

ANALYSIS



Vulnerable Sureties in a Finance Centre: How will the Courts in Hong Kong Respond to the Principle in *Barclays Bank v O'Brien*?

Introduction

In *Barclays Bank v O'Brien*,¹ Lord Browne-Wilkinson laid down the now familiar principle that a surety transaction offered by a wife may be liable to be set aside as against the debtor husband's creditor where the transaction, which is on its face not to the financial advantage of the wife, is procured by the legal or equitable wrong of the husband debtor, and the bank creditor is fixed with constructive notice of the wrong because it is aware that the wife runs a substantial risk that such wrongdoings have been committed against her,² but fails to take reasonable steps to satisfy itself that the wife enters into the transaction freely and with full knowledge of the facts.

Since this principle was laid down, there has been much academic debate as to what its jurisdictional basis might be.³ Traditional contract doctrines like undue influence or misrepresentation are insufficient to explain this principle, as the influence or misrepresentation comes from someone who is not a party to the contract, whereas the party to the contract is affected if he has notice of such wrongdoings. Equally, the terse remark by Lord Browne-Wilkinson that the doctrine of notice 'lies at the heart of equity' offers little guidance.⁴

The first part of this paper examines the possible jurisdictional bases and argues that the doctrine of unconscionability as developed by the Australian decision of *Commercial Bank of Australia Ltd v Amadio* offers a satisfactory

¹ [1994] 1 AC 180.

² The decision in *O'Brien* dealt with a trust reposed by a wife to her husband. More recently, in *Credit Lyonnais Bank Nederland NV v Burch* [1996] The Times, 1 July, the Court of Appeal applied *Barclays Bank v O'Brien* to the situation where a junior employee provided collateral security for all present and future debts of her employer's company in which she had no financial interest.

³ See Lehane, 'Undue Influence, Misrepresentation and Third Parties' (1994) 110 LQR 167; Cretney, '*Barclays Bank v O'Brien & Another*' [1994] Fam Law 78; O'Hagan, 'A Specially Protected Class?' [1994] NLJ 765; Thompson, 'The Enforceability of Mortgages' [1994] Conv 140; Dixon and Harpum, 'Fraud, Undue Influence and Mortgages of Registered Land — A Reply to Professor Thompson' [1994] Conv 421; Sparkes, 'The Proprietary Effect of Undue Influence' [1995] Conv 250; Goo, 'The Enforceability of Securities and Guarantee after *O'Brien*' (1995) 15 OJLS 199; Lawson, '*O'Brien* and its Legacy: Principle, Equity and Certainty' [1995] CLJ 280; Mee, 'An Alternative Approach to Third Party Undue Influence and Misrepresentation' [1994] NILQ 147; Battersby, 'Equitable Fraud Committed by Third Parties' [1995] LS 35; Rickett and McLauchlan, 'Undue Influence, Financiers and Third Parties: A Doctrine in Transition or the Emergence of a New Doctrine?' [1995] NZRLR 328; Howell, 'Notice: A Broad View and a Narrow View' [1996] Conv 34.

⁴ Note 2 above, p 195.

one.⁵ The second part then examines how courts in Hong Kong may contribute to the resolution of this jurisdictional issue.⁶

The jurisdictional basis of *Barclays Bank v O'Brien*

Is it a priority rule?

In *Barclays Bank v O'Brien*, the transaction that was set aside was a legal charge, an interest in land. Furthermore, certain statements in the judgment of Lord Browne-Wilkinson seemed to suggest that he was invoking the doctrine of notice developed typically in property law:

Given that there are two innocent parties, each enjoying rights, the earlier right prevails against the later right if the acquirer of the later right knows of the earlier right (actual notice) or would have discovered it had he taken proper steps (constructive notice).⁷

Some commentators characterise the principle in *O'Brien* as a priority rule to resolve conflicts of titles.⁸ They then argue that the doctrine of notice as used in *O'Brien* is inconsistent with existing priority rules, in that: first, Lord Browne-Wilkinson is incorrect in assuming, without discussion, that the wife's right can bind third parties.⁹ This is because, under existing priority rules, it is still controversial whether the 'right' of the wife, being a mere equity to set aside a transaction for undue influence or misrepresentation, can fall within those mere equities that are ancillary to and dependent on interests in land and so capable of binding third parties.¹⁰ Second, it has been suggested that the *O'Brien* principle could not have affected the fundamental priority rule that volunteers should be bound by prior interests whether they have notice or not.¹¹ Third, it has also been argued that the *O'Brien* principle should be inapplicable where registered land is concerned, as the Land Registration Act has made notice irrelevant.¹²

⁵ (1983) 151 CLR 447.

⁶ The local courts may soon have to deal with this issue. In *Lau Fu-wing v Overseas Trust Bank Ltd* (1996) HCt, HCA No A6280 of 1990, Seagroatt J granted leave to re-amend a statement of claim to include a new cause of action arising under *Barclays Bank v O'Brien*.

⁷ Note 2 above, pp 195H-6A.

⁸ Cretney, O'Hagan, Thompson, Goo, and Sparkes (note 4 above). For the contrary position, see Harpum & Dixon, Mee, Battersby, and Rickett & McLauchlan (note 4 above).

⁹ Cretney, p 79, Goo, p 124 (note 4 above).

¹⁰ *National and Provincial Bank v Ainsworth* [1965] AC 1175, 1261, per Lord Upjohn. See also *Latec Investments Ltd v Hotel Terrigal Pty Ltd* (1965) 113 CLR 265.

¹¹ Lehane, p 171, Goo, p 123 (note 4 above).

¹² ss 20(1) and 59(6), Land Registration Act 1925; *Williams & Glyn's Bank Ltd v Boland* [1981] AC 487, 504, per Lord Wilberforce; see O'Hagan, pp 766-7, Thompson, pp 144-5, Sparkes, pp 252-3, Goo, pp 123-4 (note 4 above).

With respect, it seems inappropriate to assume that the principle in *Barclays Bank v O'Brien* is a priority rule. This is because the facts of *O'Brien* do not even raise a priority issue. In this case, there is only one contract, that between the creditor and the surety.¹³ The issue is whether this contract is vitiated *as against the immediate contracting party*, the creditor, by undue influence or misrepresentation exerted upon by a *third party*, the husband. The doctrine of notice — as well as agency in its undistorted sense — is invoked to determine whether the creditor should be implicated in or affected by the wrongdoing of the third party, not to resolve any priority contest.

