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Contracts Review Act Defences to Mortgages

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16. Examinations under the Corporations Act and ASIC Act *5 March 2012*†

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A. Introduction

The Contracts Review Act was passed in 1980. Lacking a body of precedent to define its almost limitless reach, the courts at first shied away from implementing the Act, except in accordance with the principles of existing equitable relief. This approach was criticised by all of the judges of the Court of Appeal in the 1986 case of *West v AGC (Advances) Limited*[1] Kirby P noting:

> It is ...surprising that, although the Act has now been in force for more than six years, few are the cases in which its relief has been claimed. Fewer still are the cases in which the court has provided relief. Where such a radical disturbance of time-honoured concepts governing contractual relations between parties intrudes upon settled law, there is a natural disinclination to apply the statute as its language would suggest the Parliament to have envisaged. There is an equal inclination to by-pass the full consequences of such novel provisions by avoiding the application of the statute altogether and relying upon previously settled and more familiar avenues of redress. Alternatively, even where (as here) the statute has been held to apply, the wide jurisdiction afforded to the court may be read down, out of deference to concepts of relief which predate the enactment of its beneficial provisions. These inclinations should be recognised so that they may be resisted.

West marked a watershed and since then the Act has been given increasingly wider and more regular application. However from the beginning there has been a reluctance to penalise lenders for unjust circumstances of which they were ignorant or were not of their doing. In *West v AGC (Advances) Ltd & Ors*[2] *p*er McHugh JA (Hope JA agreeing):

> "Under this Act, a contract will not be unjust as against a party unless the contract or one of its provisions is the product of unfair conduct on his part either in the terms which he has imposed or in the means which he has employed to make the contract."

This position was eroded in the first instance in theory only in the case of *Beneficial Finance Corp Limited v Karavas*[3] with Meagher JA noting:

> "There is jurisdiction under the Act to make orders in favour of a party to a contract who proves that at the date of the contract he suffers from a relevant disability even though the other party to the contract is unaware of that disability, although in general it would be unsound to exercise the jurisdiction in those circumstances. … The reason for that view is that it is hardly just to deprive an innocent person of valuable property, of which contractual rights are a species. Nevertheless such a jurisdiction undoubtedly exists."

Gradually the Courts have evolved an approach which, which found its culmination in *Perpetual Trustee Company Limited v Albert and Rose Khoshaba*[4]*,* that where the lender is

[1] 1986 5 NSWLR 610
[2] (1986) 5 NSWLR 610
[3] (1991) 23 NSWLR 256 at 277
[4] [2006] NSWCA 41

engaged in *asset lending* it cannot be regarded as an innocent party (regardless of its ignorance of the circumstances which make the loan unjust from the mortgagor's point of view). Spigelman CJ holding:

> "In my opinion the Appellant cannot be regarded as an innocent party of the kind referred to in the authorities. Again I place particular reliance on the indifference of the Appellant and its representatives to the purpose of the loan, indicating that it was content to proceed on the basis enforcing the security."

Basten JA agreed noting:

> "To engage in pure asset lending, namely to lend money without regard to the ability of the borrower to repay by instalments under the contract, in the knowledge that adequate security is available in the event of default, is to engage in a potentially fruitless enterprise, simply because there is no risk of loss. At least where the security is the sole residence of the borrower, there is a public interest in treating such contracts as unjust, at least in circumstances where the borrowers can be said to have demonstrated an inability reasonably to protect their own interests."

The Act therefore now captures not only unfair behaviour by lenders but also reckless behaviour (asset lending) in circumstances where the circumstances from the mortgagor's perspective are otherwise unjust and is for that reason of great concern to so called *low-doc* lenders and *no-doc* lenders. The fact lenders can lose their money as a result of circumstances of which they had no knowledge of has sent shockwaves through the lending industry. However a careful study of the authorities reveals that the incidence of the Act's application is not random and lenders can tailor their underwriting policies so as to avoid it being successfully invoked against them.

B. The Act's parameters

1. The main provisions

The main provision of the Act is section 7 which reads:

1) Where the Court finds a contract or a provision of a contract to have been unjust in the circumstances relating to the contract at the time it was made, the Court may, if it considers it just to do so, and for the purpose of avoiding as far as practicable an unjust consequence or result, do any one or more of the following:

    (a) it may decide to refuse to enforce any or all of the provisions of the contract,

    (b) it may make an order declaring the contract void, in whole or in part,

    (c) it may make an order varying, in whole or in part, any provision of the contract,

    (d) it may, in relation to a land instrument, make an order for or with respect to requiring the execution of an instrument that:

        (i) varies, or has the effect of varying, the provisions of the land instrument, or

        (ii) terminates or otherwise affects, or has the effect of terminating or otherwise affecting, the operation or effect of the land instrument.

