements.

The enactment of this legislation was greeted with alarm and downright fear by some practitioners:[4]

> On 1 June 1982 there will be delivered to the New Zealand public (largely now blissfully unsuspecting) a monster the like of which has not been seen anywhere else in the world - the Credit Contracts Act 1981.

Others regarded the introduction of the Act as a significant victory for consumerism. Paul Darvell observed that, in giving courts the power to re-open oppressive contracts, the Act represented a "fundamental introduction of consumerism into the law relating to the provision of credit".[5]

Now, in 1998, Webb[6] contends that there remains an unacceptable degree of uncertainty as to when a court will find a contract oppressive and the basis upon which such a decision will be made. Hammond J in *Prudential Building & Investment Society of Canterbury v. Hankins*[7] seems to suggest that the current approach to the concept of oppression has no firm jurisprudential foundation and is lacking in doctrinal basis.

This paper seeks to examine some of the most recent cases (1996 onwards) in the unfair/oppressive contract area, firstly in New Zealand and then also in Australia and the United Kingdom. This analysis appears to the author to draw out the observations of Webb (above) (and not the balancing dicta of Blanchard J. in *Wilkinson*). Firstly, there is uncertainty and confusion in the area. Secondly the courts do not appear to make their decisions by reference to any single fundamental principle but rather proceed on an ad hoc

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[4] Allen, W.H. "The Credit Contracts Act - New Zealand's Frankenstein monster" (1982) NZLJ 149 [*"Frankenstein"*]

[5] Darvell, P. (1980) "Reformed law will cover all solicitors' lending" Northern News Review, 5, No.10, 1-2. Cited in Consumers Institute *The reform of consumer credit law in New Zealand* Consumers' Institute Report (Wellington, 1998), 8 [*"Consumers' Institute Report"*]

[6] Webb, D "A proposed decision-making process for oppressive credit contracts" [1997] NZ Law Review 394, 394 [*"proposed decision-making process"*]

basis dealing with each case on its own facts with the court considering whether it is sufficiently similar to any previously decided case and, if not, whether the circumstances of the case are such that relief ought to be granted in any event. The analysis also demonstrates blatant inconsistencies in decisions with very similar facts.

The writer will then examine two very different developments that have been suggested in the area of unfair contracts. The first being rationalisation of the common law and the second possible legislative codification. Both aim to enhance certainty and predictability whilst promoting a rigorous theoretical basis.

The Credit Contracts Act is then critiqued to assess its performance against its aims. In this section, the author will analyse not only the oppression provisions but also the disclosure provisions of the Act. Suggestions for reform of the Act are mooted and discussed in an attempt to protect consumers whilst promoting freedom of contract and commercial reality.

Finally, this paper looks at a potential alternative avenue for improving accessibility to the law for the consumer - the group most at risk from subjection to unfair contracts, in the form of the Banking Ombudsman.

The author comes to the conclusion that reform is urgent and imperative. The Act as it stands is *not* protecting consumers, but it *is* producing uncertainty and unnecessarily impacting on business. Enforcement of and accessibility to the law must also be improved along with the substantive law itself and the common law can usefully be developed by rationalisation of the two equitable doctrines of undue influence and unconscionability.

II. DEFINITIONS

A. Undue influence

The essential features of the doctrine of undue influence were authoritatively stated by Lord Browne-Wilkinson in *Barclays Bank Plc v. O'Brien*.[8] His Lordship distinguished between class 1 (actual undue influence) and class 2 (presumed undue influence) cases. The latter

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[7] [1997] 1 NZLR 114, 124 [*"Hankins"*]
[8] [1994] 1 A.C. 180 [*"O'Brien"*]

require proof of a relationship in which trust and confidence is reposed by the plaintiff in the defendant, and that the transaction concluded between them is to the plaintiff's manifest disadvantage.[9] On proof of these elements the defendant must show that the plaintiff made an informed decision and that the transaction was the plaintiff's genuine wish, otherwise it is set aside. Class 2 is subdivided into class 2A cases, where there are certain relationships that raise the presumption (such as solicitor/client, trustee/beneficiary, and doctor/patient), and others (class 2B) where the plaintiff has to prove on the facts that the necessary trust and confidence was present. Class 1 cases are those where the plaintiff must prove that actual undue influence was exerted by the defendant and that the plaintiff entered into the transaction because of it. No presumption is raised against the defendant and the plaintiff does not need to show that the transaction was manifestly disadvantageous to him or her.

B. Unconscionability

Five factors normally present in a case of unconscionability, as classically understood, were proposed by Tipping J. in *Bowkett v. Action Finance Ltd:*[10]

"(1) The weaker party is under a significant disability;

(2) The stronger party knows or ought to know of the disability;

(3) The stronger party has victimised the weaker in the sense of taking advantage of the weaker's disability, either by active extortion of the bargain or passive acceptance of it in circumstances where it is contrary to conscience that the bargain should be accepted;

(4) There is a marked inadequacy of consideration and the stronger party either knows or ought to know that to be so;

(5) There is some procedural impropriety either demonstrated or presumed from the circumstances"

C. Credit Contracts Act 1981

Section 10 of the Credit Contracts Act enables a Court to reopen a contract and give relief if a 'credit contract' is oppressive, if a party exercises a right or power conferred by the contract in an oppressive manner, or if a party has induced another to enter into the contract by oppressive means. 'Credit contract' is defined widely in section 3 as essentially a contract in which credit is offered and a charge is imposed. Interest-free credit contracts are therefore

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[9] In *CIBC Mortgages Plc v. Pitt* [1994] 1 A.C. 200 at p209 [*"Pitt"*], Lord Browne-Wilkinson observed that the requirement of manifest disadvantage may have to be looked at again in future.

not covered by the Act . Section 9 states that a contract may be oppressive whenever it is "oppressive, harsh, unconscionable, unjustly burdensome, or in contravention of reasonable standards of commercial practice".

III. RECENT CASE LAW

A . O'Brien and Pitt

In *Barclays Bank v. O'Brien* the House of Lords considered the competing interests that the law must reconcile when dealing with cases where a wife becomes surety for her husband.[11] A transaction procured by undue influence can be set aside against the creditor if the wrongdoing spouse is the agent of the creditor or if the creditor has actual or constructive knowledge of undue influence. A creditor is put on inquiry if a transaction is not for a spouse's benefit or there is a substantial risk that in procuring the wife to act as surety the husband has committed a legal or equitable wrong that entitles the wife to set aside the transaction. Unless a creditor who is put on inquiry takes reasonable steps to satisfy himself that the wife's agreement to stand surety has been properly obtained, the creditor will have constructive notice of the wife's equity to set aside the transaction. Reasonable steps for His Lordship consisted of the creditor insisting that the wife attend a private meeting (in the absence of her husband) with a representative of the creditor at which she is told of the extent of her liability as surety, warned of the risk she is running and urged to take independent legal advice. In cases where a creditor has knowledge of further facts which render the presence of undue influence "not only possible, but probable", the creditor must insist on independent advice.[12]

Rickett and McLauchlan have criticised the approach of his Lordship as having pragmatic appeal, but lacking in conceptual coherence:[13]

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[10] [1992] 1 NZLR 449, 460

[11] See discussion in Section II. above for the different classes of undue influence as laid down by Lord Browne-Wilkinson. Note also that although the principles are stated in terms of married parties, His Lordship made it clear (at 198) that they apply to all other cases where there is an emotional relationship between cohabitees, including those of the same sex.

[12] *O'Brien*, above n8, 196-197

[13] Rickett, C.E.F.; McLauchlan, D.W. "Undue influence, Financiers and Third Parties: A doctrine in transition or the emergence of a new doctrine?" [1995] NZ Law Review 328; 344, 346. [*"Undue Influence and Third Parties"*]

> Although premised on notice, because it is discussed within the dimensions of equity, the test conceived by Lord Browne-Wilkinson seems concerned with the recognition of a duty on the creditor to take positive steps to safeguard the interests of the particular persons included within the class at risk

and later:

> It really is very difficult to escape the conclusion that, regardless of Lord Browne-Wilkinson's disclaimers, the O'Brien test is no more than an extended version of the special equity theory dressed up in notice terminology.

The "special equity theory":[14]

> [C]onsiders that equity affords special protection to a protected class of surety viz. those where the relationship between the debtor and the surety is such that influence by the debtor over the surety and reliance by the surety on the debtor are natural features of the relationship.

This was expressly rejected by Lord Browne-Wilkinson in favour of a more general approach which his Lordship felt was not only more principled in terms of the nature of equity, but would also provide protection of the legitimate interests of those who would otherwise benefit as recipients of the special equity.[15]

In a decision heard by the same Appellate Committee and decided the same day *CIBC Mortgages plc v. Pitt*[16] the case of a loan to a husband and wife (as distinct from surety transactions) was considered. The bank had lent money to Mr and Mrs Pitt secured over their jointly owned house in the belief that they would use it to buy a holiday home. The wife had signed a loan application to that effect but did not read it or the bank's loan offer which mentioned this purpose. In fact, having exerted pressure on his wife to obtain her consent to the borrowing, the husband used most of the money to buy shares in his own name, losing heavily in the market crash of 1987. Although undue influence was established the Bank had no notice of it as there was no indication that the transaction was anything other than a normal advance to Mr and Mrs Pitt for their joint benefit. The bank was not put on inquiry and could not be fixed with constructive notice of the undue influence.

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[14] *O'Brien*, above n8, 187-188
[15] *O'Brien*, above n8, 195
[16] *Pitt*, above n9

Andrew Beck notes: "It is important that all cases involving security by partners for business debts now be viewed in the context of *Barclays Bank v. O'Brien*".[17] The author agrees but notes the potential ambit of *O'Brien* is wider than merely security by partners for business debts. Further regard must be had to the restriction on the doctrine as articulated by Lord Browne-Wilkinson again in *Pitt.*

B. New Zealand cases

1. Exercise of power or right in an oppressive manner

In *Taylor & Anor. v. Westpac Banking Corporation* (1996) 5 NZBLC 104, 104 the appellants had purchased a commercial building in 1987. To finance the acquisition they took out a loan from Westpac which in turn, took a first mortgage over that and three other properties owned by the appellants. The loan became due for repayment in September 1995. At that time the appellants were negotiating with the tenants for a new lease of the premises and with prospective purchasers for the sale of the tenanted building. Until these negotiations concluded, the appellants were unable to repay the loan and they requested Westpac delay exercising its power of sale. The Bank agreed to do so until February 1996. The appellants were still unable to pay by February and the Bank refused to delay the sale further. The appellants sought an injunction to prevent Westpac exercising its power of sale. They claimed the manner of the exercise of this power was oppressive in terms of section 10(1)(b) of the Credit Contracts Act 1981 as selling now would prejudice their negotiations and further that as the value of the property exceeded the outstanding loan, Westpac's security was not in danger and it would not be prejudiced by the delay.

The Court of Appeal dismissed the appeal and refused to grant the injunction. Thomas J. stated that the exercise of a power of sale by a lender is not inherently oppressive. However, other surrounding circumstances may make it so.[18] His Honour observed that the courts will not countenance the contention that the necessity or prudence of the mortgagee's decision to exercise its power of sale can be challenged whenever the security is adequate and a mortgagor considers that the sale should be delayed in order to obtain a higher price. Nor would the court second-guess Westpac's commercial wisdom in exercising its power of sale

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[17] Beck, A "Contract" [1998]1 NZ Law Review 25, 36 [*"Contract 1"*]
[18] (1996) 5 NZBLC 104,104, 104,108 [*"Taylor"*]

at that time.[19] The Court concluded by commenting that Westpac was simply exercising a right conferred under the contract. The exercise of a power of sale will almost inevitably cause consequences which may appear harsh to the mortgagor. However, these are a normal consequence of the exercise of the power of sale and something additional will be required before the mortgagee's exercise of its power of sale is oppressive.[20]

This decision, although unsurprising on the facts (the Court of Appeal did not even believe the exercise by Wespac of its power of sale was unfair), is a prime illustration of the (laudable) reluctance of courts to interfere and second-guess a business' commercial decisions especially where experienced business people are involved. In the absence of anything to suggest the decision was unreasonable or outside the bounds of acceptable commercial practice the courts will refuse to interfere and not allow wealth tied up in the assets to become economically sterile. Westpac were well within their contractual rights to exercise their power of sale when they did, they had already delayed doing so at the request of the appellants, and they had done nothing which could be suggested to be procedurally unconscionable.