In this light, Lord Browne-Wilkinson's reference to there being *two* competing 'rights' seems misleading. The 'earlier right' he referred to should at most be a hypothetical right that would have existed had there been a transaction between the husband and wife. In any case, it seems unnecessary for Lord Browne-Wilkinson to refer to any earlier right, whether actual or hypothetical, to justify the application of the doctrine of notice. In its original conception, the doctrine of notice is not necessarily proprietary. It is based on the notion of good faith or conscience. It allows the Court of Chancery to weigh the merits of the parties, on the basis of acts done by them and information known to them, in order to decide whether it is in *foro conscientiae* for the defendant to enforce his legal right.¹⁴ The defendant's guilty knowledge may be about a prior personal or proprietary right, or it may just be about a state of affairs. Under this doctrine, actual or constructive notice is an intermediate legal concept to enact a standard of reasonable behaviour — unless reasonable steps have been taken, constructive notice will be fixed. The priority rules belong to one line of deductions from this abstract standard. The principle in *O'Brien* is another of such deductions, and is separate from and not bound by the priority rules.¹⁵

Equitable-tortious duty of care

Rickett and McLauchlan argue that, as the use of the doctrine of notice in the *O'Brien* principle is to ensure that creditors take reasonable steps to protect the surety, the same result can be achieved more satisfactorily by recognising a tortious duty of care that is sourced in equity.¹⁶ They claim that such a duty of care can avoid the conceptual difficulty of an extended notion of notice, focus

¹³ Dixon and Harpum, p 422, Mee, pp 151-2, Battersby, pp 41-3 (note 4 above); Swadling, 'Restitution' [1993] All ER Rev 367.

¹⁴ See Pomeroy, *A Treatise on Equity's Jurisprudence* (New York: Lawyers' Co-operative Publishing Company, 1941, reprinted New York: The Law Book Exchange, Ltd, 1994), Pt II, Ch II, Sect VII.

¹⁵ See Gardner, 'Knowing Assistance and Knowing Receipt: Taking Stock' (1996) 112 LQR 56, 60-4. Another example where the doctrine of notice was used outside of the strict priority context is *AG v Guardian Newspapers (No 2)* [1990] 1 AC 109, 281, where Lord Goff formulated a general principle that a duty of confidence arose when confidential information came to the knowledge of a person in circumstances where he has notice that he should be precluded from disclosing the information to others.

¹⁶ Note 4 above, pp 345-59.

correctly on the primary liability of the creditor, and above all avoid the all-or-nothing remedy of rescission by awarding equitable compensation which is evolving by analogy to common law damages.¹⁷ They admit that the judiciary in England,¹⁸ Australia,¹⁹ and New Zealand²⁰ are unenthusiastic about arguments for recognising a tortious duty of care on lenders towards guarantors. However, they argue that earlier inhibitions for such a duty have disappeared after *Henderson v Merret Syndicates Ltd*²¹ relaxed the concurrence rule in *Tai Hing Cotton Mill v Liu Chong Hing Bank Ltd*,²² and after *Henderson*²³ and *White v Jones*²⁴ endorsed the status of the equitable duty of care arising from special relationships between the parties.

However, the benefit of recognising such a duty of care appears marginal. Why, in the first place, must the duty be sourced in equity? The reason given by Rickett and McLauchlan is one based on expediency rather than principle — because the tort and contract avenues are closed off by history and precedent, it is easier to argue the matter in equity.²⁵ It is doubtful whether the equity route is really easier. In establishing the contents of the new equitable duty, we confront the same obstacle we have experienced in imposing the duty of care in tort, namely, holding the defendant responsible for and causing loss to the plaintiff by *omitting* to prevent the wrongful conduct of a third party.²⁶ Precedents in tort are likely to be, and indeed should be, closely referred to to ensure coherence within the various categories of obligations. Moreover, if the duty of care can be established as a common law tort, there will be no need to rest the remedial regime on the uncertain development of equitable compensation.

A more fundamental problem of the duty of care analysis is that the nature of the principle in *O'Brien* is fundamentally different from principles imposing a duty of care. Unlike a tortious duty of care, that principle does not give the wife any claim right against the bank for compensation for consequential losses arising from the latter's failure to act. Rather, it simply strips the bank of its

¹⁷ *Ibid*, pp 348–9.

¹⁸ *Lloyds Bank v Egrement* [1990] 2 FLR 351; *Barclays Bank v Khaira* [1992] 1 WLR 623. These two cases were decided before *O'Brien*. See also *Levitt v Barclays Bank* [1995] 1 WLR 1260, decided after *O'Brien*, which only accepted that a creditor was under the limited duty to disclose to the surety contractual arrangements made between the principal debtor and the creditor which made the terms of the principal contract materially different in a potentially disadvantageous respect from those which the surety might naturally expect.

¹⁹ *Commercial Bank of Australia v Amadio* (note 5 above); *Westpac Banking Corporation v Robinson* (1993) 30 NSWLR 668; Murdoch, 'Creditor's Duty of Disclosure in Contracts of Guarantee' (1995) 8 JCL 286.

²⁰ *Westpac Banking Corporation v McCreanor* [1990] 1 NZLR 580; *Shivas v Bank of New Zealand* [1990] 2 NZLR 327.

²¹ [1994] 3 WLR 761.

²² [1986] AC 80.

²³ Note 21 above, pp 799–80.

²⁴ [1995] 1 All ER 691, 712–18. See also Maxton and Rickett, 'Equity' [1995] NZ Law Review 246.

²⁵ Note 3 above, pp 347–8.

²⁶ Fleming, *The Law of Torts* (Sydney: Law Book Co Ltd, 8th ed 1992), pp 151–5.

benefit under the surety transaction.²⁷ The restitutionary remedy the wife obtains upon rescission may, depending on the circumstances of individual cases, be more or less generous than compensation. In the final analysis, there is much to be said for retaining the *O'Brien* principle as a basis for rescission while at the same time developing the tortious duty of care at common law. In this way, the full range of remedies, restitutionary and compensatory, may be used.