Section 9 provides the matters to be considered by the Court when determining whether, for the purpose of section 7, a contract is unjust.

1) In determining whether a contract or a provision of a contract is unjust in the circumstances relating to the contract at the time it was made, the Court shall have regard to the public interest and to all the circumstances of the case, including such consequences or results as those arising in the event of:

    (a) compliance with any or all of the provisions of the contract, or

    (b) non-compliance with, or contravention of, any or all of the provisions of the contract.

2) Without in any way affecting the generality of subsection (1), the matters to which the Court shall have regard shall, to the extent that they are relevant to the circumstances, include the following:

    (a) whether or not there was any material inequality in bargaining power between the parties to the contract,

    (b) whether or not prior to or at the time the contract was made its provisions were the subject of negotiation,

    (c) whether or not it was reasonably practicable for the party seeking relief under this Act to negotiate for the alteration of or to reject any of the provisions of the contract,

    (d) whether or not any provisions of the contract impose conditions which are unreasonably difficult to comply with or not reasonably necessary for the protection of the legitimate interests of any party to the contract,

    (e) whether or not:

        (i) any party to the contract (other than a corporation) was not reasonably able to protect his or her interests, or

        (ii) any person who represented any of the parties to the contract was not reasonably able to protect the interests of any party whom he or she represented,

    because of his or her age or the state of his or her physical or mental capacity,

    (f) the relative economic circumstances, educational background and literacy of:

        (i) the parties to the contract (other than a corporation), and

        (ii) any person who represented any of the parties to the contract,

    (g) where the contract is wholly or partly in writing, the physical form of the contract, and the intelligibility of the language in which it is expressed,

    (h) whether or not and when independent legal or other expert advice was obtained by the party seeking relief under this Act,

    (i) the extent (if any) to which the provisions of the contract and their legal and practical effect were accurately explained by any person to the party seeking

relief under this Act, and whether or not that party understood the provisions and their effect,

(j) whether any undue influence, unfair pressure or unfair tactics were exerted on or used against the party seeking relief under this Act:

(i) by any other party to the contract,

(ii) by any person acting or appearing or purporting to act for or on behalf of any other party to the contract, or

(iii) by any person to the knowledge (at the time the contract was made) of any other party to the contract or of any person acting or appearing or purporting to act for or on behalf of any other party to the contract,

(k) the conduct of the parties to the proceedings in relation to similar contracts or courses of dealing to which any of them has been a party, and

(l) the commercial or other setting, purpose and effect of the contract.

3) For the purposes of subsection (2), a person shall be deemed to have represented a party to a contract if the person represented the party, or assisted the party to a significant degree, in negotiations prior to or at the time the contract was made.

4) In determining whether a contract or a provision of a contract is unjust, the Court shall not have regard to any injustice arising from circumstances that were not reasonably foreseeable at the time the contract was made.

5) In determining whether it is just to grant relief in respect of a contract or a provision of a contract that is found to be unjust, the Court may have regard to the conduct of the parties to the proceedings in relation to the performance of the contract since it was made.

2. General comments on the Act

The most quoted judicial commentary on the Act comes from *West v AGC (Advances) Limited* per McHugh J[5]:

> "The *Contracts Review Act* 1980 is revolutionary legislation whose evident purpose is to overcome the Common Law's failure to provide a comprehensive doctrinal framework to deal with "unjust" contracts. Very likely its provisions signal the end of much of classical contract theory in New South Wales. Any contract or contractual provision, not excluded from the operation of the Act and which the Court considers is unjust in the circumstances existing at the time when it was made, may be the subject of relief under the Act. Moreover, the provisions of s9(2) do not exhaustively indicate the criteria as to what can be taken into account in determining whether a contract or any of its provisions is unjust… the Court is entitled to have regard to all the circumstances of the case, subject to s9(4) and the public interest ..."

This does not amount to a unbridled rejection of the sanctity of contract as Sully J in W*estpac v Gordon and Reilly*[6] noted:

> "It would not accord… with the legislative will …to interpret and apply the provisions of the Act as to make any contract which falls within the … ambit of the Act nothing more than a provisional engagement, the obligations and entitlements under which … depending upon the view which happens to be taken by a particular Judge……No doubt the Act may be understood as expanding the nature and the scope of circumstances in which the law will interfere with a contractual engagement that is on its face regular. But it does not follow, in my opinion, that in such a case the Bank is to be treated as though it were a charitable foundation, a social welfare agency, or a conduit for the provision of legal aid services. To hold otherwise would be, in practical terms, to destabilise normal commercial intercourse, a cardinal component of which is, in the nature of things, certainty as to entitlements and obligations."

