Circumstances in which the Actions or Knowledge of Third Parties may be Attributed to a Bank or other Financier

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By

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Overview

Preliminary comments

[1] In this paper, I address the circumstances in which the knowledge and actions of a third party (usually referred to by me as "B") will be attributed to someone else (to whom I will usually refer as "A"), with a particular focus on the circumstances in which this is appropriate where A is a financier.

[2] Of course, where B was the employee of A and was relevantly acting in the course of that employment, B's actions or knowledge will readily be attributed to A. In saying this, I recognize that the Privy Council judgment in *Meridian Global Funds Management Asia Ltd v Securities Commission*[2] demonstrates that even in the case of employer and employee a nuanced assessment is required for the purposes of criminal, quasi-criminal and regulatory liability. Although I will come back to *Meridian* later in the paper, I put aside attribution as between employer and employee as out of scope for the purposes of this paper.

[3] In situations where B was not the employee of A, I am inclined to think that a prerequisite for attribution is that B was acting, at least broadly, at the request of A. I say this

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1 A Judge of the Supreme Court of New Zealand.

2 *Meridian Global Funds Management Asia Ltd v Securities Commission* [1995] 3 NZLR 7.

because at least for the moment, I cannot think of other circumstances where attribution arguments are likely to be successful, at least in a commercial context.[3]

[4] With employment cases to one side, there might be thought to be, broadly, two circumstances to address; first where B is acting as the agent of A, and secondly where B is not acting as the agent of A.

[5] Most lawyers would intuitively take the view that where B was acting as the agent of A, attribution will be appropriate far more often than where B was either an independent contractor (where the underlying relationship is commercial or economic) or simply a volunteer (in a social or family context). As will become apparent, I find a binary approach (ie agent or not an agent) to be of at best limited assistance. And of course, where B was A's agent, there may still be an impressionistic issue whether B was relevantly acting within the scope of the agency – an issue which I tend to regard as just a surrogate for the ultimate question whether B's actions are to be attributed to A.

[6] The primary theme of this paper is the need to keep steadily in mind what I see as the reality that this ultimate question is best answered not by a formalistic approach to agency but rather in terms of the policy requirements of the underlying legal rules which are engaged by the case.

The generality of attribution rules – A Contributory Negligence Act 1947 and non-delegable duty excursion

[7] Although – or perhaps because! – this paper is for a banking and financial services law conference, I think it important to note that the attribution rules (and more particularly the underlying problems they raise) are not confined to financing transactions. It is very difficult to follow the principles as they apply to financial transactions without a general understanding of how attribution works in the law more generally.

[8] I can illustrate this first by reference to s 3 of the Contributory Negligence Act 1947, which provides:

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[3] I see liability based on facilitation by A of B's conduct (eg knowing assistance in breach of fiduciary duty or accessory liability) as turning on the actions of A rather than attribution.

3 Apportionment of liability in case of contributory negligence

(1) Where any person suffers damage as the result partly of his own fault and partly of the fault of any other person or persons, a claim in respect of that damage shall not be defeated by reason of the fault of the person suffering the damage, but the damages recoverable in respect thereof shall be reduced to such extent as the Court thinks just and equitable having regard to the claimant's share in the responsibility for the damage:

On an extremely literal approach to the wording of s 3, it is only the fault of the plaintiff which is material and not the fault of others. But such a literal approach is plainly unsustainable. So the courts are frequently required to decide whether the actions of someone other than the plaintiff should be attributed to the plaintiff for the purposes of s 3.

[9] Sometimes this is really easy. For instance in the paradigm case of a collision between two commercial vehicles it is so obvious that it goes without saying that the negligence/fault of the employee drivers is to be attributed to their employers who are the owners of the vehicles. Accordingly the damages payable by and to the employer owners must be adjusted accordingly.

[10] This "out of scope" example is a simple illustration of what is referred to as "the both ways rule",[4] a rule which goes back at least as far as the speech of Lord Watson in *The Bernina.*[5] Under the "both ways" rule, where the plaintiff is vicariously responsible for the actions of the third party, the actions of that third party will be attributed to the plaintiff under the Contributory Negligence Act.

[11] This rule works very well in the sort of situation I have just discussed, but it provides little assistance in other, more nuanced situations particularly where there is an underlying policy of the law or perhaps an arrangement between the parties intended to protect the claimant from a particular kind of loss.[6] What of the case of the company which has suffered loss from the breach of duty of its employees which ought to have been, but was not, detected by auditors. If the company sues the auditors, can the auditors attribute the actions of the

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4 Helpfully discussed by Andrew Bartlett "Attribution of Contributory Negligence: Agents, Company Directors and Fraudsters" (1998) 114 LQR 460.

5 *Mills v Armstrong (The Bernina)* (1888) 13 App Cas 1 (HL) at 16.

6 This is discussed by Bartlett in the article already referred to, n 4, and also by Evans "Attribution and Professional Negligence" (2003) 19 Professional Negligence 470; and Murdoch "Client Negligence: a Lost Cause" (2004) 20 Professional Negligence 97.

company officers to the company and, in this way, secure a reduction in their liability for losses?[7]

[12] Getting perhaps a little closer to the title of the present paper, in what circumstances will the knowledge or actions of a solicitor be attributed to the client?