Restitution

Another possible basis of the *O'Brien* principle is that of restitution. The argument is that the creditor is *enriched at the expense of* the surety in an *unjust* manner, because the latter's consent to the transfer of benefit, in kind or in money, is vitiated by undue influence or misrepresentation.²⁸ For some restitution lawyers, actual or constructive notice is necessary to impose liability.²⁹ For others, liability is strict, subject to a change of position defence, which is only available to those who acted in good faith, that is, without notice.³⁰

If the ability to fit the facts of a particular case into the structural pattern of a cause of action is sufficient to determine the basis of the obligation, the *O'Brien* principle would indeed be restitutionary. But should this test be a sufficient criterion to determine what the nature of the obligation is? Such a test does not distinguish between restitution as a primary obligation and restitution as a remedial obligation; in both situations the facts can satisfy the simplistic formula of 'restitution for unjust enrichment at the expense of the plaintiff.' To categorise a particular legal rule, it is necessary to look also at the policies pursued by the rule. The policy consideration behind *Barclays Bank v O'Brien* was stated clearly by Lord Browne-Wilkinson, namely, to draw a proper balance between, on the one hand, protecting wives who reposed trust and confidence in their husbands from entering into surety transactions upon the latter's abuses of such confidence, and, on the other hand, ensuring that matrimonial homes remain a viable and attractive source of security.³¹ Hence, only where the creditors have notice, actual or constructive, of such abuses would a surety transaction be set aside. The relevant conduct that is proscribed by the doctrine of notice is the creditors' knowingly taking advantage of the sureties' vulnerable position. This is not a restitutionary matter, for the rule laid down in

²⁷ See the remarks by Mason J in *Commercial Bank of Australia Ltd v Amadio* (note 5 above), p 463 that the absence of the duty in tort to make disclosure has no bearing on the availability of the equitable relief on the ground of unconscionability.

²⁸ Goff & Jones, *The Law of Restitution* (London: Sweet & Maxwell, 4th ed 1993), pp 284-6; Burrows, *The Law of Restitution* (London: Butterworths, 1993), p 197; Birks, *Introduction to the Law of Restitution* (Oxford: Clarendon Press, 1989), pp 458-61; *Restitution — The Future* (Sydney: The Federation Press, 1992), pp 43-52; Bamforth, 'Unconscionability as a Vitiating Factor' [1995] LMCLQ 538, 556.

²⁹ Goff & Jones (note 28 above); Burrows (note 28 above).

³⁰ Mee (note 3 above).

³¹ Note 1 above, pp 422-3.

O'Brien has never required that the surety transaction must be of benefit to the creditor. What is needed is a jurisdictional basis that focuses on the wrongful conduct of the creditor in entering into the transaction.

Unconscionability

In Australia,³² New Zealand,³³ and Canada,³⁴ the principle of *Barclays Bank v O'Brien* can be neatly analysed under the doctrine of unconscionability developed in *Commercial Bank of Australia Ltd v Amadio*. The doctrine states that:³⁵

[I]f A having actual [or constructive] knowledge that B occupies a situation of special disadvantage in relation to an intended transaction, so that B cannot make a judgment as to what is in his own interests, takes unfair advantage of his (A's) superior bargaining power or position by entering into that transaction, his conduct in doing so is unconscionable.

Might it not be argued that a wife who is subject to the undue influence or misrepresentation of her husband is in a situation of 'special disadvantage,' such that if the bank has notice, actual or constructive, of this situation, and still enters into the surety transaction, it will be acting unconscionably?³⁶ The key lies in what amounts to a situation of 'special disadvantage.' Mason J in *Amadio* endorsed the examples given by Fullagar J in *Blomley v Ryan*,³⁷ which include situations of poverty or need of any kind, sickness, age, sex, infirmity of body or mind, drunkenness, illiteracy or lack of education, and lack of assistance or explanation where assistance or explanation is necessary. He added that the common concern of these disabling conditions was that they seriously affected the ability of the innocent party to make a judgment as to his own best interests.³⁸ This underlying concern accords with that of the principle in

³² *Tresize v National Australia Bank* (1994) 122 ALR 185; *Akins v National Australia Bank* (1994) 34 NSWLR 155, Supreme Court of New South Wales.

³³ *Harlick v ASB Bank Ltd* [1995] 5 NZBLC 103.

³⁴ *Mackay v Bank of Nova Scotia* (1994) 20 OR (3d) 698, Ont Gen Div; *Royal Bank of Canada v Dominques* (1995) OJ No 35, Ont Gen Div; *Del Grande et al v The Toronto Dominion Bank* (1995) Coo J, Ont Gen Div. These cases are available on Lexis.

³⁵ Note 5 above, pp 467-7.

³⁶ Like undue influence, the doctrine is equally applicable to gifts as to contractual transactions. See *Louth v Diprose* (1992) 175 CLR 621; but see *Langton v Langton* [1995] 2 FLR 890.

³⁷ (1956) 99 CLR 362, 405.

³⁸ Note 5 above, p 462. It is appreciated that two members of the High Court had expressed views that the doctrine of undue influence and unconscionability were closely related but distinct from each other. The former was said to look at the quality of consent of the weaker party, the latter looked at the wrongful conduct of the stronger party: Mason J, p 461; Deane J, p 474. However, the view that undue influence looks at the overborne will of the complainant has been strenuously contended. See Winder, 'Undue Influence and Coercion' (1939) 3 MLR 97, 103; Cartwright, *Unequal Bargaining* (Oxford: Clarendon Press, 1991), p 196. But see Birks and Chin, 'On the Nature of Undue Influence' in Beatson and Friedman (eds), *Good Faith and Fault in Contract Law* (Oxford: Clarendon Press, 1995), pp 80-1. See also Bigwood, 'Undue Influence: "Impaired Consent" or "Wicked Exploitation"?' (1996) 16 OJLS 503.