2. *All obligations security by partners for business debts.*

Both *O'Brien* and *Pitt* were important in the High Court's decision in *Baxter v. The ANZ Banking Group (NZ) Ltd & Ors* (1996) 5 NZBLC 104,281. The Bank provided finance for Mr Baxter's business with security over the matrimonial home. The Bank's solicitors insisted that Mrs Baxter be given independent advice, and introduced her to a solicitor for this purpose. The solicitor noted Mrs Baxter's belief that if she did not agree to the transaction her marriage would be at an end. Subsequently the Baxters separated after an abusive relationship, and Mr Baxter demanded that Mrs Baxter sign a document for an equity loan. The Bank agreed to this based on the existing mortgage. Mr Baxter also undertook further liability in respect of his company. The Bank conceded that it was placed on inquiry, and the question was the adequacy of advice provided.

The Court held that the original transaction could not be attacked - by insisting on independent advice the Bank had taken reasonable steps in accordance with *O'Brien*. However with respect to the subsequent extension of credit, Mrs Baxter could not be said to have given her husband the freedom to enter into any future transaction he wished to, and the

[19] *Taylor*, Above n18, 104,108-104,109

Bank had allowed Mr Baxter's company to incur further debt without reference to Mrs Baxter. The Bank had therefore not ensured that she had knowledge of the risks she was running and an interim injunction was granted preventing the bank acting on its security in this respect. The Court held the equity loan was covered by *Pitt* and could not be challenged. Because the loan was ostensibly for domestic purposes, (rather than Mr Baxter's business) as in *Pitt*, the Bank had not been placed on inquiry of the possibility of undue influence and thus did not have to insist on independent advice. Mrs Baxter also pleaded causes of action under the Credit Contracts Act 1981 and s 9 of the Fair Trading Act. The Court held that there was a serious argument available to her under each of these in relation to the extension of security for the subsequent finance.

This decision was the logical extension of *O'Brien* - independent advice is required for a jointly liable partner where there are subsequent dealings different from the original, relating back to previous security. Beck argues that the case also shows that the courts have adopted a pragmatic approach and are looking for substance rather than technical compliance with rules.[21] The case also highlights the "*Pitt* trap". There may be only the most slender of differences between situations where a spouse is able to escape liability, and one where liability is imposed. In this case the equity loan Mrs Baxter was forced to sign under physical pressure from her husband was to enable him to complete the purchase of a Ferrari. Because it was not for his business and the Bank had no knowledge of the marital discord, the Bank was able to enforce its security. Whereas, in respect of the subsequent guarantee of her husband's business debts, Mrs Baxter was able to escape liability. In neither case was the transaction for the financial benefit of Mrs Baxter nor did she receive independent advice. In situations like the instant, the *Pitt* exception to the *O'Brien* principle seems manifestly unfair and brings into question Beck's substance over form contention.

Two later cases where the courts do not seem to have followed *O'Brien* are *Dungey v. ANZ Banking Group (NZ) Ltd* (1997) 6 NZBLC 102,194 and *Clarke v. Westpac Banking Corporation* (1997) 6 NZBLC 102,182.

In *Dungey* Mrs Dungey went to the bank with her de facto partner, Mr D, to obtain overdraft finance for his business. The bank officer suggested a joint account, but Mrs Dungey did not appreciate that she would be liable for the whole of it by virtue of a mortgage she had already given. She received no independent advice. On Mr D's death, the bank claimed the $90,000

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[20] *Taylor*, Above n18, 104,110

owing from Mrs Dungey. The Court held that the bank would have had constructive knowledge of undue influence, but there was no evidence of any, either actual or presumed. Mrs Dungey succeeded, however, under the Fair Trading Act 1986. The Court accepted that the relationship was such as could give rise to a presumption of undue influence and one may question how this situation differs from *O'Brien*. Both parties visited the bank together and the transaction was freely entered into but it may be doubted whether that is sufficient to rebut the presumption of undue influence in light of the *O'Brien* principles. "It is suggested that the bank should have insisted on independent advice".[22]

The Court concluded that it was misleading and deceptive (in terms of the Fair Trading Act) to recommend a joint account which entailed full liability for the debt, without explaining that this was entirely different from a guarantee. Doogue J. also found that the bank had also breached the Code of Banking Practice. Yet, notwithstanding this, there was no finding of "oppressive" conduct within the Credit Contracts Act 1981.

In *Clarke*, the Clarkes had mortgaged their property to secure a loan in 1980. In 1993, Mr Clarke borrowed further money to invest in a company, and gave a guarantee secured by the same mortgage. It appeared Mrs Clarke had no knowledge of these subsequent dealings. The Court held that the bank was under no duty to explain the effect of documents to customers, nor was it required to advise Mr Clarke to take independent advice when he signed the guarantee. The bank also had no duty to advise Mrs Clarke of her husband's intention to give a guarantee or as to its effect. The Court felt the situation was governed by contract as Mrs Clarke had committed herself under the mortgage signed some 13 years earlier to meet any liability which Mr Clarke may subsequently incur under any guarantee.

The Clarkes pleaded oppressive conduct pursuant to the Credit Contracts Act 1981, but the Court also considered the possibility of an undue influence claim. The latter was rejected on the grounds that a relationship between a banker and customer is not one which ordinarily gives rise to a presumption of undue influence and there was no actual undue influence in evidence. The Court did not address the possibility of Mrs Clarke being subjected to undue influence on the part of her husband, despite finding that throughout their married life she left all business, banking and financial matters to her husband and trusted him to deal with those matters on behalf of both of them - surely a classic *O'Brien* presumed undue influence situation. The Court also found that the Bank had breached the Code of the New Zealand

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[21] Beck, A "Contract" [1997] NZ Law Review 1, 11 [*"Contract 2"*]

Bankers' Association as they did not advise Mr Clarke to get independent advice because of the risk of the ultimate liability he was assuming, but that the code did not amount to "reasonable standards of commercial practice" and thus there was no breach of the Credit Contracts Act 1981.

Paterson J. in coming to his conclusion on the bank's duties/obligations issue relied on a number of decisions to similar effect, all of which predated *O'Brien*. Neither *Baxter* nor *O'Brien* were referred to at all by his Honour, yet it is submitted, with respect, that the situation in *Clarke* was very similar to that in *Baxter* in relation to subsequent advances using existing security. The fact that Mr Clarke was an experienced business person seemed to weigh heavily with the Court. However Mrs Clarke's position seems to have been somewhat glossed over. She relied on her husband in such matters, received no independent advice and did not know at all about the guarantee of her husband's business debts. His Honour's decision may well be commercially realistic, drawing on *caveat emptor* type reasoning but, with respect, it does seem inconsistent with decisions like *Baxter* and *O'Brien*. Furthermore, if the Code of Banking Practice does not amount to evidence of "reasonable standards of commercial practice", it is difficult to see what would. As discussed in section VI below, the Banking Ombudsman scheme is an integral part of the Code of Banking Practice and the Ombudsman in making recommendations on complaints is directed to take note of any applicable rule of law, the general principles of good banking practice *and any relevant code of practice*.

3. *The Court of Appeal's contribution*

Once a lender knows, for example, that a guarantor has limited commercial ability, is on the point of entering a transaction that is financially disadvantageous from his or her point of view and that the guarantor is dependent on the advice of the principal debtor, what should the bank do to ensure the efficacy of its guarantee and thus avoid the effect of the presumption of undue influence or misrepresentation, or the Credit Contracts Act?

In *Wilkinson v. ASB Bank Ltd* (1998) 6 NZBLC 102,427 the Court of Appeal developed a series of guidelines for such situations. The Court of Appeal's advice is as follows:[23]

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[22] *"Contract 1"* Above n17, 31

[23] *Wilkinson*, above n1, 102,440-102,442. As summarised in Maxton, J.K. "Equity" [1998] 1 NZ Law Review 37, 42-43 [*"Equity"*]

1.To allay the suspicion of undue influence the bank should insist that the guarantor be given advice by an independent solicitor, obtaining a certificate that the effect & implications of the documents have been explained and appear to have been understood.
2.If a guarantor declines to obtain independent advice the bank should record the refusal in writing and have it signed and secondly ensure that a solicitor explains the documents and their consequences to the guarantor.
3.The solicitor engaged should raise with the guarantor issues of the principal debtor's creditworthiness and the guarantor's potential financial exposure.
4.It is prudent for a bank to insist that the guarantor is advised by a solicitor who is not acting for another party to the transaction. But, if a reasonable person, with the knowledge of the bank would believe that the solicitor's independence has been compromised or if the bank knew or had good reason to believe that the solicitor was unaware of crucial facts, known to the bank, about the transaction and the risk to which the guarantor was being exposed, the bank may not be able to rely on a solicitor's certificate.
5.Finally, there may be cases where the substance of the transaction or a term of the guarantee or security is so disadvantageous that no solicitor could properly advise the guarantor to sign. The bank, at the very least, should seek a certificate from the independent solicitor which states that this particular matter has been pointed out to the guarantor.

The Court had to decide whether a mortgage and guarantee given by Mrs Wilkinson, a woman of 70, for her husband's business purposes was enforceable by the ASB. A number of matters (including her age, the lack of financial advantage to her from the transaction, the fact that the loan offers were not accepted by her but by others on her behalf and the suggestion that the documents be signed under power of attorney) indicated the possibility that undue influence had been practiced on Mrs Wilkinson by her husband. The question was whether the Bank's right to recover the debt and enforce the security was affected by constructive notice of these circumstances.

The Court of Appeal held that the Bank had taken sufficient steps and that, therefore, it's rights were unaffected. The ASB had insisted throughout that independent advice be given to Mrs Wilkinson. Although the ASB knew that the solicitor who advised Mrs Wilkinson had been the family solicitor previously, the Court rejected an argument that that compromised his independence. It was not to be assumed that because a solicitor had some involvement with

the principal debtor, he or she was unable to function independently in advising a guarantor.[24]

> Wilkinson is a decision that is important for both bankers and solicitors. To an extent not matched in other decisions it attempts to give practical guidance to financiers and their legal advisors in the execution of guarantees.[25]

The advice of the Court of Appeal in *Wilkinson* should be the benchmark to judge cases within the factual matrix of this subsection, like *Clarke*. On such an analysis, again *Clarke* falls down. Principally because of the holding that the bank did not have to advise Mrs Clarke of the existence and effect of the subsequent extension of credit under the matrimonial home security or of the necessity to obtain independent advice.

4. Silence and oppression

The most interesting and contentious recent decision in this area was that delivered by Hammond J. in *Prudential Building and Investment Soc. of Canterbury v. Hankins* [1997] 1 NZLR 114. The High Court was asked to find that silence by a financier in the face of an (arguably manufactured)[26] mistake as to the nature of a loan was oppressive. In the course of his judgment, Hammond J. examined in some detail the concept of "oppression" under the Credit Contracts Act 1981. His Honour suggested that the current approach is unsatisfactory, and looked to United States and Canadian materials for guidance.