[13] Obviously a solicitor is often the agent of his or her client. Often enough a client will be bound by the actions of the solicitor, for instance under s 6 of the Contractual Remedies Act 1979 in respect of pre-contractual misrepresentations, or if the solicitor confirms a conditional contract. But there must be, at most, a very limited number of situations in which a client will be vicariously responsible for the negligence of his or her solicitor. Nonetheless, the New Zealand Court of Appeal has recently attributed the negligence of a solicitor to a client so as to reduce damages to which she would otherwise have been entitled. This was in the context of a leaky home case, *Byron Avenue*.[8]

[14] In *Byron Avenue*, the many plaintiffs sued a number of defendants, but primarily the local authority, in relation to losses they suffered as a result of acquiring units in an apartment building which leaked. In the case of one of the plaintiffs, the problems with the apartment she bought would have come to her attention before she committed to the purchase if her solicitor had obtained a LIM or a copy of the body corporate minutes. The solicitor did not do so and so she purchased a defective apartment. The Court concluded that the solicitor's failure to obtain a LIM amounted to negligence and that it could be attributed to the client as contributory negligence, thus diminishing the damages to which she would otherwise have been entitled against the local authority.

[15] As the New Zealand lawyers present will well know, leaky building syndrome and associated litigation have produced huge systemic problems for the building industry, local authorities and the courts, not to mention the owners of leaking and now rotting homes. To my way of thinking (which of course may not survive scrutiny in the Supreme Court by my new colleagues), the courts owe it to all participants in the process to develop bright line rules. In this context, the decision to attribute the negligence of the solicitor to the client was

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7 See *Dairy Containers Ltd v NZI Bank Ltd* [1995] 2 NZLR 30 (HC); *Daniels v Anderson* (1995) 16 ACSR 607, (1995) 37 NSWLR 438 (NSW CA) particularly at 564 - .

8 *O'Hagan v Body Corporate 189855* alt cit *Byron Avenue* [2010] NZCA 65.

entirely independent whether it was realistic to treat the client as generally being vicariously responsible for the actions of the solicitor. Rather, it was based on policy, as I endeavoured to explain in my judgment:[9]

> The obtaining of a LIM and, at least from now, the minutes of the body corporate are obvious precautions for a purchaser to take. It is difficult to see why the local authority should be worse off where a solicitor has failed to take these precautions than where the fault is simply that of the purchaser. As well, the practical result of holding that a client is not responsible for the fault of the solicitor is to require an extremely awkward circularity of action, with the local authority required to join the solicitor and seek contribution, a course which may run into difficulties over privilege between the purchaser and solicitor. In a case in which a solicitor had negligently failed to make appropriate inquiries, it is far simpler for the client to sue the solicitor.
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> Accordingly, and for very pragmatic reasons, I am of the view that the fault of a solicitor who fails to make appropriate inquiries may be attributed to the client.

[16] Similar considerations apply to the amorphous concept of the non-delegable duty. This tends to be alleged where the defendant has engaged an independent contractor to carry out an activity which is particularly dangerous and either personal injury or property damage has resulted. The idea is to make the defendant liable for the negligence of an independent contractor – usually, of course, one who cannot meet a judgment. In general the courts are pretty reluctant to attribute what is sometimes called the "collateral negligence" of an independent contractor to that contractor's principal.[10] In New Zealand a non-delegable duty is sometime invoked against developers in defective building cases. This was discussed by the Court of Appeal in *Mount Albert Borough Council v Johnson.*[11] Although the formal reasoning process associated with the imposition of a non-delegable duty on a defendant does not require a formal attribution of the third party's acts or knowledge to the defendant, the end result comes down to pretty much the same thing. As noted, non-delegable duty cases characteristically involve claims based on either personal injury or property damage and are thus of little direct relevance to financing transactions. That said, I note that as the speech of Lord Reid in *Davie v New Merton Board Mills Ltd*[12] indicates, the more closely the actions of the independent contractor are integrated into the defendant's business (particularly if they involve the sort of work which would normally be carried out by an employee), the more

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9 At [145]-[146].

10 The relevant law is discussed at some length in *Transfield Services (Australia) Pty Ltd v Hall* (2008) 75 NSWLR 12 (NSW CA).

11 *Mount Albert Borough Council v Johnson* [1979] 2 NZLR 234 (CA).

12 *Davie v New Merton Board Mills Ltd* [1959] AC 604 (HL) at 646.

likely it is that the defendant is liable. This sort of reasoning has found its way into the cases which deal with the liability of hospitals for the negligence of non-employed medical specialists.[13]

What do we mean by "agency"?