O'Brien. In protecting wives who repose trust and confidence in their husbands, the ultimate aim is to ensure that the wives enter into contracts under conditions which best enable them to look after their own interests. In *Amadio* itself, an old Italian couple who had little command of English, and whose son abused the confidence they reposed upon him, were held to be unable to make a judgment as to what was in their best interests and thus occupied a situation of special disadvantage.³⁹

Thus far, it is clear that the underlying policy concerns of the doctrine of unconscionability and of the principle in *O'Brien* are common. The remaining difficulties in seeing unconscionability as the basis of the principle in *O'Brien* are the differences between these doctrines as to the process of proof. First, in *Amadio* it was not made clear whether the presence of undue influence per se was sufficient to render the couple to be in a situation of special disadvantage, or that it was also necessary that the couple were of advanced years, had little command of English, and lacked business expertise. As the very characteristic of being in a situation of special disadvantage is one's inability to act in one's best interests, and the consequence of undue influence is precisely to render the victim unable to act in his best interests, it is submitted that the presence of undue influence should per se be sufficient. Second, under *Amadio* the complainant need not show that the transaction is manifestly disadvantageous to him;⁴⁰ whereas a complainant trying to establish a case under *O'Brien* needs to show that the transaction is manifestly disadvantageous if presumed undue influence is concerned (Class 2), but not if actual undue influence is concerned (Class 1).⁴¹ Nonetheless, the decision of *National Westminster Bank v Morgan*,⁴² which held that manifest disadvantage must be shown in cases of presumed undue influence, was rightly criticised in *O'Brien*. The position may change in the future. Finally, the presumptions available to establish undue influence under Class 2(A) and 2(B) cannot be invoked to prove unconscionability. While this may pose greater difficulty where Class 2(A) undue influence is concerned, it appears that the practical effect of not being able to invoke the presumption is dismal in cases of Class 2(B) undue influence. This is because, in proving Class 2(B) undue influence, a complainant still has to show that he has reposed trust and confidence in the wrongdoer⁴³ for the presumption of undue influence to apply. Also, the risk of such Class 2(B) undue influence is sufficient to put the creditor on inquiry.⁴⁴ Similarly, in *Amadio* the old couple, by showing that they had placed reliance on their son, were held to be in a

³⁹ Note 5 above, pp 466-7.

⁴⁰ *Ibid*, p 475.

⁴¹ *CIBC Mortgages plc v Pitt* [1994] 1 AC 200. The classification was adopted in *O'Brien*.

⁴² [1985] AC 686.

⁴³ Where a wife complains that she has been unduly influenced by her husband, there will be an invalidating tendency which makes it easier for her to establish presumed undue influence under Class 2(B): see *Barclays Bank v O'Brien* (note 1 above), p 196.

⁴⁴ *Ibid*, p 197.

position of special disadvantage.⁴⁵ And, the possibility that they entered into the transaction upon such disadvantage is also sufficient to put the bank creditor on inquiry.

Once difficulties arising from the differences in the process of proof are resolved, the doctrine of unconscionability is superior to the other possible jurisdictional bases discussed above. As against the proprietary analysis, the doctrine of notice is invoked without the unnecessary confusion that it is to resolve priority conflicts. As against the equitable-tortious duty of care approach, it allows the victims an alternative restitutionary remedy. As against the restitutionary option, it focuses the analysis of the case rightly upon the wrongful conduct of the creditor.

The current difficulty for English, and Hong Kong, law is simply the lack of recognition of the doctrine of unconscionability.⁴⁶ However, there are signs that the picture may change. In the recent decision of *Credit Lyonnais Bank Nederland NV v Burch*, the English Court of Appeal, though obiter, stated emphatically that a legal charge provided by a junior employee for all present and future liabilities incurred by her employer's company, in which she had no financial interest, could be struck down as an unconscionable bargain.⁴⁷ Significantly, Millet J took the view that, in the context where a person provides a guarantee upon the undue influence of a third party, 'the two equitable jurisdictions (to set aside harsh and unconscionable bargains and to set aside transactions obtained by undue influence) have many similarities.'⁴⁸ In Hong Kong, the enactment of the Unconscionable Contracts Ordinance⁴⁹ provides, in appropriate cases, statutory relief for unconscionable contracts. The questions are: how far can a surety in a situation like *Barclays Bank v O'Brien* take the benefit of the new statutory regime, and to what extent will the presence of statutory unconscionability make it more likely for the doctrine to be accepted at common law?

The reception of the doctrine of unconscionability in Hong Kong

The Unconscionable Contracts Ordinance

Under the Unconscionable Contracts Ordinance, with respect to contracts made on or after 20 October 1995 for the sale of goods or supply of services in

⁴⁵ The difficulty remains that it is unclear whether the old couple's advanced years, lack of business expertise, and small command of English were also necessary to establish the position of special disadvantage.

⁴⁶ See *Boustany v Pigot* (1993) 69 P & CR 299, noted Cartwright, 'An Unconscionable Bargain' (1993) 109 LQR 530.

⁴⁷ Note 2 above.

⁴⁸ *Ibid.*

⁴⁹ s 5(1), Unconscionable Contracts Ordinance 1994 (UCO). Under s 1(2), it should come into operation on a day to be appointed by the Secretary for Trade and Industry by notice in the Hong Kong Government Gazette. He appointed 20 October 1995 (LN 476 of 1995). See also Wickens and Ong, 'The Unconscionable Contracts Ordinance' (1995) 25 HKLJ 321.

which one of the parties deals as consumer, if the courts find the contract or any part of it unconscionable they may refuse to enforce the whole or part of the contract, or limit, revise, or alter any unconscionable part of the contract. A plaintiff in a situation like *O'Brien* may claim relief under the ordinance subject to three hurdles: the limited scope of the ordinance, the establishment of unconscionability, and the limited range of remedies available under this ordinance.

The scope of the ordinance

The ordinance is very limited in scope. It applies only to *contracts* for the sale of goods or *supply of services*⁵⁰ in which one of the parties *deals as consumer*.⁵¹ The most difficult hurdle for an applicant is the requirement that he deals as consumer.⁵² 'Dealing as consumer' is defined in the three paragraphs under s 3(1), which mirrors s 12(1) of the Unfair Contract Terms Act 1977 in all material terms.⁵³ Under s 3(1)(a), one of the contracting parties — often the complainant — should neither make the contract in the course of a business nor hold himself out as doing so.⁵⁴ It is clear from *R & B Brokers Co Ltd v United Dominions*⁵⁵ that the mere fact that one contracts in a business capacity does not necessarily mean that one deals in the course of business. It is necessary that the transaction be integral to the company's business or, if not, that there is a degree of regularity. Hence, in the absence of a degree of regularity, a private company dealt as a consumer in purchasing a car for the business and personal use of its directors.