The defendants were seeking to obtain for the development of a parcel of land, a loan of $1.6m. However the financier (Action Finance, which had since sold the security to Prudential) was not prepared to advance more than $850,000 which it did. The advance was secured by a mortgage over a residence held by a family trust of which the first defendant was trustee. The defendants needed significantly more than the $850,000 to proceed with their development plan and appear, at least in their own minds, to have considered this advance as an interim measure until later advances were made and different security substituted. Action Finance though, considered the arrangement to be in accordance with the

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[24] *Wilkinson*, above n1, 102,443

[25] *Equity*, above n23, 43

[26] Webb, D "When will silence be oppressive under the Credit Contracts Act?" (1997) 3 NZBLQ 154,154 [*"silence"*]

express terms of the contract, and complete. The defendants never met any of their obligations under the mortgage.

$600,000 of the advance was for refinancing, involving the exchange of a cheque for that sum to be used to satisfy earlier advances and consolidate the borrowings. In returning the cheque to Action Finance the solicitor for the defendants noted, in a letter and in the endorsement on the cheque itself, that the cheque was payment in temporary settlement. The letter also noted that the settlement was only an interim measure until an advance of $1.6m was made and a replacement mortgage over a separate property executed. It was these statements which were central to the claim of oppression.

It was found as a matter of fact and law that the transaction was not an interim measure, but a final one. The statements by the defendants were seen by Action Finance as an attempt to vary unilaterally the terms of the mortgage, and impose on Action a duty to advance a further $800,000 which had not been agreed to. The (understandable) response to this was to ignore the statements and treat the relationship in accordance with the original contractual basis. Hammond J. found that the lender, by remaining silent in the face of an attempt on the part of the borrower to alter the terms of the executed loan arrangements (or misunderstanding the nature of the transaction) had acted oppressively.

His Honour recognised, but did not adopt,[27] the suggestion that there was a single unifying principle in the concept of oppression: that of "abuse of relationship" between the parties.[28] "The cases also evidence a disinclination on the part of our Courts to proceed on anything other than a case-by-case basis".[29] Although his Honour noted some "useful sub-principles" that have evolved.[30]

His Honour then focused on "unconscionable", the limb of the definition of oppression relied on by the defendants. He drew a distinction between procedural unconscionability - the manner in which the contract was entered into or the exercise of powers under the contract;

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[27] *Hankins*, above n7, 124

[28] *Anderson v. Burbery Finance Ltd* [1986] 2 NZLR 20, 27. His Honour also cited Pol, R "Credit Contracts: The Factors Going to Oppression" (1989) 6 AULR 139.

[29] *Hankins*, above n7, 123

[30] *Hankins*, above n7, 123. See discussion at below n82 - Section V.A.1. See also *Gault on Commercial Law* (Brooker's, Wellington,1994) vol 2, Credit Contracts Act, paras. 11.06-11.27, which identifies 21 matters derived from a consideration of the cases, which may bear on whether conduct is oppressive. Hammond J. also reproduces a list of considerations produced by the Ontario Law Reform Commission in its 1987 *Report on the Amendment of the Law of Contract* in the context of unconscionability.

and substantive unconscionability - the benefits, risks and burdens of the contract itself. His Honour also suggested a third class of unconscionability: that which occurs in enforcement or collection,[31] although, with respect, this seems to be merely a subset of procedural unconscionability.

Hammond J. suggested that section 2-302 of the Uniform Commercial Code, which creates a statutory doctrine of unconscionability, and the jurisprudence which has arisen from that section, were of relevance. *Williams v. Walker Thomas Furniture Co.* 350 F 2d 455, 499 (1965) (DC Cir). was cited by Hammond J. The case stated that there must be both an "absence of meaningful choice" (that is, procedural unfairness) and contract terms which are unreasonably favourable to one party (that is, substantive unfairness). However Hammond J. went on to find a complete absence of substantive unconscionability. The arrangements were not unfair, nor did they allocate benefits in anything other than a commercially reasonable manner. His Honour effectively decided that procedural unfairness alone was sufficient to found an action for oppression, contrary to the US position.

Hammond J. after his theoretical discussion, does not seem to adopt any particular approach in coming to his conclusion and his decision has thus been criticised. Notwithstanding the finding that the true state of affairs was clearly expressed by the words of the contract the Court imposed a duty to respond to the defendants apparent misapprehension; "...[I]t seems axiomatic to me that a lender is under an obligation to ensure the clarity of a transaction."[32] Webb states:[33]

> It seems difficult to justify a finding that the lender is ultimately responsible for a misapprehension created by the inattention, or possibly contrivance, of the other party, simply because it does not reiterate the clear contractual position.

Both parties were experienced in business and used to arranging complex finance deals, there was thus no inequality of bargaining power; the contract contained no unreasonable or unexpected terms; the borrower was not 'ambushed'; the lender did not act in a way to mislead the borrower; the borrower was independently advised; and it had previously been made clear that the amount of funds sought would not be made available. One commercial

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[31] *Hankins*, above n7,125
[32] *Hankins*, above n7,127
[33] *silence*, above n26, 157

party, at the most convenient moment, fancied a term to exist which simply did not. The failure of the lender to dispel this illusion was found to be oppressive.

C. English cases

In *Barclays Bank plc v. Thomson* [1997] 4 All ER 816 the wife owned the family home and mortgaged it to the bank to secure an overdraft for her husband's business. The bank engaged the husband's solicitors to act on its behalf in obtaining her signature. They certified that they had explained to her the full content of the charge and that she was aware of what she had signed. They had not, however, pointed out to her that the charge was unlimited. Simon Brown L.J. could see no good reason whatever why a bank, perhaps conscientiously instructing solicitors to give independent advice to a signatory who might otherwise go unadvised, should thereby be disabled from relying on the solicitors' certificate that such advice has been properly given.

Barclays Bank plc v. Boulter [1997] 2 All ER 1002 confirms that once a guarantor alleges undue influence or misrepresentation it is for the bank to plead and prove that it did not have constructive notice thereof, not on the guarantor to prove that it did.

Royal Bank of Scotland plc v. Etridge [1997] 3 All ER 628 involved a charge given by a wife over her house, the family home, to support her husband's business overdraft. The charge was signed in the presence of a solicitor whom the bank had appointed to act on its behalf. It seems that he also acted for the husband. The case seems indistinguishable from *Thomson* however the Court of Appeal held that the fact that the bank had instructed the solicitor constituted him "their own solicitor for the purposes of giving the appropriate information or advice to the bank". Therefore awareness of insufficient advice would be imputed to the bank. Such an approach was described as wholly artificial in *Thomson* and Blanchard J. in *Wilkinson* stated that "*Etridge* seems to be a departure from the position taken in other cases"[34] and went on to essentially adopt the *Thomson* approach.

Credit Lyonnais Bank Nederland NV v. Burch [1997] 1 All ER 144 was viewed by the judges of the Court of Appeal as the clearest possible case for relief on *O'Brien*. However:(i) the relationship between the surety and principal debtor, of employee and employer, clearly falls outside the "emotional and sexual nature" type referred to in *O'Brien* as giving rise to

[34] *Wilkinson*, above n1, 102,437

presumed undue influence; (ii) the Bank twice wrote to the proposed surety advising of the unlimited nature of the charge and of the desirability of obtaining independent advice; and (iii) the Court suggested that the nature and extent of the disadvantage in the transaction to the surety may be so severe that the lender must insist on independent advice *and* must reasonably believe that the advice was obtained, was competent and even that it was followed.

Miss Burch was an 18 year old employee of a company controlled by a Mr Pelosi. She agreed to execute a charge over her flat to assist the company's application for an increase in its overdraft. Burch discussed the solicitors letters to her (advising of the unlimited nature of the mortgage and advising her to seek independent advice) with Pelosi and he either prepared her reply or told her what she should say. Burch was unaware of the extent of the company's indebtedness and did not obtain independent advice.

The result, with respect, seems difficult to justify along the lines of *O'Brien*. Chen-Wishart argues that the case exposes *O'Brien* as rooted in, and merely one application of, relief against unconscionable transactions and it is in that wider context that *Burch* can, and should, be understood. Secondly she argues that the case reveals the potency of serious substantive unfairness in triggering relief under the *O'Brien* principle.[35] Chen-Wishart contends that it was substantive unfairness which gave rise to the inferences that the procedural pre-conditions of relief existed in this case. A jurisdiction explained in terms of vitiated consent or unconscientious conduct is hard pushed to explain why a complainant, not under a legally recognised incapacity, who chooses not to obtain advice or to act against advice when such advice is recommended by the creditor, should be relieved from a "bad bargain". However, if the Court had openly admitted to some concern to prevent substantive unfairness, then the result is much easier to understand.[36] Chen-Wishart points out that the accepted wisdom that procedural unfairness is the only legitimate juridical basis of relief in consensual dealings needs challenging and that it is in fact often substantive unfairness underlying decisions cloaked in the language of procedural unconscionability.[37] The courts need to inject transparency into their decisions. If they are prepared to grant relief on the basis of substantive unfairness this should be stated in a court's reasoning. Otherwise, if there is no procedural unconscionability then the court should refuse to grant relief from the

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[35] Chen-Wishart, M "The *O'Brien* principle and substantive unfairness" (1997) 56 CLJ 60, 60 [*"substantive unfairness"*]

[36] *substantive unfairness*, above n35, 70

[37] *substantive unfairness*, above n35, 60

consequences of a "bad bargain". Legal rhetoric one way, when the reality is often the other, does nothing for legal certainty.

David Capper[38] agrees that it is stretching the "relationship of trust and confidence" somewhat to fit an employer-employee relationship into it, and it is also difficult to see why the bank's letter to the defendant pointing out the unlimited nature of the transaction and the desirability of obtaining independent advice did not constitute sufficient steps on its part to rid itself of the consequences of any constructive notice.

> What really caused the Court of Appeal to set this mortgage aside was its utter substantive unfairness and the better judicial basis for the decision is the unconscionable conduct of the bank in taking a security so thoroughly unbalanced.[39]

Capper cites the case in illustration of "some of the major doctrinal problems associated with undue influence and unconscionability"[40] to support his contention (examined more fully below) that the doctrine of undue influence may be usefully subsumed into an enlarged conception of unconscionability.

The New Zealand Court of Appeal in *Wilkinson* considered all four of the above cases (notably all of English Court of Appeal authority) in coming to their decision and formulating their guidelines referred to above. The English authorities appear to be following *O'Brien* considerably closer than some of the New Zealand authorities which the author has considered above. The case of *Burch* though, forces a reconsideration of the accepted wisdom with respect to the procedural/substantive unfairness distinction and also with respect to the true basis for the decision in *O'Brien*. Although claiming to be following *O'Brien*, the court appears to have significantly extended available relief. If understood as substantive unfairness and unconscionability, the decision is more readily acceptable.

Unfortunately the English jurisprudence suffers from inconsistency also - just as *Baxter* and *Clarke* are inconsistent in New Zealand, *Thomson* and *Etridge* come to different conclusions in England. In fact *Etridge* appears to be a departure from the position taken in other cases

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[38] Capper, D "Undue Influence and Unconscionability: A Rationalisation" (1998) 114 L.Q.R. 479 [*"Rationalisation"*]
[39] *Rationalisation*, above n38, 502
[40] *Rationalisation*, above n38, 503

also.[41] What is notable is the commonality in the type of fact situation that the courts are addressing in this area, between New Zealand and the United Kingdom. In both jurisdictions the courts are dominated by 'all obligations' securities executed essentially for the benefit of a spouse's (or in the case of *Burch* an employer's) business purposes.