[17] On a strict approach to agency, B is A's agent if authorised by A to act on its behalf so as to affect A's (legal) relationship with third parties.[14]

[18] As I have already foreshadowed, I find a formal approach to agency comparatively unhelpful in deciding whether attribution is appropriate. I can illustrate this in two ways, again by reference to the position of a solicitor and client:

(a) A solicitor whom I retain to conduct a conveyancing transaction on my behalf will undoubtedly be my agent with power to affect my relationships with third parties (for instance as to confirmation). But if my solicitor while acting for me (and charging me for the time!) drives a car to a meeting and negligently damages another car, I am plainly not vicariously liable.

(b) Under New Zealand market practice, a real estate agent I employ in relation to the sale of my house is likely to be authorised to accept a deposit on my behalf and in that sense is a true agent. But my undoubted liability for misrepresentations made by the real estate agent is at best collaterally associated with the formal agency. For instance, if for some reason, I had stipulated that the deposit should be paid to my solicitor and not my agent, I would still be liable for misrepresentations made by the real estate agent, even though the real estate agent in this instance would be purely an independent contractor with no authority to affect my contractual relationships with third parties. The reason I am vicariously liable for such misrepresentations is simply because that agent is standing in my shoes and representing me in dealings with potential purchasers.

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13 For a full discussion of this, see *Ellis v Wallsend District Hospital* (1989) 17 NSWLR 553 (NSW CA).

14 See Francis Reynolds *Bowstead and Reynolds on Agency* (18th Edition, Sweet and Maxwell, London, 2006) at [1-001].

[19] The awkwardness of the underlying concepts is illustrated by *Colonial Mutual Life Assurance Society Limited v Producers and Citizens Co-Operative Assurance Co Australia Limited.*[15]

[20] In issue was whether an insurance company was vicariously responsible for defamatory remarks made by its canvassing agent about another insurance company. He was strictly only an agent in relation to his authority to accept premiums. Otherwise, he was an independent contractor. The canvassing agent's ability to accept premiums was, at least as a matter common sense, irrelevant to whether the insurance company was vicariously liable for defamatory remarks he made. Indeed the judgment of the Court, in holding the insurance company vicariously liable, proceeded on the basis that the canvassing agent had been its representative. Interestingly, Gavan Duffy CJ and Stark J chose to use an apparent oxymoron when describing the canvassing agent as:[16]

> ... an agent of the defendant in the nature of an independent contractor.

It is by parity of reasoning that misrepresentations by a real estate agent will be attributed to a vendor. Whether that reasoning would extend to holding a vendor liable for defamatory remarks made by a real estate agent may be more doubtful.

[21] Often enough where attribution is in issue, the only ability of the "agent" to affect the principal's legal relationships with third parties is in respect of the actions in respect to which vicarious liability are asserted. So in the English case *Morgans v Launchbury*[17] – a case which concerned the liability of the owner of a car for the actions of a bailee – Lord Wilberforce noted that:

> I accept entirely that "agency" in contexts such as these is merely a concept, the meaning and purpose of which is to say "is vicariously liable," and that either expression reflects judgment of value – respondeat superior is the law saying the owner ought to pay.

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15 *Colonial Mutual Life Assurance Society Limited v Producers and Citizens Co-Operative Assurance Co Australia Limited* [1931] HCA 53, (1931) 46 CLR 41.

16 At 46.

17 *Morgans v Launchbury* [1973] AC 127 (HL) at 135.

And Gleeson CJ commented in *Scott v Davis*:[18]

> Lord Wilberforce made the point that to describe a person as the agent of another, in this context, is to express a conclusion that vicarious liability exists, rather than to state a reason for such a conclusion.

[22] Coming back to the *Colonial Mutual* case, it is worth considering why, given the caution in personal injury and property damage cases about attributing the "collateral negligence" of an independent contractor to a principal, the High Court had no difficulty attributing to the insurance company the collateral defamation of its independent contractor. It may simply reflect the perception that the independent contractor/canvassing agent was representing the insurance company in its dealings with outsiders, a consideration which is not present in most of the non-delegable duty cases except those which concern activities of an independent contractor who is closely integrated into the defendant's enterprise (for instance in the case of what is perhaps the now slightly antiquated concept of the honorary (ie non-employed) surgeon working in a hospital).

Policy

[23] Pausing here, the examples I have provided seem to me to illustrate my point that attribution involves a policy judgment. For the purposes of this judgment, the substance of the relationship between A and B is fundamental but the categorisation of that relationship in terms of the formal rules of agency is not necessarily controlling. Also highly material will be the particular legal context and the underlying policy of the legal rules which are engaged.

[24] The importance of a policy judgment was made by Lord Hoffmann in *Meridian*, to which I have already referred.[19] This case concerned the question whether the knowledge by Mr Koo of the acquisition of shares he made on behalf of Meridian, albeit in fraud of Meridian and corruptly, should be attributed to Meridian for the purposes of a liability to a penalty for breach of a regulatory disclosure regime. The Court considered that:[20]

> Once it is appreciated that the question is one of construction rather than metaphysics, the answer in this case seems to Their Lordships to be ... straightforward ... .

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18 *Scott v Davis* [2000] HCA 15, (2000) 204 CLR 333 at 339.
19 Above [2].
20 At 16.