Unfortunately, even such a liberal interpretation is unlikely to help some victims in situations like *O'Brien*. They may provide guarantees as directors of family (or shelf) companies⁵⁶ or as partners of family partnerships.⁵⁷ The borrowing of money to finance a company's ventures is certainly within its

⁵⁰ Hong Kong Law Reform Commission, 'Report on Sale of Goods and Supply of Services [Topic 21], para 6.2.3. The Law Reform Commission prefers the exclusionary approach in the Supply of Goods and Services Act 1982 (UK), which leaves the term 'services' undefined but then authorises the Secretary of State to exempt specified services. Under the Unconscionable Contracts Ordinance there is no similar power of exemption, but s 2(2) excludes contracts of apprenticeship from contracts of services, and clarifies that contracts of services remain so notwithstanding that goods are also transferred or bailed under such contracts. In Australia, a slightly different approach is taken, namely, without limiting the generality of the term, 'services' is defined as including, inter alia, banking services (s 4(1)(c), Trade Practices Act 1974 (Cth)). Common in the definitions of these three statutes is the advantage of not exhaustively listing what counts as 'services' and so giving the term its fullest possible scope. Given such an approach to definition, it is submitted that the omission of the Hong Kong legislation to positively include banking services should not be interpreted as a restrictive step. Indeed, the Law Reform Commission itself, in providing an example of unconscionability, refers to credit card services, which are typically provided by banks: para 7.6.2.

⁵¹ s 5(1) UCO.

⁵² *Ibid.*

⁵³ Except that s 12 UCTA 1977 covers only contracts for the sale of goods.

⁵⁴ s 3(1)(a) UCO.

⁵⁵ [1988] 1 All ER 847.

⁵⁶ As in *Del Grande v The Toronto Dominion Bank* (note 34 above).

⁵⁷ As in *Swift v Westpac Banking Corporation* (1995) Federal Court of Australia, Queensland (Gen Div), Kiefel J.

power.⁵⁸ Hence, these sureties will not be considered as 'dealing as consumers' and will be excluded from the protection of the Unconscionable Contracts Ordinance.⁵⁹ One justification for this result may be that individuals who voluntarily choose to assume business capacities should not enjoy the benefit of consumer protection legislation. But such a justification ignores the fact that a person who provides a guarantee under the undue influence of the debtor may also assume his business capacity under the same kind of influence.⁶⁰ In *Del Grande v The Toronto Dominion Bank*, where a wife provided a guarantee as the one-third shareholder of a family company in which she had never played an active role, the Ontario Court of Justice rejected the bank's defence that the corporate procedures could be applied to her because of the business capacity.⁶¹ It is hoped that the courts in Hong Kong will adopt a similar approach. Otherwise, a fraudulent principal debtor who is more careful in planning his fraud can effectively oust the Unconscionable Contracts Ordinance.

Under s 3(1)(b), the other party must enter into the contract in the course of a business. The bank-creditor, the other party to the contract, will have little difficulty establishing this requirement.

Finally, under s 3(1)(c), the services provided under or pursuant to the contract under examination must be of a type 'ordinarily supplied or provided for private use, consumption or benefit.' The relevant service in a surety transaction is the loan facility offered to the principal debtor. In *Begbie v State Bank of New South Wales Ltd*, in determining whether the loan was for private or business purposes the court looked at the use intended by the debtor, not the surety.⁶² This court further held that a loan for the purchase of a private residence was private, whereas a loan to assist a corporation to buy a business or undertake commercial development was commercial.⁶³ While such a guideline offers some help, it is certainly inadequate in characterising projects that fall within these two extremes. What if, as a common phenomenon in Hong Kong, the purchaser of a residential property operates his import/export

⁵⁸ *Re Introductions Ltd* [1970] Ch 199; *Rolled Steel Products v British Steel Corporation* [1986] Ch 246.

⁵⁹ A similar requirement in s 51AB of the Trade Practices Act 1974 has been held to exclude commercial transactions: *Begbie v State Bank of New South Wales* (1994) ATPR 4-288; *ANZ Banking Group v Harvey* (1994) ATPR 46-1323; *Swift v Westpac Banking Corporation* (note 57 above). In Australia, unconscionability in commercial dealings is dealt with separately under s 51AA. There is no equivalent section in Hong Kong.

⁶⁰ *Malayan Banking Bhd v Kim Produce Pte Ltd* [1991] 2 MLJ 448, where an inexperienced businessman who guaranteed the debt of a company with which he was a sleeping director successfully set aside the guarantee against the bank on the basis of misrepresentation by the managing director of the debtor company.

⁶¹ Note 34 above, pp 96-7, per Coe J: 'I understand the technical point sought to be made, but am unimpressed.'

⁶² Note 59 above.

⁶³ *Ibid.* *Begbie* concerns a similar requirement under s 51AB(5) of the Trade Practices Act that the service must be 'of a kind ordinarily acquired for personal, domestic or household use.' In this case, the woman who provided the mortgage was herself a co-venturer with the principal debtor, Anivor Ltd. She thought that the loan was used by the company for property development, but the other directors used the money to pay their personal loans.

business in the premises? Moreover, as s 3(1)(c) seems not to be drafted with tri-partite contractual situations in mind, a fundamental problem arises. Take the example of a housewife who provides a personal spousal guarantee to secure a loan granted to her husband solely to fund his business ventures, in which she is completely uninvolved. This example will fall outside s 3(1)(c) because the loan is used by the debtor for business purposes. However, at common law this transaction would have immediately put the creditor on inquiry,⁶⁴ because it is on its face of no financial advantage to the wife and it runs the substantial risk of undue influence or misrepresentation having been committed to a person under emotional ties to another. Ironically, the ordinance is not available when the vulnerable surety needs it most.

The finding of unconscionability

Even if an applicant can show that the surety contract falls within the scope of the ordinance, he has to overcome another hurdle, that the contract, or part of it, is unconscionable.⁶⁵ In determining whether unconscionability is established, the court may consider, *among other things*, five circumstances listed in s 6(1) of the ordinance.⁶⁶ These circumstances are copied verbatim from those listed in s 51AB of the Trade Practices Act 1974 (Commonwealth of Australia). Ideally, this allows Hong Kong courts to benefit from the equivalent Australian jurisprudence. But only a fraction of the full package has been imported, and that small fraction is of cold comfort to a surety who provides a guarantee as a result of misrepresentation or undue influence by the principal debtor.