Similar sentiments were echoed by Basten JA in *Perpetual Trustee Company Limited v Albert and Rose Khoshaba*[7] at paragraph 115:

> "That is not to say that the Court is launched on an uncharted sea with no navigational guides, but rather that constraints which would preclude intervention according to established principles of legal or equitable doctrine, may not be decisive under the Act. Thus, while equity provides relief against the unconscientious conduct of the defendant, the Act may permit relief in circumstances where the conscience of the defendant is not affected. Similarly, a contract, or a provision thereof, may be unjust in circumstances where there was no pre-existing duty owed by, say, a lender to a borrower to act in a particular way."

[5] 1986 5 NSWLR 610 at 621
[6] (unrep, SCNSW, 1/4/93)
[7] [2006] NSWCA 41

During the Second Reading debate the Minister who introduced the Bill, quoted a statement of Professor Peden who said that the legislation was[8]:

> "… intended to confer on the courts a new and wide discretion to determine the existence and extent of harshness in a contract, and thereby develop a doctrine of unconscionability suitable to present and future business and community needs and standards"

This statutory *doctrine of unconscionability* is still developing and will no doubt continue to evolve. In *Perpetual Trustee Company Limited v Albert and Rose Khoshaba*[9] Chief Justice Spigelman noted:

> "In many respects this case, in its basic structure, is similar to that considered by this Court in *West v AGC (Advances) Ltd* (1986) 5 NSWLR 610 where the Court held, by majority, that the contract was not "unjust"… Of course each case must depend upon its own facts. Furthermore, *West* is now 20 years old. When the Parliament adopts so general, and inherently variable, a standard as that of 'justness', Parliament intends for courts to apply contemporary community standards about what is just. Such standards may vary over time, particularly over a period of two decades.

3. Fraud and *non est factum*

A borrower claiming forgery or *non est factum* will, in the case of a registered mortgage[10], be unable to have the mortgage set aside. The principles of indefeasibility operate to protect the innocent registered mortgagee (pursuant to section 42 of the Real Property Act). In these circumstances the courts have held there is no contract to review. This was confirmed by Dunford J in *Permanent Trustee Company Limited v Frazis*[11]who held:

> "I fail to see how parties who deny that they entered into a contract can at the same time argue that such contract was unjust. The *Contracts Review Act 1980* is an Act designed to review unfair contracts, not an Act to set aside … obligations constituted by forged documents. The applicants' present predicament is not due to them having entered into a contract which was "unjust" within the meaning of that Act, but to the operation of the relevant provisions of the *Real Property Act 1900* and in particular to the force and effect which that Act gives, on registration, to forged instruments.[12]"

In *Small & Ors v Gray & Ors*[13] the Court considered the case of a couple who mortgaged their home to assist their daughter and son-in-law. McDougall J granted relief under the Act to the mother but not her defacto husband who claimed his signature was forged. This allowed the lender to sell the property and have full access to his half of the proceeds.

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[8] Quoted by McHugh JA in *West* supra at 621
[9] [2006] NSWCA 41
[10] In the case of an unregistered mortgage non est factum makes the deed a nullity and unenforceable by the lender against the security or pursuant to the personal covenants.
[11] [1999] NSWSC 319
[12] This decision was followed by Harrison AJ in *Permanent Custodians v Yazgi & Anor* [2007] NSWSC 279 at paragraph 134.
[13] [2004] NSWSC 97

4. Transferred mortgages

An interesting question arises when the mortgage sought to be challenged under the Act has been transferred to a third party. This exact issue arose in *Robinson v Watts*[14] with Hunter J holding[15]:

> "While there appears to be no authority directly in point, I am also of the view that s 7 of the Act must be read subject to s 42 of the Real Property Act …In my view, the estate or interest of Robinson under the transfer of mortgage from Smits, taken without notice of any of the circumstances attaching to the granting of the mortgage, by reason of the operation of s 42 of the R.P Act, cannot be cut down by resort to s 7 of the Act, and in particular s 7(1)(a) or (d)."

As well as holding that indefeasibility of title pursuant to s42 RPA protected the lender His Honour commented on a like position a unregistered mortgagee might find itself in[16]:

> "Even if Robinson's interest was not acquired by a land instrument, I am unable to envisage circumstances in which that interest could be vitiated under s 7 of the Act by unjust circumstances, in which an antecedent and otherwise valid contract was entered into and of which circumstances he had no notice."

A different result attached in *Kerry Jane Fraser v Kirsty Power*[17] where the transferees were not considered innocent. In that case they became subrogated to the rights of the registered mortgagee after being sued on related guarantees. Accordingly Simos J felt at liberty to set aside the mortgage.