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> It is a question of construction in each case as to whether the particular rule requires that the knowledge that an act has been done, or the state of mind with which it was done, should be attributed to the company. Sometimes, as in *Pioneer Concrete* [[1994] 3 WLR 1249] and this case, it will be appropriate. Likewise in a case in which a company was required to make a return for revenue purposes and the statute made it an offence to make a false return with intent to deceive, the Divisional Court held that the mens rea of the servant authorised to discharge the duty to make the return should be attributed to the company: see *Moore v I Bresler Ltd* [1944] 2 All ER 515. On the other hand, the fact that a company's employee is authorised to drive a lorry does not in itself lead to the conclusion that if he kills someone by reckless driving, the company will be guilty of manslaughter. There is no inconsistency. Each is an example of an attribution rule for a particular purpose, tailored as it always must be to the terms and policies of the substantive rule.

Now back to my topic

[25] I propose to explore my topic directly by reference to two particular issues with which I am reasonably familiar, the attribution of a principal debtor's knowledge to a lender and outsourcing of credit assessment.

Attributing a principal debtor's knowledge and actions to a lender

[26] As everyone here will know, such attribution has frequently been in issue in relation to the dealings between a principal debtor and guarantors. When the lender seeks to enforce the guarantee, the guarantor claims undue influence or misrepresentation on the part of the principal debtor and attempts to attribute either those actions or knowledge of them to the lender. Usually the principal debtor (or where the principal debtor is a company, the principal of the company) and guarantor are related. Most commonly they are husband and wife respectively, although other relationships, particularly parent and child, feature in the cases.

[27] An illustrative early case is *Contractors Bonding Ltd v Snee.*[21] Mrs Snee had guaranteed the obligations of a travel company associated with her son and she later gave security over her home in support of her guarantee. Her home was used as security and when the business failed the lenders sought to exercise their power of sale. Mrs Snee challenged

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[21] *Contractors Bonding Ltd v Snee* [1992] 2 NZLR 157.

the guarantee and supporting security on grounds which included undue influence exercised on her by her son. The facts of the case involve some subtleties which are not particularly material in the present context. What is important is the principle upon which the Court acted which is adequately captured by the head note:

> The mere fact that a person had entered into a contract with a creditor or lender as a result of undue influence exercised by a third party will not of itself entitle that person to have the contract set aside. Some further element is necessary which affects the conscience of the creditor or lender. If the undue influence has been exercised by the agent of the creditor or lender, that is sufficient. Where the creditor has entrusted the third party with the task of obtaining execution of the document, that may be sufficient to make that person the agent of the creditor, but that is a question of fact. In cases not amounting to agency, the question is whether the circumstances are such that the creditor is to be regarded as having notice of the exercise of undue influence, or of circumstances which could give rise to a presumption of undue influence. Where the procurement of execution of the document is entrusted to someone such as the debtor who has a motive for ensuring its execution, that will be a relevant factor to take into account, but the mere fact that the document is sent to the debtor for execution by himself and his guarantor is not of itself sufficient

[28] Since then, the law has moved on and the leading cases, from the point of view of New Zealand law, are the judgments in:

(a) *Barclays Bank plc v O'Brien*;[22]

(b) *Wilkinson v ASB Bank Ltd*;[23]

(c) *Royal Bank of Scotland plc v Etridge (No 2)*;[24] and

(d) *Hogan v Commercial Factors Ltd*.[25]

[29] In terms of the principles settled in the cases I have just mentioned, cases of this type throw up three issues:

(a) Was the guarantor subject to undue influence or misrepresentation?

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22 *Barclays Bank plc v O'Brien* [1994] 1 AC 180.
23 *Wilkinson v ASB Bank Ltd* [1998] 1 NZLR 674 (CA).
24 *Royal Bank of Scotland plc v Etridge (No 2)* [2001] UKHL 44, [2002] 2 AC 773.
25 *Hogan v Commercial Factors Ltd* [2006] 3 NZLR 618.

(b) If so, were the circumstances as known to the lender such as to put the lender on inquiry as to the risk of undue influence or misrepresentation?

(c) If so, did the lender act in such a way as to insulate itself from the consequences of such undue influence or misrepresentation?

For a guarantor to avoid liability in these circumstances all three issues must be answered in his or her favour (that is, issues (a) and (b) Yes and (c) No).

[30] Whether the guarantor was subjected to undue influence or misrepresentation must be established independently. Although some guarantors fall at this hurdle,[26] establishing undue influence / misrepresentation is often not hard, as the principal debtor may accept (or at least not strenuously resist) deny misconduct; this for reasons based around family dynamics and perhaps self-interest. But what is more relevant for present purposes are the second and third issues just identified.