Misrepresentation, whether by the contracting party or a third party, is not even included in the circumstances listed under s 6(1). The omission in s 51AB of the Trade Practices Act 1974 (Cth) is justifiable, as deceptive or misleading conduct is dealt with separately under s 52.⁶⁷ Regrettably, it is not so under the Hong Kong legislation. The closest circumstance under s 6 which might be relevant to misrepresentation is s 6(1)(c), whether the consumer is able to understand the documentation. However, an ordinary and natural reading of this paragraph shows that it refers to the consumer's general intellectual or linguistic ability rather than any misunderstanding arising from misrepresentation by other persons. While undue influence by the immediate contracting party or someone acting on his behalf is a relevant circumstance under s 6(1)(d), this paragraph does not include undue influence by someone in a

⁶⁴ *Durrant v Ecclesiastical Building Society* [1994] 2 FLR 551.

⁶⁵ s 5(2) UCO: the burden of proof is on the person who claims that the contract or part of it is unconscionable.

⁶⁶ s 6(1) UCO.

⁶⁷ s 52 TPA. See Meagher, Gummow, & Lehane, *Equity: Doctrines and Remedies* (Sydney: Butterworths, 3rd ed 1992), pp 360-4; *Alderton v The Prudential Assurance Co Ltd* (1993) 41 FCR 435; *Burke v State Bank of NSW Ltd*, NSW SCt, 17 October 1994. Both cases are decided under s 42(1), Fair Trading Act (NSW) 1987, which corresponds to s 51AB TPA.

situation where the contracting party would be fixed with notice under *Barclays Bank v O'Brien*. The apparent gap in the corresponding subsection of the Trade Practices Act 1974 (Cth) is filled by s 75B(c), which extends liability to a person who has been, directly or indirectly, knowingly concerned in, or party to, the contravention.⁶⁸ These two omissions are good examples of the potential problems of merely importing the operative section of foreign legislation without taking into account the comprehensive legislative framework for that section.

Fortunately, the circumstances listed in s 6(1) of the Unconscionable Contracts Ordinance are not exhaustive. The Hong Kong courts are not precluded under the ordinance from deciding that a surety agreement is unconscionable because the creditor has notice of misrepresentation or undue influence by the principal debtor. But without the benefit of the statutory circumstances, which are often broader in scope than their counterparts at common law,⁶⁹ it is doubtful if the courts would go beyond the existing scope of the common law.⁷⁰

Remedies under the ordinance

If the remedies available under the ordinance were more extensive than those under common law, victims in situations like *O'Brien* might still wish to rely on the statutory regime. But again, the ordinance is likely to disappoint. Under s 5, the courts are only given express discretion to refuse to enforce the contract (s 5(1)(a)), to enforce the remainder of the contract without the unconscionable part (s 5(1)(b)), or to limit the application of, or revise or alter, any unconscionable part (s 5(1)(c)).⁷¹

As compared with the remedial regime in the Trade Practices Act 1974 (Cth) for unconscionable conducts, the Hong Kong legislation does not provide the wider range of remedies available under the former, for example injunction (s 80(1)), remedial orders under s 87(1) and (1A), which include restitution of money or property (s 87(2)(c)), payment of compensatory damages (s 87(2)(d)), repair or provision of parts for goods supplied (s 87(2)(e)), supply of specified services (s 87(2)(f)), and variation or termination of an instrument creating or transferring an interest in land (s 87(2)(g)).⁷²

⁶⁸ It is appreciated that the scope under s 75B(c) and that under *O'Brien* may not necessarily be identical, but this depends on how the words 'indirectly, knowingly concerned' are interpreted. See also s 9(2)(j) of the Contracts Review Act 1980 (NSW), which covers the 'undue influence ... exerted by any person to the knowledge ...' of the contracting party.

⁶⁹ s 6 UCO includes such circumstances as the inequality of bargaining power, the inclusion of unreasonable terms, and the use of unfair tactics, all of which are unlikely to be sufficient reasons on their own for setting aside contracts at common law.

⁷⁰ See Heydon, *Cases and Materials on Equity and Trusts* (Sydney: Butterworths, 4th ed 1992), p 327 for the view that the main advantage of the statutory regime is remedial, not substantive.

⁷¹ s 5(1)(a)–(c) UCO.

⁷² See Tonking, 'Remedies under the Trade Practices Act 1974 — Statutory, Legal and Equitable' (1979) 53 ALJ 770.

As compared with the remedial regime at common law (and equity), the statutory options under s 5(1) of the Unconscionable Contracts Ordinance may be wider, in that the power to refuse to enforce the entire contract under s 5(1)(a) is not subject to preconditions like equitable bars to rescission.⁷³ Nonetheless, courts in Australia have held that those bars, albeit not being fetters to the exercise of the court's discretion, are relevant considerations.⁷⁴ In any case, s 6(3) of the Unconscionable Contracts Ordinance allows the court to take into account the conduct of the parties in relation to the performance of the contract in deciding what relief to give. Moreover, the powers to enforce part of the contract or to vary its terms (s 5(1)(b) & (c)) are traditionally not available under the equitable remedy of rescission, which relates to the entire contract. However, this wider power is not necessarily for the benefit of a victim of unconscionability.⁷⁵ He may prefer to have the entire contract set aside. And if the availability of rescissionary bars was a relevant consideration in deciding whether to refuse to enforce the entire contract, whatever remedial gains there might be in bringing a claim under the ordinance rather than at common law remain uncertain. It is hoped that the Hong Kong courts would adopt the generous approach in *West v AGC (Advances) Ltd*,⁷⁶ which held that the unconscionability legislation was beneficial legislation and should be interpreted liberally, so that its remedial reliefs should not be fettered by the scope of the remedies at common law.

Worse still, the scope of s 5(1)(a) may be narrower than the equitable remedy of rescission, in that while the courts have power in equity to order the mutual restitution of benefits conferred under a contract rescinded ab initio, they are not expressly so authorised under s 5.⁷⁷ The wording of s 5(1)(a) — 'refusal to enforce the contract' as opposed to declaration that the contract is 'void ab initio' (s 87(2)(a), TPA 1974) — also make it difficult to imply such a power. If restitutionary remedies were not available under s 5, victims of unconscionability would prefer to pursue the more familiar remedies under common law. If this is the case, the purpose of the statutory regime will be frustrated.⁷⁸

⁷³ Meagher, Gummow, & Lehane (note 67 above), para 1324.

⁷⁴ *Mister Figgins Pty Ltd v Centrepont Freehold Pty Ltd* (1981) 36 ALR 23; *Creative's Landscape Design Centre Pty Ltd v Platz* [1989] ATPR 40-980; *Argy v Blumts and Lane Cove Real Estate Pty Ltd* (1990) 26 FCR 112.