D. Australian cases

Patrick Lowden and Justyn Walsh argue the recent decision of the New South Wales Court of Appeal in *Elders Rural Finance Ltd v. Smith* (1996)[1997] ASC 56-366 may have significant implications for lenders.[42] The Smiths conducted a farming and grazing business on a property known as 'Roseleigh'. In mid-1985 they approached Elders for financing of the acquisition of a property. Elders agreed, but the proposal was then abandoned. A short time later, Elders alerted the Smiths to a property called 'Nuneham Park' which had come onto the market. After Elders had prepared detailed 10-year cash flow projections as to the grazing operation on the properties, they agreed to lend the Smiths $973,000. The loan was secured by mortgages over Nuneham Park, Roseleigh and other properties. The Smiths were not trained in accounting, commerce or law and did not review the projections. However, they did know the quality of land, the value of it, and what return to expect from it.

The investment was a disaster. The Smiths were not even able to maintain interest payments on the property, and Elders sued to recover the loan. The Smiths claimed relief under the Contracts Review Act 1980 (NSW) on the basis that the loan contract was "unjust". This is defined in section 4 of the Act as including "unconscionable, harsh or oppressive", all three terms appear in the definition of "oppressive" under section 9 of New Zealand's Credit Contracts Act 1981. Therefore the decision is highly relevant.

At first instance, Bryson J found that:[43]

- the Smiths were not deprived of any real or informed choice about the nature of the documents they entered into;

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[41] Banchard J. in *Wilkinson*, above n1, 102,437, refers to two - *National Westminster Bank plc v Beaton* (unreported, 14 April 1997) and *Midland Bank plc v Serter* [1995] 1 FLR 1034.

[42] Lowden, P & Walsh, J "Am I my brother's keeper?" Journal of Banking & Finance Law and Practice 8(2) June 1997 138

[43] (1995) 35 NSWLR 395

- there was nothing unjust, unreasonable, or unusual in any of the terms of the loan or security documents;
- there was nothing unfair in the benefits Elders derived from the transaction;
- the Smiths were not overborne, pushed or cajoled into the transaction by Elders;
- Elders did not act unfairly or otherwise than in good faith; and
- Elders had no duty to advise or give any explanation of the transaction to the Smiths.

However, Bryson J also found that:

- Elders knew the Smiths were financially unsophisticated and relied on professional advice and assistance in deciding what to do;
- Elders' projections "would be realised only in an extraordinary combination of favourable circumstances which did not happen and was not realistically likely to happen, still less to continue for years".
- Elders agreed to make available the loan only because its position was protected by security and further Elders did not communicate this to the Smiths, who viewed the approval of their loan as a "vote of confidence" in the proposal.
- Whilst Elders were protected if the project failed, the Smiths were not and would have been "destroyed".

Bryson J. went on to find that the contract was "unjust" for the purposes of the Contracts Review Act.

The Court of Appeal upheld Bryson J's judgment by a 2 to 1 majority. The unprincipled, highly discretionary nature of the inquiry is shown by Mahoney P's comment that: "In the end, the meaning of injustice lies in the reaction of the individual judge, informed by what has been said to those to whom he ought to have regard"[44]

His Honour found that in his opinion the contract would not have been set aside by a court of equity as sufficiently harsh, oppressive or unconscionable, but that the Act was intended to set a less onerous standard. The majority's decision was based on the fact that Elders knew or ought to have known that the transaction was likely to be a disaster from the Smiths' perspective (the inaccuracy of the projections prepared by Elders weighed heavily with the

[44] (1996) [1997] ASC 56-366, 57,237 [*"Elders"*]

Court), knew the Smiths' had little capacity to realise this (although it was also found that the Smiths had enough experience and ability to make an assessment of the worth and carrying capacity of the property), and chose to proceed because its own position was protected by security.

Mahoney P. stated (contrary to Bryson J.) Elders were under a duty, not legal but in justice, to ensure that the Smiths appreciated the extent and likelihood of the burdens that might fall upon them. Importantly, Handley J.A. found that the distinction drawn in previous cases between the transaction or investment on the one hand, and the contract on the other, was not applicable here as Elders was more than a mere financier - they prepared the projections. This blurring of the distinction was disapproved of by Meagher J.A. in his dissenting opinion. His Honour stated that Bryson J. had granted relief because Elders were, through their commercial experience, of greater ability to foresee impending disaster, although there was nothing in the slightest degree unjust in the contract or in the manner in which it was reached. To do this was, according to his Honour, to penalise a transaction rather than reform an unjust contract and that was an error in law.

It is this author's opinion that Meagher J.A.'s dissent is to be preferred. The case makes it clear that the fact that the terms of a loan may be fair, reasonable and fully understood by the borrower and that the borrower may have entered into the loan without any pressure from the lender or any third party does not make the loan immune from the Contracts Review Act. This places unrealistic obligations on lenders and makes their position very uncertain. Lenders now have a duty to ensure that financially unsophisticated borrowers appreciate the extent and likelihood of the burdens that might fall upon them. Essentially lenders have to advise as to the prudence of the intended transaction. Surely this can not be the function of law - protecting people from the consequences of a bad deal freely entered into, at the expense of an "innocent" lender.

E. Cases in summary

Whilst *Taylor* illustrated the reluctance of courts to interfere and second-guess a business' commercial decisions, *Hankins* imposed a duty on the lender to respond to the defendant's (arguably contrived) misapprehension about the clear words of the contract, or attempt to vary the terms and the failure to do this amounted to oppression, notwithstanding a complete lack of substantive unfairness in the bargain.

Baxter and *Clarke* - decisions 2 months apart with very similar facts - came to opposite conclusions, as did the two U.K. decisions of *Thomson* and *Etridge*. While *O'Brien* is said by most courts to be the leading decision in the area of bank's responsibilities in an undue influence situation, neither *Dungey* nor *Clarke* referred to the case in factual situations within the ambit of *O'Brien*. Yet in *Burch* the court gave relief under *O'Brien* when there was no relationship that could give rise to a presumption of undue influence nor any other procedural unconscionability.

Perhaps the best recent New Zealand decision in the area, was that of the Court of Appeal in *Wilkinson*. Not only does it lay down guidelines for lenders it also does not place an unrealistic obligation on them by holding that ASB had taken sufficient steps to rebut constructive notice of undue influence in insisting on independent advice, notwithstanding the solicitor was the family solicitor who advised the husband on his business dealings. The case has now set the benchmark from which other cases should be judged.

Elders also imposes unrealistic obligations on lenders by imposing a duty to ensure that financially unsophisticated borrowers appreciate the extent and likelihood of the burdens that might fall upon them, and it would seem, advise them against risky deals like that in the case. The fact that all the terms were fair, reasonable and fully understood by the borrowers who freely entered into the loan was not enough in the end to a majority who blurred the distinction between the contract itself and the wider transaction or investment to which the contract relates. Importantly the decision has relevance for New Zealand under the Credit Contract Act as the definition of "unjust" - the accepted pleading in the case - includes "unconscionable, harsh or oppressive". All three terms appear in the definition of "oppressive" under section 9 of the New Zealand legislation.

At the end of an analysis of recent case law, the scope of "oppression" under the Act remains unclear. How consistent is it with the common law of unfair contracts or the Fair Trading Act? In *Baxter* the Court was prepared to grant relief under all three heads, that is under the common law, the Credit Contracts Act and section 9 of the Fair Trading Act. *Clarke* similarly came to the same conclusion on all three with Paterson J. emphasising consistency with his conclusions on equitable grounds. *Dungey* however found a breach of the Fair Trading Act and the Code of Banking Practice yet refused to grant relief under the common law or the Credit Contracts Act. Hammond J. in *Hankins* although focusing on the "unconscionability" part of the definition of oppressive granted relief in circumstances where it is doubtful the

equitable doctrine of unconscionability at common law would have. However it is equally doubtful whether there was oppression in terms of the Act in this case. It is submitted that the courts have generally sought consistency with principles of the courts of equity in interpreting "oppressive" under the Act such that it is similar to unconscionability in the wider sense (including undue influence). Where the common law and the Act as interpreted diverge, the author contends the decision may well be open to question.

IV. DEVELOPMENTS - IN SEARCH OF INCREASED CERTAINTY

With recent case law giving rise to such uncertainty and a lack of sound doctrinal basis for decisions, the question is begged - what can the law do about the problem?

A. Common law

There has been a good deal of recent literature[45] inquiring into the possibility of merging the two doctrines of undue influence and unconscionability. Professor Birks and Professor Chin[46] argue that the two doctrines are fundamentally distinct, undue influence being "plaintiff-sided" and concerned with the weakness of the plaintiff's consent owing to excessive dependence upon the defendant, and unconsionability being "defendant-sided" and concerned with the defendant's exploitation of the plaintiff's vulnerability. Although they accept the two doctrines may be able to do about 95% of the work of each other they come out against merger as "developed law must accept analytical distinctions."[47]

David Capper in a July 1998 piece[48] contends that his views depart little form those of Birks and Chin as to the nature of undue influence, but he maintains that unconscionability is not fundamentally different from it and thus the two doctrines can and might be profitably merged into a wider understanding of unconsionability.

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[45] See also Thompson [1994] Conv. 233 and Phang "Undue Influence Methodology, Sources and Linkages" [1995] J.B.L. 552

[46] Birks, P; Chin, N.Y. "On the Nature of Undue Influence" in Beatson and Friedmann (ed.), *Good Faith and Fault in Contract Law* (1995) [*"Birks and Chin"*]

[47] *Birks and Chin*, above n46, 73 and 95

[48] *Rationalisation*, above n38

He submits that in application of this new doctrine, the court would have to weigh up the three key elements common to both undue influence and unconscionability of relational inequality, transactional imbalance (which would serve only an evidentiary function, ie. a strong case of transactional imbalance would strengthen a case for relief based primarily on one of the other two elements) and unconscionable conduct; and come to an overall judgment as to whether a particular transaction can stand.

As referred to above, Capper cites *Credit Lyonnais Bank Nederland NV v. Burch* as an illustration of the courts manipulating the two existing doctrines to ensure that someone who "should" win, does so: "Where this occurs it blurs the distinction between the two doctrines at the expense of that legal certainty which they are intended to maintain."[49]

This writer finds Capper's rationalisation argument highly persuasive. In New Zealand the problem is further exacerbated by the existence of a third alternative for relief (or a third way of having transactions usurped) in section 10 of the Credit Contracts Act. The author submits that it would be profitable to also subsume this within a general doctrine, applicable to all transactions, not merely 'credit contracts'. The following concluding remarks of Capper, it is submitted, would apply equally (or perhaps more so given the problems of the Act) to this suggested three way rationalisation:[50]

> [A] general doctrine might advance legal certainty, because it would not obscure the underlying policy considerations, which tend to get buried when differences are maintained between what is essentially the same. Cases might be better argued because litigants and their advisors would better understand what issues around which evidence and argument had to be organised. Parties with abundant resources would not be able to prolong litigation to the prejudice of less well resourced parties by taking obscure and unmeritorious points. And in the long term courts might find it easier to develop clear and rational criteria for the resolution of these disputes

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[49] *Rationalisation,* above n38, 501
[50] *Rationalisation,* above n38, 503

B. Legislation

In September 1990 the Law Commission published a discussion paper on *"Unfair" Contracts*.[51] The paper sets out a possible legislative scheme to regulate unfair contracts, unfair contractual terms and the unfair exercise of contractual rights. At the time the paper was roundly criticised by those in the legal profession as likely to significantly *increase* uncertainty in the law of contract.[52] I consider it here, in 1998, as an example of a statutory rationalisation of "unfair" contracts as:[53]

> The scheme is intended to operate as a code as far as it extends...It is meant to subsume all these doctrines [unconscionable contracts, duress, undue influence, estoppel, breach of fiduciary duty (and presumably the Credit Contract Act)] as far as they make contracts invalid or unenforceable or enable them to be reopened.