[31] As to when a lender is relevantly on inquiry, the New Zealand Court of Appeal in *Hogan* signalled that the approach of Lord Nicholls in *Etridge* should be applied in New Zealand. What Lord Nicholls said was this:[27]

> For practical reasons the level is set much lower than is required to satisfy a court that, failing contrary evidence, the court may infer that the transaction was procured by undue influence. Lord Browne-Wilkinson said ([1994] 1 AC 180, 196):
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> > 'Therefore in my judgment a creditor in put on inquiry when a wife offers to stand surety for her husband's debts by the combination of two factors: (a) the transaction is on its face not to the financial advantage of the wife; and (b) there is a substantial risk in transactions of that kind 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.'
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> In my view, this passage, read in context, is to be taken to mean, quite simply, that a bank is put on inquiry whenever a wife offers to stand surety for her husband's debts.
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> ...
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> The position is likewise if the husband stands surety for his wife's debts. Similarly, in the case of unmarried couples, whether heterosexual or homosexual, where the bank is aware of the relationship ...

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[26] Hogan is an example.
[27] At [44] and [47]-[49].

As to the type of transactions where a bank is put on inquiry, the case where a wife becomes surety for her husband's debts is, in this context, a straightforward case. The bank is put on inquiry. On the other side of the line is the case where money is being advanced, or has been advanced, to husband and wife jointly. In such a case the bank is not put on inquiry, unless the bank is aware the loan is being made for the husband's purposes, as distinct from their joint purposes. ...

Less clear cut is the case where the wife becomes surety for the debts of a company whose shares are held by her and her husband. Her shareholding may be nominal, or she may have a minority shareholding or an equal shareholding with her husband. In my view the bank is put on inquiry in such cases, even when the wife is a director or secretary of the company. Such cases cannot be equated with joint loans. The shareholding interests, and the identity of the directors, are not a reliable guide to the identity of the persons who actually have the conduct of the company's business.

[32] Later in his speech Lord Nicholls returned to the same subject:[28]

[A]s with wives, so with other relationships, the test of what puts a bank on inquiry should be simple, clear and easy to apply in widely varying circumstances. This suggests that, in the case of a father and daughter, knowledge by the bank of the relationship of father and daughter should suffice to put the bank on inquiry. When the bank knows of the relationship, it must then take reasonable steps to ensure the daughter knows what she is letting herself into.

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But the law cannot stop at this point, with banks on inquiry only in cases where the debtor and guarantor have a sexual relationship or the relationship is one where the law presumes the existence of trust and confidence. That would be an arbitrary boundary, and the law has already moved beyond this, ... As noted earlier, the reality of life is that relationships in which undue influence can be exercised are infinitely various. They cannot be exhaustively defined. Nor is it possible to produce a comprehensive list of relationships where there is a substantial risk of the exercise of undue influence, all others being excluded from the ambit of the *O'Brien* principle. ...

These considerations point forcibly to the conclusion that there is no rational cut-off point, with certain types of relationship being susceptible to the *O'Brien* principle and others not. Further, if a bank is not to be required to evaluate the extent to which its customer has influence over a proposed guarantor, the only practical way forward is to regard banks as 'put on inquiry' in every case where the relationship between the surety and the debtor is non-commercial. ,,, .

Different considerations apply where the relationship between the debtor and guarantor is commercial, as where a guarantor is being paid a fee, or a company is guaranteeing the debts of another company in the same group. Those engaged in business can be regarded as capable of looking after themselves and understanding the risks involved in the giving of guarantees.

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[28] At [84]-[86].

[33] What must a lender do to insulate itself from the consequences of such undue influence or misrepresentation?

[34] On the approach taken in *Etridge*, lenders are not required to inquire directly whether guarantor's consent is being procured by undue influence. Instead a lender should take reasonable steps to satisfy itself that the practical implications of the transaction have been brought home to the guarantor in a meaningful way. Ordinarily it will be reasonable for a lender to rely upon confirmation from a solicitor, acting for the guarantor, that he or she has advised the guarantor appropriately. It will be otherwise if the lender knows either that the solicitor has not duly advised the guarantor, or knows facts from which it ought to have realised that the guarantor has not received the appropriate advice. In this context, the lender should invite the guarantor to nominate a solicitor. Although that solicitor can also act for the principal debtor, it has to be clearly understood by all concerned, including of course the guarantor, that in relation to the guarantee, the solicitor is acting for the guarantor.

[35] I note that a rather different approach is taken in Australia, see *Garcia v National Australia Bank Ltd.*[29]

[36] The relevant legal principles were primarily established in the speech of Lord Browne-Wilkinson in *Barclays Bank* (albeit that they were later developed in *Etridge*).

[37] The underlying policy considerations were spelt out by Lord Nichols in *Etridge*:

> 34. The problem considered in *O'Brien's* case and raised by the present appeals is of comparatively recent origin. It arises out of the substantial growth in home ownership over the last 30 or 40 years and, as part of that development, the great increase in the number of homes owned jointly by husbands and wives. More than two-thirds of householders in the United Kingdom now own their own homes. For most home-owning couples, their homes are their most valuable asset. They must surely be free, if they so wish, to use this asset as a means of raising money, whether for the purpose of the husband's business or for any other purpose. Their home is their property. The law should not restrict them in the use they may make of it. Bank finance is in fact by far the most important source of external capital for small businesses with fewer than ten employees. These businesses comprise about 95 percent of all businesses in the country, responsible for nearly one-third of all employment. Finance raised by second mortgages on the principal's home is a significant source of capital for the start-up of small businesses.