⁷⁵ The complainants in *Allied Irish Bank v Byrne* [1995] 1 FLR 430, affirmed by the Court of Appeal in *TSB plc v Camfield* [1995] 1 All ER 951, were able to benefit from the all-or-nothing nature of rescission. In *Camfield*, the court adhered to the traditional approach that rescission must be of the entire contract, and did not approve the contrary approach in *Midland Bank v Greene* [1994] 2 FLR 827 and *Bank Melli Iran v Samadi-Rad* [1995] 2 FLR 367. However, in *Vadasz v Pioneer Concrete (SA) Pty Ltd* (1995) 130 ALR 570 the High Court of Australia disapproved of the approach in *Camfield*.

⁷⁶ (1986) 5 NSWLR 610, 612 (Kirby P) and 631 (McHugh JA).

⁷⁷ Yeo, 'Case Digest — Asia Pacific' [1994] Restitution Law Review 120.

⁷⁸ See the warning by Kirby P in *West v AGC (Advances) Ltd* (note 76 above), p 612A-D.

The doctrine of unconscionability at common law

Thus far, it has been argued that because of the limitations of the Unconscionable Contracts Ordinance, the common law will continue to be of primary importance in protecting sureties in situations like *O'Brien*. As for the common law position in Hong Kong, it is unfortunate that there is a dearth of decisions in this area.⁷⁹ Moreover, the handful of local decisions reveal a reluctance to resile from the general rule that an individual is bound by his signature to a document.

It is proposed that we look at three strands of local decisions to illustrate the restrictive approach of the Hong Kong courts: (1) cases in which the doctrine of unconscionability was pleaded but the facts of the cases did not raise the issue of wrongful third-party inducement to contract as in *Barclays Bank v O'Brien*; (2) cases which contained facts that raised the above issue but the decisions were not based on it; (3) decisions on the common law doctrine of non est factum.

The doctrine of unconscionability as developed under *Amadio* has rarely been argued in Hong Kong as a distinct ground for rescinding or not enforcing contracts. Only one such instance can be found, but the complaint was not successful. In *OTB International Credit Card Ltd v Au*,⁸⁰ the Court of Appeal held that an express term in a credit card agreement requiring the cardholder to 'immediately notify the loss to the Company by registered mail or telegram' was not unconscionable, as the clause was reasonably necessary for the protection of the legitimate interests of the company, which should not be made responsible indefinitely for a lost card. Despite the misleading use of the word 'unconscionability' in this case, what the court was concerned with was the common law doctrine of restraint of trade expounded in *Schroeder Music Publishing Co v Macauley*,⁸¹ or the short-lived doctrine of inequality of bargaining proposed by Lord Denning,⁸² not the equitable doctrine of unconscionability developed after *Amadio*. Moreover, in this case, the cardholder did indeed report the loss to the credit card company immediately, albeit by telephone. He was made responsible for purchases that were made after the telephone call but before his confirmation of the loss in writing. Hence, the real issue, which has never been addressed by the court, is whether the term contains unnecessary restrictions *reasonably capable of enforcement in an oppressive manner*, especially in the circumstance that the loss has already been reported by another means.

In contrast, the facts of some cases have provided excellent opportunities for developing a local jurisprudence on the *O'Brien* issue, but this possibility has

⁷⁹ See B Ho, *Contract Law in Hong Kong* (Hong Kong: Butterworths, 2nd ed 1994), pp 224–31.

⁸⁰ [1980] HKLR 296; [1980] HKC 219; referred to in Hong Kong Law Reform Commission (note 50 above), paras 7.3.4–5.

⁸¹ [1974] 1 WLR 1308, 1313–14.

⁸² *Lloyds Bank v Bundy* [1975] 1 QB 326, 336–7.

not been fully explored. In *Kincheng Banking Corporation v Chan Siu-kit and Kao Yu-kuei*,⁸³ the creditor bank sued Kao, who understood Mandarin but not Cantonese, as guarantor to a debt owed by the principal debtor. After holding that the guarantee was void as non est factum,⁸⁴ the trial judge held that the guarantor had a good defence to the creditor's claim because he signed upon the fraudulent misrepresentation of the principal debtor, and the bank did not read or explain the document to him in Mandarin, the language that he understood. The Court of Appeal reversed the first instance decision on both points. On the latter point, the court held that even if the guarantor had acted upon the fraudulent misrepresentation of the principal debtor, the bank was not bound because the debtor was not its agent, nor was the bank a party to, or aware of, the fraud.⁸⁵ This was because it had no reason to doubt the guarantor's understanding of Cantonese. Significantly, although these propositions regarding the issue of third-party misrepresentation were not fully explained, the court should be congratulated for adopting a framework of analysis that accorded with that in *Barclays Bank v O'Brien*, that is, the creditor would be liable if the third party was its agent or if it was aware of (had reason to suspect) the fraud. However, important questions that should have been asked under this framework were not asked. For example, why was it so easily assumed that the bank had no reason to doubt the guarantor's understanding of Cantonese? Given that the Court of Appeal accepted the trial judge's finding of fact that the guarantor had limited command of Cantonese, would not any bank officer who had cared to converse with the guarantor directly have discovered the reality?⁸⁶ Moreover, the court's extreme reluctance to hold the bank affected by the misrepresentation was due to its view that banks owed no duty to explain documents in any particular dialects. In this the court has failed to appreciate that the absence of a tortious duty of explanation, breach of which would attract compensatory damages, is compatible with fixing notice upon the lack of explanation, which only renders the guarantee rescindable at the option of the guarantor.⁸⁷ More unfortunately, even after *Barclays Bank v O'Brien* was decided the High Court failed to explore the opportunity offered by a recent decision which contained facts that closely resembled *O'Brien*. In *Startford Ltd v Lam Mui-fong*,⁸⁸ a wife who had granted a second mortgage of her flat to the plaintiff argued, inter alia, that she signed the relevant documents as a result of

⁸³ [1986] HKC 212, CA. See, on the other hand, *Cheung Pik-wan v Tong Sau-ping* [1986] HKLR 921: an illiterate lady who was fraudulently induced by a third party to execute a power of attorney in his favour to deal with her property was allowed to set aside an assignment of the property pursuant to that document as against someone who was not a bona fide purchaser for value without notice. The situation can be distinguished from *O'Brien* because the lady here did have a mere equity against the third party to set aside the power of attorney for fraud.