The fundamental objective of the scheme is "to achieve a better and clearer balance between the legitimate desire for contractual freedom and certainty, and the equally legitimate need to avoid injustices flowing from the misuse of a superior bargaining position."[54]

The reasons given for parliamentary intervention are, at best, questionable. First, it is suggested that it may be better to have a general statute than the present multiplication of specific statutory provisions regulating particular types of contract.[55] McLauchlan responds: "Of course, the disadvantage of such legislation is that it will inadvertently cast the net too wide or render relatively unexceptionable contractual practices subject to challenge."[56]

Ironically, given the scheme's criticism, the next main reason given for intervention is that there is "a degree of uncertainty" in the common law. The Commission attempts to define unfair contracts in an endeavour to avoid there being an unacceptable degree of uncertainty in the law in clauses 2-4:

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[51] *Unfair Contracts* Preliminary Paper No 11, Law Commission, 1990 [*"Discussion paper"*]
[52] See particularly McLauchlan, D.W. "Unfair Contracts - The Law Commission's Draft Scheme" [1991] NZ Rec LR 311 [*"Draft Scheme"*]
[53] *Discussion paper,* above n51, para 133
[54] *Discussion paper*, above n51, para 91
[55] The Consumers Institute makes the same argument with respect to consumer credit law - Chattels Transfer Act, Credit Contracts Act, Hire Purchase Act, Credit (Repossession) Act
[56] *Draft Scheme*, above n52, 314

2. **General test of unfairness**

A contract, or a term of a contract, may be unfair if a party to that contract is seriously disadvantaged in relation to another party to the contract because he or she:

(a) is unable to appreciate adequately the provisions or the implications of the contract by reason of age, sickness, mental, educational or linguistic disability, emotional distress, or ignorance of business affairs; or

(b) is in need of the benefits for which he or she has contracted to such a degree as to have no real choice whether or not to enter into the contract; or

(c) is legally or in fact dependent upon, or subject to the influence of, the other party or persons connected with the other party in deciding whether to enter into the contract; or

(d) reasonably relies on the skill, care or advice of the other party or a person connected with the other party in entering into the contract; or

(e) has been induce to enter into the contract by oppressive means, including threats, harassment or improper pressure; or

(f) is for any other reason in the opinion of the court at a serious disadvantage;

and that other party knows or ought to know of the facts constituting that disadvantage, or of facts from which that disadvantage can reasonably be inferred.

3. **Professional Advice**

In considering whether a contract, or a term of a contract, is unfair the court shall have regard, among other things, to whether the disadvantaged party received appropriate legal or other professional advice.

4. **Result must be unfair**

(1) Notwithstanding clause 2, a contract is not unfair unless in the context of the contract as a whole:

(a) it results in a substantially unequal exchange of values; or

(b) the benefits received by a disadvantaged party are manifestly inappropriate to his or her circumstances; or

(c) the disadvantaged party was in a fiduciary relationship with the other party.

(2) A grossly unequal exchange of values may create a presumption that the contract is unfair.

But for McLauchlan; "these provisions are at once too *wide* and too *narrow*. On a plain reading they catch contracts which were probably *not* intended to be caught and they exclude contracts in respect of which relief *is* available at common law"[57] and further "attempting to

[57] *Draft Scheme,* above n52, 315

'pin down the elements of unconsionability to avoid unnecessary uncertainty'[58] is a futile exercise."[59]

McLauchlan gives an example of a single and relatively low income family signing up for an expensive medical insurance scheme.[60] The requisite disadvantage is established through reasonable reliance (clause 2(d)). Even if the insurance scheme has good benefits worth the money being paid (so that there is no substantially unequal exchange of values), it may be strongly arguable in terms of clause 4(1)(b) that those benefits are "manifestly inappropriate" to the circumstances of the family.

On the other side of the coin, McLauchlan uses *Nichols v Jessup*.[61] The defendant, Mrs Jessup, owned a property with a full frontage to the road. The plaintiff, a manager of a real estate company, owned a large rear section with a large rear section with a rather narrow access from the road. The parties entered into a contract which provided for the amalgamation of the plaintiff's access and the defendant's driveway. If carried out, this arrangement would have substantially improved the potential for development of the plaintiff's land. However, the defendant later changed her mind and refused to go ahead. The plaintiff unsuccessfully sought to enforce the agreement as it was set aside on the ground that it was unconscionable. McLauchlan then varies the facts: The contract provides for payment to the defendant of a sum which would compensate her for the diminution in value of her land and pay her a significant proportion of the plaintiff's profit on the deal. Secondly, the plaintiff set out to exploit his superior bargaining position by applying persistent, albeit subtle pressure over a period of time causing the defendant to sign a contract which she flatly refused to sign at the outset. Thus there was an element of overreaching or active victimisation on the plaintiff's part. The contract would almost undoubtedly be set aside on the grounds of unconscionability. Yet there would appear to be no jurisdiction to grant relief under the draft scheme because the requirements of clause 4 are not satisfied. There is no substantial inequality in the exchange, the benefits received by the defendant are not "manifestly inappropriate", nor are the parties in a fiduciary relationship.[62]

For McLauchlan, the only reason given by the Commission which has substantial merit is that "[l]egislation could promote access to and use of the law on a subject of considerable

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[58] *Discussion paper*, above n51, para 94
[59] *Draft Scheme*, above n52, 334
[60] *Draft Scheme*, above n52, 321
[61] [1986] 1 NZLR 226

public importance and interest."[63] Legislation can also serve an educational function in providing an easier vehicle for publicity purposes than common law dicta. However this reason may only assist the case for legislation dealing with consumer contracts as opposed to legislation on unfair contracts as a whole. This comment may also be made about another reason put forward by the Commission - assisting in the provision of "practical access to justice"[64] via the provision of some machinery for public action. Clause 11 of the draft scheme gives standing to the Commerce Commission to apply on behalf of an aggrieved consumer or consumer group.

Notably the Consumers Institute released a report on the "Reform of Consumer Credit Law in New Zealand" in August of 1998 which also advocated statutory rationalisation but for *consumer* credit law. Both the Consumers Institute and the report of the Contracts and Commercial Law Reform Committee (on which the Credit Contracts Act was based) advocate a government enforcement agency to assist the consumer is obtaining practical access to justice.

The Law Commission in 1990 clearly believed that the current law was not working. This writer believes it still isn't and furthermore it is producing highly questionable decisions like that in *Hankins*. The major problem with statutory intervention in unfair contracts is that it is extremely difficult to codify in statutory language the notion of unconscionability or unfairness without in fact reducing certainty and predictability. Lord Scarman put in thus: "Definition is a poor instrument when used to determine whether a transaction is or is not unconscionable: this is a question which depends upon the particular facts of the case."[65]

Cold comfort for those subject to the vagaries of the law, but perhaps this is the best we can do. Although the Law Commission's draft scheme was a laudable attempt at rationalisation, it seems doing this by legislation merely exacerbates the uncertainty which it aims to reduce. This author favours common law rationalisation in the hope that we can improve, albeit slightly, on Lord Scarman's case by case answer. A clearer doctrinal basis for unconscionability may help development of useful guidelines and general principles which in turn may reduce uncertainty.

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[62] *Draft Scheme*, above n52, 323-324
[63] *Discussion paper*, above n51, para 77(5)
[64] *Discussion paper*, above n51, para 77(8)
[65] *National Westminster Bank Plc v. Morgan* [1985] AC 686, 709

V. THE CREDIT CONTRACTS ACT - A WAY FORWARD?

A. The oppression provisions

There is a lack of cohesion in the current approaches of the courts to oppression. Hammond J. in *Hankins* rightly considered the existing law on oppression inadequate. However, unfortunately, his Honour's decision, far from providing the foundation of a framework to replace the current law, merely adds to the confusion and goes too far in protecting borrowers, leaving lenders in a state of uncertainty. This is somewhat ironic given His Honours observation that: "The cases evidence real caution against upsetting commercial bargains"[66].

In the report which led to the implementation of the Act the law reform committee went to some lengths to formulate meaningful guidelines for the courts to take into account in approaching the oppression question. The committee said that "the development of guidelines through the cases leaves too much to chance."[67] However some of the guidelines were not included in the Bill when it was introduced to the House three and a half years later and the rest were scrapped in the course of the legislative process. The few factors which remain were described by one of the members of the law reform committee itself - some "do no more than state the obvious and the remainder...are too wishy-washy to be of any practical utility."[68]

The definition of oppression in the Act has been criticised as vague and tautological.[69] The fact that the words in section 9 were intended to give a licence to the judges to apply their own standards of what was acceptable conduct is apparent from the words of the then Minister of Justice, Hon. J. McLay, MP, in debate in the House:[70]

> The short answer is that, in the absence of any express definition of the words "oppressive", "harsh", "unjustly burdensome", "unconscionable", or "in contravention of acceptable standards

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[66] *Hankins*, above n7, 123
[67] *Report*, above n2, para. 7.21
[68] Dugdale, *The Credit Contracts Act 1981* (Butterworths, 1981) 29. Cited in McLauchlan, D.W. "Contract and Commercial Law Reform in New Zealand" (1984) 11 NZULR 36, 48 [*"McLauchlan"*]
[69] Hon. R.J. Tizard, MP (25 September 1980) 433 NZPD 3690.
[70] Hon. J.K. McLay, MP (25 September 1980) 433 NZPD 3693.

> of fair dealing", the court is obliged and expected to apply the ordinary common-sense meaning of those words to a particular transaction or a particular case.

Dugan, in analysing the Act from a U.S. lawyers perspective, and comparing it with the unconscionability doctrine generally recognised in U.S. law[71] states:[72] "The Credit Contracts Act does not make the judiciary's task an easy one" and concludes; "[t]he results of litigation will likely import considerable uncertainty into credit transactions and call for increased involvement by all segments of the legal community."[73]

Allen is trenchant in his criticism, lambasting the Act as "law for the lawyers (made by lawyers)"[74] and concluding:[75] "[T]his Act is just another example of the legislatures paternalistic and patronising habit of protecting its citizens against all evils - real and imagined"

Admittedly these comments now seem somewhat exaggerated. The Courts have generally taken a robust approach and take guidance from other doctrines and their own decisions.[76] They have utilised the existing concepts of unconscionability as well as constructing some basic rules from the cases decided under the Act. In *Italia Holdings (Properties) Ltd v. Lonsdale Holdings (Auckland) Ltd*,[77] one of the earliest cases to analyse the concept of oppression, Vautier J. emphasised the need for more than mere inequality of exchange between the parties. There must be some additional element of injustice, either in a substantive or procedural sense. His Honour there observed:[78]

> [I]t would be difficult to argue in my view that an applicant under the Credit Contracts Act could succeed in having a credit contract set aside by setting out facts which would have been

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[71] Uniform Commercial Code, s.2-302 which reads: If the court as a matter of law finds the contract or any clause of the contract to have been unconscionable at the time it was made the court may refuse to enforce the contract, or it may enforce the remainder of the contract without the unconscionable clause, or it may so limit the application of any unconscionable clause as to avoid any unconscionable result.

[72] Dugan, R. "The New Zealand Credit Contracts Act: A United States Lawyers perspective" (1984) 11 NZULR 20, 34 [*"Dugan"*]

[73] *Dugan*, above n72, 35

[74] *Frankenstein*, above n4, 149

[75] *Frankenstein*, above n4, 150

[76] See Asher, R.J. "The Statutory Reforms of the Contracts and Commercial Law Reform Committee from a 1988 Perspective" (1988) 13 NZULR 190, 193

[77] [1984] 2 NZLR 1 [*"Italia Holdings"*]

[78] *Italia Holdings*, above n77, 15

insufficient to enable a person in an unequal bargaining situation to have a contract entered into by him set aside on equitable grounds.