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[29] *Garcia v National Australia Bank Ltd* (1998) HCA 48, (1998) 194 CLR 395.

35. If the freedom of home-owners to make economic use of their homes is not to be frustrated, a bank must be able to have confidence that a wife's signature of the necessary guarantee and charge will be as binding upon her as is the signature of anyone else on documents which he or she may sign. Otherwise banks will not be willing to lend money on the security of a jointly owned house or flat.

36. At the same time, the high degree of trust and confidence and emotional interdependence which normally characterises a marriage relationship provides scope for abuse. One party may take advantage of the other's vulnerability. Unhappily, such abuse does occur. Further, it is all too easy for a husband, anxious or even desperate for bank finance, to misstate the position in some particular or to mislead the wife, wittingly or unwittingly, in some other way. The law would be seriously defective if it did not recognise these realities.

[38] Resolution of these competing considerations required a novel, law-making response, which involved the development of the equitable principles and an unconventional use of equitable concepts. This too was explained by Lord Nicholls in *Etridge*:

38. ... In *O'Brien* Lord Browne-Wilkinson prayed in aid the doctrine of constructive notice. In circumstances he identified, a creditor is put on inquiry. When that is so, the creditor 'will have constructive notice of the wife's rights' unless the creditor takes reasonable steps to satisfy himself that the wife's agreement to stand surety has been properly obtained ....

39. Lord Browne-Wilkinson would be the first to recognise this is not a conventional use of the equitable concept of constructive notice. The traditional use of this concept concerns the circumstances in which a transferee of property who acquires a legal estate from a transferor with a defective title may nonetheless obtain a good title, that is, a better title than the transferor had. That is not the present case. The bank acquires its charge from the wife, and there is nothing wrong with her title to her share of the matrimonial home. The transferor wife is seeking to resile from the very transaction she entered into with the bank, on the ground that her apparent consent was procured by the undue influence or other misconduct, such as misrepresentation, of a third party (her husband). She is seeking to set aside her contract of guarantee and, with it, the charge she gave to the bank.

40. The traditional view of equity in this tripartite situation seems to be that a person in the position of the wife will only be relieved of her bargain if the other party to the transaction (the bank, in the present instance) was privy to the conduct which led to the wife's entry into the transaction. ... But *O'Brien* has introduced into the law the concept that, in certain circumstances, a party to a contract may lose the benefit of his contract, entered into in good faith, if he *ought* to have known that the other's concurrence had been procured by the misconduct of a third party.

41. There is a further respect in which *O'Brien* departed from conventional concepts. Traditionally, a person is *deemed* to have notice (that is, he has 'constructive' notice) of a prior right when he does not actually know of it but would have learned of it had he made the requisite inquiries. A purchaser will be treated as having constructive notice of all that a reasonably prudent purchaser would have discovered. In the present type of case, the steps a bank is required to take, lest it have

> constructive notice that the wife's concurrence was procured improperly by her husband, do not consist of making inquiries. Rather, *O'Brien* envisages that the steps taken by the bank will reduce, or even eliminate, the risk of the wife entering into the transaction under any misapprehension or as a result of undue influence by her husband. The steps are not concerned to discover whether the wife has been wronged by her husband in this way. The steps are concerned to minimise the risk that such a wrong may be committed.

[39] What about agency?

[40] Prior to *O'Brien*, guarantors often alleged that the borrower was the lender's agent for the purpose of obtaining the guarantor's signature and that, accordingly, the lender was responsible for any undue influence exerted or misrepresentations made by borrower. In this respect, *Snee* was a pretty typical case. This agency approach was rather artificial (as the borrower might, in this situation, usually be thought to be acting primarily for his or her own purposes) and was treated as such in *O'Brien.*[30] Indeed, the Court of Appeal in *Etridge*,[31] Court observed:[32]

> If the husband could be treated as acting as agent for the bank when procuring his wife to become surety for the debt then the bank could not be in any better position than its agent the husband. But the theory is now almost totally discredited. As Lord Browne-Wilkinson pointed out (at [1994] AC 193-4) the supposed agency is highly artificial. In most cases the reality of the relationship is that the creditor stipulates for security, and in order to raise the necessary finance the principal debtor seeks to procure the support of the surety. In doing so he is acting on his own account and not as agent for the creditor.

[41] That there is rather more life than this in the agency argument, at least in New Zealand, is illustrated by the New Zealand Supreme Court decision, *Dollars & Sense Ltd v Nathan.*[33]

[42] In this case, the solicitor (a Mr Thomas) acting for the lender had asked the borrower (Rodney Nathan) to obtain the signatures from the guarantors (who were to be his parents). Rodney obtained his father's signature but simply forged his mother's signature. The guarantee was incorporated in a mortgage and this was duly (or unduly) registered. In issue,

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30 See particularly 194 and 195.
31 *Royal Bank of Scotland Plc v Etridge (No 2)* [1998] 4 All ER 705.
32 At [27].
33 *Dollars & Sense Finance Limited v Nathan* [2008] NZSC 20, [2008] 2 NZLR 557.

was whether the security interest apparently conferred by the mortgage was defeated on the basis that the fraud of Rodney should be attributed to the lender, Dollars & Sense.