⁸⁴ Discussion of this aspect of the decision will be postponed. See notes 90–6 below.

⁸⁵ Note 83 above, p 215E.

⁸⁶ Such an inference was made by Hunter J in *Cheung Pik-wan v Tong Sau-ping* (note 83 above).

⁸⁷ *Commercial Bank of Australia Ltd v Amadio* (note 5 above), p 463.

⁸⁸ (1995) HCt, MP No 91 of 1995, Yam J. For criticism of this case, see Nossal, 'The Enforcement of Security Obtained by Third Party Wrongdoing' [1996] *Asia Pacific Law Review* (forthcoming).

misrepresentation by her husband and his friend Lee Kwok-tim, to whom her husband owed a gambling debt of HK\$3.8 million. Yam J quickly dismissed the argument on the basis that, whether Lee had made a misrepresentation or not, he was not the plaintiff's agent. Again, agency aside, the doctrine of notice was not referred to, by counsel or court, let alone *Barclays Bank v O'Brien*. No evidence was adduced as to the relationship between the plaintiff and Lee, nor was there any argument made on the possibility of undue influence by the husband (and Lee) on the wife — especially the implications arising from possible cultural differences in the marital relationship. It is unfortunate that the litigants in both *Kincheng Banking Corporation* and *Startford Ltd* put the emphasis of their pleadings on the doctrine of non est factum, which was much stricter than the equitable doctrine of notice under *O'Brien*.

The last strand of Hong Kong decisions contains cases which pleaded the common law doctrine of non est factum. This doctrine allows a person who suffers from a disability and who signs without negligence to deny a document which is radically different from what he believed he was signing. Since the signatory is in essence pleading that 'this is not my deed,' the plea is available even if the mistaken belief is induced by fraud or misrepresentation of a third party.⁸⁹ Nonetheless, because of its limited scope, it is rarely used in England and Australia by victims in situations like *O'Brien*. In Hong Kong, however, the plea is invoked more often, albeit for no apparent benefit to the victims, since the courts in Hong Kong have also confined the doctrine to a very narrow scope.⁹⁰ This restrictive approach can be seen in that, in deciding whether the document is radically different from what the signatory believed he was signing, the Hong Kong courts have held that a bare assertion that one did not understand the language in which the contract was written would not suffice,⁹¹ unless the signatory was also illiterate.⁹² Hence, linguistic illiteracy is distinguished from illiteracy generally. The courts have been equally unsympathetic towards legal or business illiteracy. In *Kincheng Corporation*, the Court of Appeal held that a guarantor who did believe he was signing a guarantee but mistakenly thought that a guarantee did not involve any liability to repay still understood the nature of the document and was merely unable to appreciate its precise effect.⁹³

In considering another element of the plea of non est factum, namely whether the signatory has been negligent, the courts have also been strict. They

⁸⁹ *Saunders v Anglia Building Society* [1971] AC 1004; *Lloyds Bank plc v Waterhouse* [1991] Fam Law 23.

⁹⁰ *Saunders v Anglia Building Society* (note 89 above); *Norwich and Peterborough Building Society v Steed* [1993] Ch 116.

⁹¹ *Union Bank of Hong Kong Ltd v Ng Yiu-hing* [1974] HKLR 26 (a factory owner claimed he could not understand a guarantee that was written in English); *Kincheng Banking Corporation v Chan Siu-kit* (note 83 above) (a Mandarin speaker claimed he could not understand a guarantee that was explained to him in Cantonese).

⁹² *Cheung Pik-wan v Tong Sau-ping* (note 86 above), p 927 (the plaintiff could neither read the document nor understand the Cantonese explanation of it); *Gilman & Co Ltd v Ho So-wah* [1985] HKDCLR 29, Judge Downey.

⁹³ Note 83 above.

adopted the general rule that it was negligent to sign documents in blank merely upon another person's oral explanation of its legal effect.⁹⁴ *Kincheng Corporation* even went as far as to say that 'anyone who signs a document in a language he does not understand is necessarily negligent unless he has been actively misled as to its nature.'⁹⁵ Given that in Hong Kong most legal documents are still written in English and that a significant proportion of the population is illiterate in English, one wonders what practical scope this statement leaves for non est factum.

Our brief survey of the Hong Kong decisions shows that, in Hong Kong, the equitable doctrine of unconscionability is regrettably undeveloped. Litigants have yet to explore the potential benefits of *Barclays Bank v O'Brien*. As a result, any prediction on the response of the Hong Kong courts to *O'Brien* would be highly conjectural. But if the local jurisprudence on non est factum is any hint, the signs are that the courts adhere faithfully to the classical doctrine that one should be bound by one's signatures, and have not adapted principles derived from English law to suit local circumstances, for example, the linguistic difficulties of the local population and the different attitude it might adopt towards marital relationships.

Conclusion

In this paper it has been argued that the doctrine of unconscionability as developed in *Commercial Bank of Australia Ltd v Amadio* provides the best basis for the principle in *Barclays Bank v O'Brien*. It is admitted that, owing to their separate developments, there still are numerous differences between these two equitable jurisdictions as to the process and burden of proof. It remains to be seen how future courts might tackle these differences and synchronise the two doctrines. In particular, it is regrettable that the courts in Hong Kong have so far adhered strictly to the classical doctrine that an individual is bound by his signature. But, in light of the recent enactment of the Unconscionable Contracts Ordinance and the step taken by the House of Lords in *O'Brien* to protect vulnerable parties to transactions, it is hoped that the Hong Kong courts will take up these opportunities and develop a doctrine to protect vulnerable sureties that truly befits local needs.

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⁹⁴ *Union Bank of Hong Kong Ltd v Ng Yiu-hing* (note 91 above), Pickering J; *Sung Hung Kai Credit Ltd v Szeto Yuk-mei* [1985] 1 HKC 345, Judge Downey. The only exception is *Gilman & Co Ltd v Ho So-wah* (note 92 above) where Judge Downey held that the requirement of negligence should only apply when non est factum was pleaded against a third party to the contract. This proposition is not supported by *Saunders v Anglia Building Society* (note 89 above), nor is the principle applied in any other local decisions.

⁹⁵ Note 93 above, per Sir Alan Huggins. *Cheung Pik-wan v Tong Sau-ping* (note 86 above) provides an example where the complainant is misled.

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