1. Judicial approaches

There appear to be two main ways in which the courts have approached the "oppression question.[79] The first sees oppression as being founded on one main principle, of which each decision is an example. Support for such an approach can be found in the dicta of Gallen J. in *Anderson v Burbery Finance Ltd*[80] where he said; "It is the abuse of the relationship which is the foundation of re-opening."[81] This approach was expressly *not* adopted by Hammond J. in *Hankins* and is arguably so vague as to be of little assistance in any event. Furthermore, any such overarching principle, to be sufficiently flexible, would be subject to numerous exceptions and qualificatons. Thus such an approach has not been widely adopted by the courts.

The second is a more ad hoc approach in which each case is dealt with on its own facts and the court considers whether it is sufficiently similar to any previously decided case, from which "sub-principles"[82] are elicited, and if not, whether the circumstances of the case are such that relief ought to be granted in any event.

Hammond J. in *Hankins* identifies the following "sub-principles":

- mere disadvantageousness is insufficient,[83]
- oppression must be that of the lender,[84]
- the exercise of rights may become unreasonable in light of collateral undertakings,[85]
- an action can be oppressive, notwithstanding that it is contractually permitted,[86]

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[79] See the analysis of Webb, *proposed decision making process*, above n6
[80] [1986] 2 NZLR 20 [*"Anderson"*]
[81] *Anderson*, above n80, 27
[82] *Hankins,* Above n7, 123-124
[83] *Italia Holdings*, above n77
[84] *Burbery Mortgage Finance & Savings Ltd (In Receivership) v. Haira* (21 April 1994) unreported, High Court, Rotorua Registry, CP 93/89, Barker J.
[85] *Manion v. Marac Finance* [1986] 2 NZLR 586
[86] *Robinson v. United Building Society* (7 May 1987) unreported, High Court, Dunedin Registry, CP 35/87, Tompkins J.

- in alleged cases of unreasonable standards of commercial practice, there should be led evidence of the reasonable market practice sought to be relied on.[87]

Any such list is clearly non-exhaustive, as Wallace J. stated, a court will "intervene in any case where there is a sufficiently serious element of unfairness."[88] What exactly this means is problematic - What is "sufficiently serious" and indeed what is "unfair" often depends on an individuals moral values and philosophical starting-points. Under such an approach, contracting parties and litigants often cannot be entirely certain whether a contract will be upheld or re-opened by a court. Such uncertainty flows from a failure to enunciate principles at any general level that may be applied in all cases to the questions of whether the contract is oppressive. There is also a lack of transparency in the way a court approaches the question. Rarely, if ever, does the court acknowledge that the power to re-open is based on a duty of the court to impose its perception of community standards of acceptable conduct on the parties to the transaction. This lack of transparency in a courts reasoning offers little guidance to outside observers seeking to alter their behaviour appropriately so as not to fall foul of the law. The courts under this approach look at cases as a collection of factors. Yet the relevance and weight to be attached to any particular factor may be significantly affected by the existence of some other state of affairs. Although courts likely take the latter approach in practice, they do not enunciate how in their judgments.

2. *A suggested alternative approach*

Duncan Webb sets out an alternative possible approach or framework within which such questions might be considered.[89] He analyses the question in four stages. First, it can be determined whether the preconditions of unfairness exist by asking whether the complaint is of procedural or substantive unfairness, or both. Webb suggests that more than some procedural unfairness is necessary thus the distinction is pivotal. Further it is argued, the distinction serves the practical purpose of ensuring that the unfairness complained of is properly identified.

Second, the effect of the unfairness can be analysed by categorising it as going to either i)consent ii)equality of exchange iii)the nature of the relationship between the parties. This is said to provide a framework for decisions and reduce the uncertainty. If a complaint of

[87] *Cambridge Clothing Co Ltd v. Simpson* [1988] 2 NZLR 340
[88] *Didsbury v. Zion Farms Ltd* (1989) 1 NZ ConvC 190,229, 190,238.

unfairness does not go to establish some fact about one of the above three categories then "it is hard to see how it can bear any persuasive weight."[90]

Third, one can identify several recurring factors which fall within each of the categories of unfairness. By looking at the particular facts of the case, and comparing them to factors present in other cases, it is argued the judge will be able to achieve parity with other decisions.

Finally, it can be determined whether the unfairness is of a sufficient degree for which relief ought to be available. This involves a value-judgment as to whether the conduct complained of is sufficiently objectionable to provide relief.

Webb states that the above analysis: "has sought to establish that in making such decisions the court can do so in a reasoned and coherent way" and "The proposed process differs substantially from the current approaches of the courts."[91] However, with respect, this author does not believe the suggested framework substantively increases the level of predictability and certainty in the decision making process. Nor do I believe that it differs substantially from the current approaches of the courts. It seems to this author to merely add additional labelling at different points and give the appearance of judges making decisions in a reasoned and coherent manner.

Credit Lyonnais Bank Nederland NV v. Burch[92] shows that the procedural/substantive unfairness distinction does not accurately reflect judicial action. If the situation is manifestly substantively unfair, then procedural unfairness will be inferred. Secondly cases will not be easily compartmentalised into Webb's three categories, and further what one judge considers as going to the nature of the relationship another may consider as going to consent. Webb's third stage is exactly what judges do now under the ad hoc approach and is therefore subject to the same criticisms of uncertainty. Finally, determining whether the unfairness is of a sufficient degree for which relief ought to be available returns to the subjective view of the judge.

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[89] *proposed decision making process*, above n6, 394-421
[90] *proposed decision making process*, above n6, 412
[91] *proposed decision making process,* above n6, 421
[92] [1997] 1 All ER 144. [*"Burch"*]

However perhaps such labelling is useful in providing a little more transparency to the decision making process, encouraging judges to talk openly about the basis of their decisions. Furthermore such an approach does identify questions to which the court's mind ought to be turned in considering the matter and perhaps some consistency can be achieved by the "adoption of a common framework of analysis as opposed to illusory objectivity."[93] Unfortunately there are value judgments to differing degrees at all levels of the decision making process in this area. The concept of oppression under the Credit Contracts Act rests on a judgment of the courts as to whether the conduct complained of is unacceptable. That judgment is, in the end both uncertain and subjective and despite its laudable aims, no framework for analysis like the above will change this.

3. Interest rate ceilings

Ison in his book on "Credit Marketing and Consumer Protection"[94] considers statutory unconscionability provisions as a protection for consumers. Ison prefers instead an interest rate ceiling. Firstly he argues the legal result should be, as far as possible, clear, predictable and certain, so that creditors and consumers alike will know where they stand. A rate ceiling it is claimed, provides that certainty whereas unconscionability provisions;[95] "require an adjudication at the behest of someone who is usually ill equipped to undertake litigation" and "[b]ecause unconscionability prescibes no clear rule of illegality, these sections of the Act [a reference to the Consumer Credit Act 1974 (U.K.)] give little guidance for out of court settlements".

Secondly Ison argues that a rate ceiling can be used to define the perimeters of consumer credit:[96]

> An unconscionability provision can never be used for this purpose, partly because of the rarity of its invocation, and partly because the criteria that the courts are required to use by these provisions relate to the fairness of the interest rate having regard to the risk involved, rather than to the propriety of the interest rate having regard to social policy or other objectives.

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[93] *proposed decision-making process*, above n6, 421
[94] Ison, T.G. *Credit Marketing and Consumer Protection* (London, Croom Helm, 1979) [*"Credit Marketing"*]
[95] *Credit Marketing*, above n94, 208-209
[96] *Credit Marketing*, above n94, 209

The Contracts and Commercial Law Reform Committee recommended that any contract with a finance rate exceeding 48 percent per annum should be presumed to be harsh and unconscionable.[97] But this recommendation was not adopted by Parliament. The Ministry of Consumer Affairs notes: "It is likely to be counter-productive to set a ceiling interest rate as this may mean that some consumers would not be able to obtain credit at all."[98] The Consumers' Institute agrees: "If people can service high-interest loans and want to take them out, we do not believe they should be prevented from doing so by the government."[99]

This author agrees with the Ministry and the Consumers' Institute in this respect. As uncertain as an unconscionability provision can be, an interest rate ceiling is likely to hinder consumers rather than protect them, it runs foul of freedom of contract and furthermore it does not address any other potential cause of genuine unfairness. Nonetheless, it is notable that Ison criticises unconscionability provisions for their uncertainty.

B. The disclosure provisions

A review of unfair contracts law in New Zealand, including recommendations for reform would be incomplete without a consideration of Part II of the Act. The disclosure provisions are very important in promoting prevention over cure, they are also probably more contentious than the aforementioned oppression provisions.

Part II provides for disclosure of the contractual terms and other prescribed information in the case of contracts falling within the definition of "controlled credit contract". This definition includes the large majority of day to day credit contracts but the disclosure provisions apply to many contracts which do not involve consumer credit. The exceptions are very limited. They include:[100]

(a) contracts where the debtor is a company with a paid-up capital of $1,000,000;

(b) contracts where the total credit outstanding is or will be $250,000 or more;

(c) contracts where the debtor is a financier other than a person who simply "makes a practice of providing credit in the course of a business carried on by him".

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[97] *Report*, above n2, 73

[98] Ministry of Consumer Affairs, (1988) "Consumers and Credit: A Discussion Paper" Wellington: Ministry of Consumer Affairs, 87. Cited in *Consumers' Institute Report*, above n5, 25

[99] *Consumers' Institute Report*, above n5, 29

[100] Credit Contracts Act 1981, s. 15

Under section 22, the borrower in a controlled credit contract can cancel the contract within 3 working days of having received initial disclosure. This gives the borrower a "cooling-off period" after they have all the details of the contract to decide whether they want to continue with the 'loan'.

> As it stands now, the Credit Contracts Act requires urgent review. There is,..., a widespread feeling that the Act imposes documentation technicalities which, though generally not as difficult to comply with as first thought, serve little or no practical purpose.[101]

The "total cost of credit" measure is a mislabelling as not all the costs of credit are included in it. Charges such as premiums for loan-repayment insurance or legal fees imposed by the lender are excluded, but may form part of a credit contract. The Consumers' Institute Report points out[102] that the simplified calculation of the finance rate contained in the Act gives a misleading impression of the cost of credit. Furthermore finance rates are not calculated for "revolving-credit facilities" (credit facilities such as bank overdrafts, budget accounts, and credit cards), the argument being quoting a finance rate for such loans is impossible as the structure of the loan is not known in advance.[103] Thus consumers can not compare accurately the cost of using these facilities with the cost of credit from other sources - one of the objectives of this part of the Act.

The law only requires that initial disclosure be made within 15 working days after the contract is signed. Some consumer advocates argue that disclosure that occurs at the time the contract is signed or afterwards, is disclosure that has come too late to fulfill the intention of the law as borrowers are unlikely to back out of the deal at that stage.[104] Sarah MacKenzie, solicitor at the Wellington Law Centre contended for hire-purchase deals the cooling-off period is largely a myth: "[T]he customer must still pay for the goods, so will have to get finance from somewhere else and fast. This means most consumers are unlikely to cancel, even if the credit contract they have entered into is oppressive."[105] The most important elements of disclosure, such as quoting the finance rate, should take place before the contract is entered into.