[43] This was an odd case. If Rodney had obtained his mother's signature by undue influence or misrepresentation, she would undoubtedly have been able to have the guarantee set aside under the *O'Brien* principle. If Rodney's fraud had been more elaborate and had involved him introducing an imposter who went to see Mr Thomas pretending to be Mrs Nathan and she had forged Mrs Nathan's signature, then Dollars & Sense would undoubtedly have obtained a good security over the property, albeit that Mrs Nathan would have had a statutory claim against the Crown for compensation. Although Rodney might have been appointed by Dollars & Sense to deal with Mrs Nathan over the documents, he in fact did not deal with her at all.

[44] Mrs Nathan won her case all the way through the New Zealand court system, albeit over my dissent in the Court of Appeal.

[45] This issue was put this way in the Supreme Court:[34]

> The first question which this Court must address is whether expressly or by implication D & S utilised Rodney's services as its agent to procure execution of the loan documentation, including the mortgage. Did D & S make it Rodney's task to obtain execution, thereby creating an agency and prescribing its scope? Did D & S, to adapt the words of Dixon J in *Colonial Mutual Life Assurance Society Ltd v Producers and Citizens Co-operative Assurance Co of Australia Ltd*, entrust to Rodney the function of representing it in its transaction with the parents so that the service to be performed by Rodney consisted of standing in the place of D & S (or of its solicitor) and assuming to act in its right and not in an independent capacity?

[46] Taking a rather different view of the agency argument to what had been taken by the Court of Appeal in *Etridge*, the Court went on:[35]

> It was certainly in Rodney's interests to obtain his parents' signatures so that he could get his hands on the loan money. That was his main, if not his sole, objective. In order to achieve that objective, it was necessary for his parents to sign the mortgage. He was, therefore, acting in his own interests in arranging signature. But this does not preclude the conclusion that he was also to act on behalf of D & S in obtaining signature of the relevant documents.http://www.lexisnexis.com/nz/legal/frame.do?reloadEntirePage=tru

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[34] At [8].
[35] At [24]-[26].

> e&rand=1280880959054&returnToKey=20_T9866864215&parent=docview&target=results_DocumentContent&tokenKey=rsh-20.486336.0803777276 - fn-20082NZLR_557-21 Without that execution D & S could not become registered proprietor.
>
> ...
>
> It may be that it is unsound practice for financiers to leave it to borrowers to organise the signatures of guarantors, with the borrowers in so doing fulfilling the role of agents for the financiers. It is to be hoped that the practice has now become rare for it is fraught with potential peril for the financier and the financier's solicitor. It will in a particular case be very much a question of factual assessment and judgment whether the borrower has indeed acted as an agent for the lender to obtain signature or has merely acted as the conduit for the delivery of the documents. But to say that it is never possible for the borrowers to act as agent, as was suggested by the Court of Appeal in *Etridge*, is to fail to appreciate the realities of cases like the present. ...
>
> In view of this engagement of Rodney by D & S, through Mr Thomas, to get the mortgage signed and then witnessed, it would be artificial and commercially unrealistic to take the view that there was no relevant element of agency in what Rodney did. Any doubt about Mr Thomas's acceptance of Rodney's role was removed when the documents came back witnessed by a lay person, no objection was taken, the advance was made and the mortgage was presented for registration. If it were necessary to determine the point, we would be inclined to the view that, at the very least, this acceptance amounted to a ratification by Mr Thomas of Rodney's authority to arrange execution of the documents.

[47] This left the question of whether the actions of Rodney were within the agency.

[48] If Dollars & Sense had won the case, the economic losses associated with Rodney's fraud would have fallen on the Crown (under the statutory compensation scheme which is part of legislative scheme associated with indefeasibility of title) and there would have been adverse consequences for Mrs Nathan of a sentimental nature (associated with the sale of the property). My take on the case is that this was seen as unacceptable given the reality that the whole imbroglio was very much the fault of Dollars & Sense, a point which I think emerges from the following passage in the judgment.[36]

> The tenor [of the relevant authorities] is that someone who creates an agency in which there is a risk of improper behaviour by an agent (or, as in this case, by someone entrusted with a sub-agency) should expect to bear responsibility where that risk eventuates and loss is thereby caused by the agent to a third party. The nature of that risk and the extent of the liability will depend upon the nature and scope of the agency. In this case, even without the benefit of hindsight, a moment's reflection

[36] At [48].

> exposes the risk of a borrower's being tempted to mislead his guarantors or to exercise undue influence over them or, at the worst, to forge their signatures. Forgery was a peril which was avoidable if Mr Thomas had not put Rodney in a position where it was left to him to obtain the necessary signatures. It is not therefore at all unreasonable for Rodney's forgery to be regarded as an act done in the course of the agency.

Outsourcing credit approval functions

[49] In *Bartle v GE Custodians Ltd*[37] the Court of Appeal was required to deal with a complaint of oppression in relation to a credit transaction. Mr and Mrs Bartle were a retired couple whose assets comprised $48,000 in the bank and an unencumbered house worth around $400,000. Their only income was national superannuation. With a view to obtaining some additional income they entered into transactions which were marketed by a group of companies known as Blue Chip. This involved them buying an apartment.

[50] It was not a very good deal (at least for Mr and Mrs Bartle):

(a) The purchase price of the apartment (including a car park and a furniture package) was $552,000. Allowing for the 15 per cent commission which Blue Chip took from the vendor, the market value of the apartment can have been no more than around $470,000. That is a generous assessment given that the apartment was sold around three years later for $240,000.

(b) The amount borrowed by Mr and Mrs Bartle was almost $640,000.

(c) The only income generated by the business venture was rent which was never going to be enough to meet the outgoings. This shortfall was to be met in part from the difference between what was borrowed and the purchase price of the apartment. Otherwise the shortfall was the responsibility of Blue Chip.

(d) Although not provided for in the legal documentation, it is clear that Mr and Mrs Bartle and Blue Chip dealt with each other on the basis that at the end of 4

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[37] *Bartle v GE Custodians Ltd* [2010] NZCA 174, (2010) 9 NZBLC 102,946.

years, Blue Chip would purchase the apartment on terms which would at least relieve them of their debt obligations.

(e) In the meantime, they were to receive an income of $451 per fortnight (before tax), which was in part funded by being rental on the apartment and in part by the money they had borrowed themselves.

(f) If Blue Chip became insolvent, the deal was likely to be disastrous. The value of the apartment was inherently unlikely to increase sufficiently to mop up both the deficit between its value when purchased and the total amount borrowed, and also the shortfall between income and outgoings.

(g) The business model exemplified by this transaction was so speculative that the prospects of Blue Chip failing were very real, to say the least.

[51] Mr and Mrs Bartle had at most a bounded comprehension of the underlying risks.

[52] As between the lender (GE) and Mr and Mrs Bartle, this was "asset-based lending"[38] on the Bartles' unencumbered house, as there was no income available to service the loan.

[53] In issue before the Court was whether the credit transactions between GE and the Bartles could be categorized as "oppressive" for the purposes of s 120 of the Credit Contracts and Consumer Finance Act 2003. Obviously the greater the knowledge of the background facts which could be attributed to GE, the stronger the case for Mr and Mrs Bartle. Central to the defence advanced by GE was that their knowledge was very limited because they had outsourced credit approval to another company, TML. In issue therefore was whether TML's knowledge should be attributed to GE.

[54] The services provided by TML to GE involved origination and management of mortgages. TML was plainly GE's agent in the management of mortgages. By way of example only, TML as agent for GE, issued any necessary Property Law Act notices. More material to the case however was TML's position in relation to GE in relation to the

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[38] As described by Jeannie Paterson "Knowledge and neglect in asset-based lending: When is it unconscionable or unjust to lend to a borrower who cannot repay?" (2009) 20 JBFLP 18.

origination of mortgages, and most particularly in respect of credit assessment. The core agreement between GE and TML provided that, with the exception of powers expressly delegated under the deed, TML was an independent contractor and not an agent or employee of GE.

[55] I took the view that this independent contractor categorization at least arguably did not extend to the obtaining of valuations (where TML might be thought to have been acting as agent for GE) and more relevantly, certainly did not extend to TML's role in respect of mortgage insurance. In this role I thought that it did act as agent for GE. The proposals which TML, acting as agent for GE, completed in relation to Mr and Mrs Bartle recorded:

> The Insured acknowledges its duty under New Zealand law to disclose to the Insurer every material circumstance within the actual or presumed knowledge of the Insured, a material circumstance being a circumstance which would influence the judgement of a prudent insurer in fixing the premium or determining whether to accept the risk of insurance.

I thought that the information which would be material to a prudent insurer would also be material to a prudent lender in terms of credit assessment. This provided a possible basis for concluding that when TML gathered information relevant to the ability of Mr and Mrs Bartle to meet their mortgage obligations it was doing so at least in part as an agent for GE in the context of the requirement for it to obtain mortgage insurance. This provided (or seemed to me to provide) a reasonably orthodox basis for attributing TML's knowledge to GE.

[56] I also thought that there was a broader context as well, in which TML was very much the representative of GE and in fact operating in a way which was conceptually similar to the canvassing agent in *Colonial Mutual Life*.[39] The certificates which TML was required to give GE indicated that GE wanted to know that there had been reasonable inquiry into the ability of borrowers to repay – an inquiry which in the context of the underlying relationships could only be carried out by TML. TML was carrying out credit assessment functions which are commonly the responsibility of an employee of a lender. So its functions were closely integrated into this aspect of GE's lending business.

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[39] Above n 15.

[57] I also considered that attribution of TML's knowledge to GE was consistent with the scheme, purpose and policy of the legislation on the basis that it would be inimical to the orderly operation of the statute, if out-sourcing of virtually all the usual functions and assessments of financiers provided immunity from those statutory consequences.

[58] The Supreme Court has granted leave to appeal!