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[101] *McLauchlan*, above n68, 62
[102] *Consumers' Institute Report*, above n5, 42
[103] *Consumers' Institute Report*, above n5, 40
[104] *Consumers' Institute Report*, above n5, 38
[105] Interview with the Consumers Institute, cited in *Consumers' Institute Report*, above n5, 38

Writing in 1990, some years after the Act's introduction, Burt contends that the Act is "plainly unfair in the way its disclosure provisions work in practice."[106] First because the disclosure requirements are too cumbersome, and secondly because the penalties for non-disclosure are outrageously severe. Section 24 can render the security unenforceable and under section 25 the lender can lose all their interest. Burt cites three cases in support - *Anderson v Burbery Finance*;[107] *Patrikios Holdings Ltd. v United Fisheries Ltd.*[108] and *Emus Holdings (Auckland) Ltd v Pither.*[109] The common feature in all three, argues Burt, is that the Court found no deception or moral failure on the creditor's part nor was the debtor prejudiced. "Yet in view of the strong terms in which the Act requires disclosure, the Court has in each case found itself obliged to impose a significant penalty".[110] He advocates leaving sanctions to the Fair Trading Act when the finance rate quoted is inaccurate and misleading.[111]

However, the courts do have wide discretionary powers under section 32 to reduce the penalties that would otherwise be imposed upon an errant creditor. The court is to have regard to, *inter alia*, the extent to which a debtor or guarantor has been prejudiced by the non-disclosure. Stuart Walker in a case note on *Freedom Homes Ltd v. Reelick*[112] states: "The High Court has restated the principle that section 32 is there to cover those situations where it would be unjust to let debtors use the Act to renege on financial obligations they have willingly assumed and understood."[113] Interestingly in all three cases Burt cites, relief was granted under section 32, yet the lender was still forced to pay a significant penalty. This author does not believe that the available sanctions are overly problematic given that discretionary relief is available. The problem arises because of the cumbersome nature of the disclosure requirements themselves.

The theory of disclosure is sound. It improves the information (and therefore efficiency) of the consumer credit market. However the law has not successfully turned that theory into reality. The timing and quality of disclosure must be improved. By "quality", it is meant information that consumers can understand and comprehensive coverage, so that consumer

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[106] Burt, R D G "The Credit Contracts Act and the Reluctant Judge" NZLJ July 1990, 240; 242 [*"Reluctant Judge"*]
[107] [1986] NZLR 20, upheld on appeal at [1988] 2 NZLR 196
[108] [1986] BCL 220
[109] [1987] BCL 11
[110] *Reluctant Judge*, above n106, 241
[111] *Reluctant Judge*, above n106, 242
[112] (30 March 1993) unreported, High Court, Auckland Registry, CP 2483/89.

can see the true cost of borrowing money. In this way, consumers can make a truly informed decision as to whether they should enter into a particular contract.

C. *Other issues*

1. *Complexity*

A good deal of the law is written in technical language that many consumers do not understand. This, despite the fact that the Act is meant to be self-policing and as such used by regular consumers. Not only is the Act itself complex, which McLauchlan argues is defensible; "It would be impossible to enact simple legislation regulating the day-to-day activities of the credit granting industry",[114] there is little awareness in the community of the purpose and significance of the information disclosed.[115] Therefore, there is a definite need for a consumer education programme, not only with respect to the information disclosed, but also with respect to the individual's rights and obligations under the Act.

2. *Coverage*

To improve the operation of a market the law must cover all relevant transactions and exclude all irrelevant transactions. Consumer credit law in New Zealand does not meet this requirement. For example, McLauchlan notes that the disclosure requirements of the Act cover loans made to commercial organisations:[116]

> What is the justification for imposing formal disclosure requirements where businessmen enter into large scale financing transactions involving say $200,000?...the present system whereby many arms-length commercial transactions have to conform, often at considerable expense, with statutory disclosure requirements is quite unwarranted.

The Act is supposed to be a consumer protection measure, interfering in arms-length commercial transactions and imposing unnecessary compliance costs does not achieve this objective. The Consumers' Institute suggest amendment so that the law covers all credit

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[113] Walker, Stuart "Disclosure requirements - discretion under section 32 to reduce penalties on non-complying creditor" *Butterworths Conveyancing Bulletin* 6(15) June 1993, 176

[114] *McLauchlan*, above n68, 59

[115] *McLauchlan*, above n68, 63

[116] *McLauchlan*, above n68, 63 and 64

contracts where the borrower uses the money for household purposes.[117] McLauchlan suggests lowering the exemption from the Act's disclosure requirements of transactions involving $250,000 or more, to $50,000.[118] The Ministry of Consumer Affairs would add to that home finance regardless of the monetary limit.[119] This writer prefers the brightline of a monetary limit over the term "household purposes" as this latter phrase has the potential to introduce further uncertainty, but it is important to include home finance as it is obviously the largest financial undertaking for most consumers. Thus the paper adopts the suggestion of the Ministry of Consumer Affairs.

3. *Fragmentation*

Consumer credit law is spread out over several Acts - Chattels Transfer Act, Credit Contracts Act, Hire Purchase Act, and the Credit (Repossession) Act. This makes the law fragmented and difficult to understand, especially for the consumer. Hire Purchase agreements invariably fall within the definition of credit contracts under the Credit Contracts Act and are therefore subject to the provisions of both Acts. However, it may happen that, although the Hire Purchase Act provisions have been complied with, conduct may be oppressive under the Credit Contracts Act.[120] The Ministry of Consumer Affairs[121] and the Consumers' Institute[122] believe that all consumer credit law should be consolidated into one straightforward Act. The long promised personal property securities legislation should go some way to remedying this, but it is very unlikely to include the necessary provisions of the Credit Contracts Act, so separate legislation will still be necessary.

D. Summary of suggested reform

There is little doubt that the Credit Contracts Act 1981 is not working. The breadth and undefined nature of the term "oppression" has led to the courts, in some instances tipping the balance too far in favour of the borrower, and in others, giving inconsistent decisions. This is causing uncertainty and a lack of predictability for lenders. There is no consistent approach

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[117] *Consumers' Institute Report*, above n5, 47
[118] *McLauchlan*, above n68, 63
[119] Ministry of Consumer Affairs (1990) "Working papers on credit law reform", Wellington: Ministry of Consumer Affairs. [*"Consumer Affairs (1990)"*]. Cited in *Consumers' Institute Report*, above n5, 38
[120] *Marac Finance v. McKee*, (1987) 2 NZBLC 102, 867
[121] *Consumer Affairs (1990)*, above n119. Cited in *Consumers' Institute Report*, above n5, 30
[122] Consumers' Institute, *Consumer*, Wellington, Consumers' Institute. Cited in *Consumers' Institute Report*, above n5, 31

or clear principles upon which courts base their decisions and around which businesses can organise their behaviour.

The fundamental principles underlying court intervention in unfair contracts are the same whether they are credit contracts, or contracts of some other kind. Whilst issues of consent, bargaining power, and inequality of exchange will differ in detail and complexity depending on the kind of contract being considered, the analysis of whether the contract is sufficiently unfair to warrant intervention ought to be subject to the same analysis regardless of the subject matter of the contract and this seems to be the way the courts have approached the question of oppression under the Act. Therefore there seems no real need for a separate law of unfair *credit* contracts.

However the Act was intended as a consumer protection measure so before blindly recommending a repeal of the Act it is necessary to assess consumer protection. In its briefing papers to the incoming Minister in 1996, the Ministry of Consumer Affairs claimed that: "Consumer and community groups consider *credit* to be the most widespread and severe of all problems faced by consumers."[123] This may justify separate credit contract legislation after all, for *consumers*.

In terms of statutory intervention in unfair contracts generally, the only reason given by the Law Commission which has substantial merit is that "[l]egislation could promote access to and use of the law on a subject of considerable public importance and interest."[124] Legislation can also serve an educational function in providing an easier vehicle for publicity purposes than common law dicta. Both of these reasons are most applicable to the consumer. Even though this author believes there is sufficient protection from abuse for consumers in the common law and the Fair Trading Act 1986 (demonstrated by the prevalence of that Act as an alternative head of relief pleaded in many of the cases referred to in Section III above), there does appear a need for separate statutory protection for credit contracts, limited in coverage to that sector of the community. A limit of $50,000 (inflation adjusted) with home finance regardless of the money limit for transactions to come within the Act would serve the purpose.

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[123] Ministry of Consumer Affairs, (1996) "Briefing to the Incoming Minister" [*"Briefing"*] Wellington, Ministry of Consumer Affairs. Cited in *Consumers' Institute Report*, above n5, 4. (Emphasis added)
[124] *Discussion paper*, above n51, para 77(5)

Clearly even if we accept that consumers need legislative protection, the existing law is inadequate to achieve this. The Ministry of Consumer Affairs framed it thus: "Existing credit law in New Zealand is unclear, inconsistent, and consequently unfair."[125] The Consumers' Institute shared the Ministry's concerns and in its report on the "Reform of Consumer Credit Law in New Zealand" suggested wide ranging changes, many of which have already been noted. Rationalisation of consumer credit law into one simple comprehensive statute is one recommendation, which is clearly warranted, but requires coordination with the forthcoming personal property securities legislation. Better disclosure requirements are needed. It is necessary to simplify both compliance with, and the contents of, disclosure. Borrowers need to be better educated. No matter how simple and clear the disclosure requirements are, if consumers don't understand the realities of borrowing money and their rights under the law, any disclosure is futile.

Most importantly, laws need to be better enforced. The Act does little to prevent sharp practices by those most likely to engage in them - smaller financiers who provide relatively small sums over short terms. The problem is that the victims of such non-compliance are in no position to take action, nor is it worth their while. The lack of provision for an enforcement agency means that fringe financiers can realistically judge that they have little to fear from non-compliance. The Contracts and Commercial Law Reform Committee recommended that the Commercial Affairs Division of the Department of Justice should enforce the Act.[126] The Consumers' Institute recommend giving the enforcement job to the Commerce Commission as a supplement to the Act's self-policing provisions.[127] The author agrees with the latter suggestion. With it's experience in enforcing the Fair Trading Act, the Commerce Commission is an ideal choice - but will require sufficient funding for the purpose. However, the next section raises another independent alternative - an Ombudsman scheme.

The most difficult recommendations to formulate, are those for amending the existing oppression provisions. If legislative intervention is justified, limited to the consumer, to protect the consumer then section 9 - the meaning of "oppressive" needs changing. As we have seen, the existing section 9 has produced uncertainty and, in some cases tipped the balance too far in favour of the borrower. An amended section 9 can at best only reduce the

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[125] *Briefing*, above n123, 5
[126] *Report*, above n2, 190
[127] *Consumers' Institute Report*, above n5, 1

uncertainty to the level of the common law, so I suggest a change that steers the courts to the common law for guidance.

Remove the term "oppressive" and replace it with "unconscionable".

(a) This is the part of existing definition the courts have focused on.

(b) Removing all the other terms which merely confuse the issue and recording in the explanatory notes to the Act that the term is to be understood in line with the common law meaning of the term in its wider sense - that is including the existing doctrines of unconscionability and undue influence will enable as much certainty as is possible. Furthermore, the fact that the Act is limited to consumer transactions should ensure that any uncertainty doesn't unduly impinge on ordinary commercial bargains.

VI AN OMBUDSMAN SOLUTION?

Setting aside for a moment the problems in the substantive law of unfair contracts, in this section the author will consider an alternative procedural protection for those most at risk in credit contracts, those the Credit Contracts Act sought to protect - the consumers. These suggestions may, along with the proposed alterations to the Act itself, substantially fulfill the goals of the legislation without unduly hampering commercial business. Furthermore enforcement of the Act is, as we have seen, a very real problem. An Ombudsman scheme as discussed below may provide an alternative solution to the concerns raised in this regard by many commentators.

The limitations of a formal court system of adjudication include cost, delay and inflexibility. The typical characteristics of consumer disputes mean that such limitations are even more pronounced. Most consumer disputes are small. The cost of pursuing such a claim through the traditional court system frequently outweighs the value of the claim itself and the consumer is faced by an opponent usually more powerful, more experienced at litigation, and more likely to have the advantage of legal advice and representation.[128] These practical problems of accessibility to the law mean that any critique of the substantive law itself is somewhat erudite. Indeed the difficult issues involved in the substantive law of unfair contracts may be somewhat ameliorated by addressing satisfactorily the prior practical problems.

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[128] Farrar, Ann "A Banking Ombudsman for New Zealand" NZLJ September 1992 320, 327

Enter the Ombudsman concept. The typical characteristics of an Ombudsman seem ideally suited to resolution of consumer complaints with respect to unfair credit contracts. Access is usually direct, informal and free of charge. Procedures are non-adversary and non-technical, reasons are given for whatever is decided and there is a range of possible recommendations available. Recourse to the Ombudsman is a last resort after internal complaints procedures and appeals have failed to provide a resolution.

The Banking Ombudsman scheme took effect from 1 July 1992. It was the first of only two schemes to be permitted to use the name "Ombudsman".[129] The Banking Ombudsman's help is free. Anyone (including companies) dissatisfied with a banking service in New Zealand from a participating bank can submit a complaint. The office's Terms of Reference give jurisdiction to deal with complaints about all types of banking business normally transacted through bank branches.[130] However the Ombudsman cannot deal with complaints about general bank policy or about commercial judgment decisions on lending unless there has been maladministration.[131] The Banking Ombudsman has power to make binding awards of compensation up to $100,000 to cover direct losses. The Terms of Reference explicitly require the Ombudsman, in making any recommendation or award, to do so by reference to what is, in her opinion, fair in all the circumstances.[132] Any applicable rule of law is to be observed, and regard must be had to the general principles of good banking practice and any relevant code of practice. Indeed the Code of Banking Practice makes membership of the Ombudsman scheme obligatory to those banks that adhere to the Code.

The relevance of the Banking Ombudsman scheme for this paper lies in its wide overlapping jurisdiction with the courts in the area of the provision of credit, guarantees and other "oppressive" contracts. In the last financial year mortgage or home loan finance, business finance and consumer finance together accounted for 27% of all complaints.[133] The Banking Ombudsman herself takes the view that a complaint alleging breach of the part of the Code of

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[129] The Chief Ombudsman must grant permission under s28A of the Ombudsman Act 1975. See *Criteria for the Use of the Name "Ombudsman"*, May 1997. The other authorised Ombudsman scheme is the Insurance and Savings Ombudsman whose office commenced operations in 1995.

[130] Banking Ombudsman: Terms of Reference, para.1

[131] Banking Ombudsman: Terms of Reference, para. 18(b)

[132] Banking Ombudsman: Terms of Reference, para. 16

[133] "Annual Report 1997-1998/ Office of the Banking Ombudsman" (Wellington, The Office, 1998) 6 [*"Annual Report"*]

Banking Practice on provision of credit is a complaint of maladministration rather than about banks commercial judgment and is therefore justiciable.[134]

In *Westpac Banking Corporation v. Kalbfleish,*[135] a case whose facts preceded establishment of the Office, Master Gambrill observed: "This case cries out to be referred to the Ombudsman."[136] The case involved the bank seeking to enforce an unlimited guarantee over 6 years after it was given, to recover losses with respect to large sums lent to the guarantors partner independently and subsequently without the knowledge or consent of the guarantor. Thus the facts were very similar in that respect to those in *Baxter* and *Clarke*, and indeed "oppressive" conduct under the Credit Contracts Act was pleaded in *Kalbfleish* and accepted as arguable by Master Gambrill.

A case noted in the 1997/98 annual report of the Banking Ombudsman also involved facts similar to those in *Baxter* and *Clarke*. It concerned an all obligations mortgage, subsequent marriage break up and the bank viewing the mortgage over the matrimonial home as security for 3 business loans personally guaranteed by the complainants spouse independently and subsequent to the execution of the mortgage. The Banking Ombudsman was able, via the office's inquisitorial, independent approach, to resolve the issue satisfactorily for both parties without the need for recourse to litigation.[137]

Many disputes over unfair contracts, whether covered by the Credit Contracts Act or the common law, that would formerly have been dragged through litigation or indeed not addressed at all, can now be brought before the Banking Ombudsman. The office is already dealing with complaints over that most common of factual situations - the all obligations security executed by one partner, often over the matrimonial home, for business debts of the other partner.

The success of the Banking Ombudsman leads to consideration of extending the Office's jurisdiction to cover all financial institutions and all forms of institutional credit provision. The U.K. Review Committee on Banking Services criticised the inefficiency or potential

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[134] *Annual Report*, above n133, 24
[135] *Westpac Banking Corporation v. Kalbfleish* (23 December 1993) unreported, High Court, CP 13/93, Master Gambrill ["*Kalbfleish*"]
[136] *Kalbfleish*, above n135, 2
[137] Case 3b, *Annual Report*, above n133, 15-16

inefficiency of a scheme that was not comprehensive in this respect.[138] In reviewing the Australian Banking Ombudsman scheme, Prof. Everett noted; "A voluntary scheme is obviously likely to be troubled by a lack of institutional coverage."[139] John Holloway agrees:[140]

> Coverage does seem to be something of a problem...While there may be sensible, perhaps compelling, reasons to have the scheme cover more of the financial services sector, any extension of coverage beyond what is proposed could, from our state experience, present real problems in establishing and fine tuning the Ombudsman's operations. I think there is much to commend a building block approach.

The author submits that the scheme has been running successfully in New Zealand now for long enough to build upon it. Statutory compulsion may indeed be necessary for coverage over those institutions most likely to indulge in questionable lending practices with unwary consumers. This does not appear to present substantial problems for the scheme. Flexibility should not be hampered under a statutory scheme as the Parliamentary Ombudsman shows. Secondly, the scheme does not block access to the courts in such a way that the ability to make binding awards is brought into question. The "Test Case" provision[141] enables the bank, at any time before the Banking Ombudsman has made an award, to give notice that in the opinion of the Bank the complaint involves or may involve an issue which may have important consequences for the business of the participating bank or banks generally or an important or novel point of law. Providing the Banking Ombudsman concurs, the investigation must then be discontinued and the parties can take the dispute to the courts. Furthermore, paragraph 18(d) of the Terms of Reference provides that the Ombudsman does not have power to consider a complaint if it appears to her that it is more appropriate that the complaint be dealt with by a court.

However, it may well be that a more efficient and workable solution is setting up a separate Ombudsman scheme for other financial institutions not covered by either the Banking

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[138] *Recommendations of the Review Committee on Banking Service Law (the Jack Committee)*, December 1988. Cited in Everett, Prof. Di "Consumer Remedies and the Banking Ombudsman" *Banking Law and Practice, 7th Annual Conference 1990*, Banking Law Association, Melbourne (International Business Communications Pty. Ltd., NSW, Australia, 1990)199 [*"Consumer Remedies 1"*]

[139] *Consumer Remedies 1*, above n138, 200

[140] Holloway, John "Consumer Remedies and the Banking Ombudsman" *Banking Law and Practice, 7th Annual Conference 1990*, Banking Law Association, Melbourne (International Business Communications Pty. Ltd., NSW, Australia, 1990) 221

[141] Banking Ombudsman, Terms of Reference, para. 23

Ombudsman scheme or the Insurance and Savings Ombudsman scheme. This would require compliance with the Chief Ombudsman's criteria for the use of the name "Ombudsman". Extended consideration of this issue is beyond the scope of this paper, beyond noting that the author submits that the issue is worthy of further study. It is the contention of the author that the Ombudsman concept is ideally suited to the problems faced by consumers in the area of unfair contracts and the flexibility and inquisitorial nature of the office may alleviate the severity of the problems with the substantive law. Regard will need to be paid to harmonisation with a reformed Credit Contracts Act, particularly with respect to monetary limits. It may well be that this Act is an appropriate vehicle to statutorily legitimise the scheme.

VII. CONCLUSION

The recent case law on unfair contracts from three different jurisdictions gives rise to an unacceptable level of uncertainty as to when a court will strike down a contract and the basis upon which such a decision will be made. Of particular concern are the decisions in *Elders*[142] and *Hankins.*[143]

This inconsistency is unacceptable, but it seems, comes with the territory. More decisions like *Wilkinson*[144] where the court enunciates guidelines are required, as is a more commercially realistic attitude by the courts which does not place unrealistic burdens on lenders who have not engaged in any over-reaching or victimisation. Most of all a consistent, principled approach must be taken by the courts, with judges openly articulating the true basis for their decision.

The author contends that rationalisation of the law is a positive, and useful development. The writer adopts David Capper's thesis[145] that the existing doctrines of undue influence and unconscionability can and might be profitably merged into a wider understanding of unconsionability. The court would have to weigh up the three key elements common to both undue influence and unconscionability of relational inequality, transactional imbalance and unconscionable conduct; and come to an overall judgment as to whether a particular transaction can stand. Currently there are increasing instances of the courts manipulating the

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[142] *Elders*, above n44
[143] *Hankins*, above n7
[144] *Wilkinson*, above n1
[145] *Rationalisation*, above n38

two doctrines to ensure someone who should win does so because of difficulty in allocating a plaintiff's claim to the appropriate category. This can only lead to uncertainty.

The Credit Contracts Act and more recently the Law Commission's Draft Scheme[146] on "unfair" contracts both demonstrate the shortcomings of legislative intervention in this area. The problem is that it is extremely difficult to codify in statutory language the notion of unconscionability or unfairness without in fact reducing certainty and predictability or extending the net too widely or too narrowly. The only persuasive reasons provided by the Law Commission for legislation are its accessibility and education functions - both of which are consumer orientated. It is consumers who are most at risk, and consumers are the only group where legislation can be justified.

The Credit Contracts Act even limited in its coverage to consumers, requires significant amendment. The existing disclosure provisions are complex, incomprehensible for consumers and incomplete. Consumers also need to be better educated as to their rights and obligations when entering into credit contracts. The Act is toothless in so far as it does little to prevent sharp practices by those most likely to engage in them. Furthermore the limitations of a formal court system are even more pronounced for consumer disputes, giving rise to real problems of accessibility to the law. Therefore an enforcement agency, such as the Commerce Commission, must be given responsibility for ensuring compliance. Alternatively, an Ombudsman scheme may provide the answer. Whether by extending the coverage of the existing Banking Ombudsman scheme or setting up a new scheme to cover other financial institutions, this model of dispute resolution is already being successfully employed for many of the types of disputes the courts previously dealt with in this area and may well be profitably extended. Finally the "oppression" provision in this reformed consumer legislation needs to be changed to minimise uncertainty. The author advocates simply removing the potentially confusing references to "oppressive" and replacing them with "unconscionable". That is, relief is available for contracts and behaviour in procuring contracts that is "unconscionable". This term is to be understood and interpreted in line with it's wider meaning in the common law (perhaps as developed in line with Capper's rationalising suggestions).

The current Credit Contracts Act with its unhelpful definition of "oppressive" and lack of guidelines has generated even more inconsistency in an area already rife with uncertainty.

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[146] *Draft Scheme*, above n52

The Act is not fulfilling it's objectives. The meaning of "oppressive" is unclear, the disclosure provisions are cumbersome and incomplete, and enforcement of and accessibility to the law is inadequate. Reform is undoubtedly necessary, unfortunately however, if personal property securities legislation is anything to go by, this is unlikely to occur quickly. In the meantime, it is up to the courts to eliminate inconsistencies and provide guidance and clarity in their decision making.

Chris Dann.

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