5. Indefeasibility

Relief pursuant to the Contracts Review Act is clearly envisaged by Act to be an exception to the system of indefeasibility of title (section 7(d)). The mechanics of this were explained by Simos J in *Kerry Jane Fraser v Kirsty Power*[18]:

> "In my opinion, once a plaintiff has made out the necessary case … under the *Contracts Review Act 1980*, entitling him or her to have the relevant transaction set aside, the Court is entitled to mould its relief so as to achieve a just result, even if the effect of its order is to deprive the wrongdoer of the benefit of the indefeasibility provisions of the *Real Property Act 1900*. The Court is, in my opinion, entitled to do this, not by way of overriding the statute, but by making the appropriate order against the wrongdoer personally, for example, by ordering the wrongdoer, in a case such as the present case, to execute a discharge of the subject mortgage. And, in my opinion, as stated above, such an order may be made regardless of whether or not the relevant facts bring the case within the personal equities exception to indefeasibility of title under the *Real Property Act 1900."*

[14] [2000] NSWSC 584
[15] At paragraph 72
[16] At paragraph 75
[17] [2000] NSWSC 257
[18] [2000] NSWSC 257

6. Orders affecting land

Subsection 19(1) of the Act provides:

> An order made under sections 7(1)(b) .. has no effect in relation to a contract so far as the contract is constituted by a land instrument that is registered under the Real Property Act 1900.

This has received very little judicial consideration. In *Drury v Stone*[19] Fitzgerald JA (with Powell JA, Beazley JA agreeing) commented in reference to s19(1):

> "Subsections 7(3) and 19(1), which appear intended to preserve the indefeasibility of registered title, escaped notice until the argument in this Court. Subsequent to the hearing, the appellant applied for leave to amend to seek an order that the bank execute and register a discharge of its mortgage."

Since this decision it has been custom to seek such orders.

In *Robinson v Watts*[20] Hunter J, in refusing to grant relief under the Act to the detriment of a transferee with no notice of the unjust circumstances, held[21]:

> "Even if the circumstances in which the mortgage was given were unjust within the meaning of the Act, the form of relief would be limited by s 19 of the Act (relating to land instruments)."

7. Territorial jurisdiction

Whether the Act applies to a transaction depends on whether NSW is the *proper law of the contract*. The High Court has held that in relation to mortgages registered under the NSW Real Property Act the proper law of contract is NSW. This was explained in *State Bank v Sullivan*[22] per James J:

> The only member of the High Court [in Oceanic Sunline Special Shipping Co Inc v Fay (1988) 165 CLR 197] to refer to the *Contracts Review Act* was Brennan J ..it seems to me, with respect, that Brennan J …was clearly correct in saying that, if Greek law was the proper law of the contract, the *Contracts Review Act* would not apply.
>
> An alternative submission was made by counsel for Mr Sullivan that … the proper law of the mortgage would have been the law of the State of New South Wales, as being the system of law of the place with which the contract consisting of the mortgage had its closest and most real connection. Counsel pointed to various factors connecting the contract with New South Wales, including that the mortgage was executed in New South Wales, the Bank

[19] [2000] NSWCA 45
[20] [2000] NSWSC 584
[21] At paragraph 72
[22] [1999] NSWSC 596

> carried on business principally in New South Wales, the principal debtor …was a New South Wales company...
>
> I do not consider that this submission made by counsel for Mr Sullivan should be accepted. In my opinion, the crucial factors in determining with which system of law the contract had its closest and most real connection are that the contract was a mortgage of land in Queensland subject to the Queensland *Real Property Act*, that the mortgage was registered at the Queensland Land Titles Office and that it contained references to Queensland Statute law…
>
> The decision of the High Court in McClelland v Trustees Executors and Agency Company Limited (1936) 55 CLR 483 is directly, or virtually directly, in point. In that case all four members of the High Court held that the proper law of a mortgage of land in New South Wales under the New South Wales *Real Property Act*, which was registered in New South Wales and which incorporated some provisions of New South Wales Statute law and excluded others was the law of New South Wales, even though the mortgagor was a resident of Victoria, the mortgagee was a company incorporated in Victoria and the mortgage had been executed in Victoria.
>
> …Both on general principle and on the authority of the decision of the High Court in McClelland, I find that the place with which the mortgage had its closest and most real connection was Queensland. Accordingly… the proper law of the mortgage would be the law of Queensland and the New South Wales *Contracts Review Act* would not apply."

8. . . . for business or a trade

Section 6(2) of the Act excludes jurisdiction where the *contract was entered into in the course of or for the purpose of a trade, business or profession.* The courts have read this exclusion down (in favour of borrowers) so that it is weaker than the similar exclusion under the Uniform Consumer Credit Code. Moreover unlike the UCCC there is no provision for the borrower to make a declaration for the purpose of the exclusion which is determinative.

In *Ellison v Vukicevic*[23] Young J referred to and applied the statement by Lee J in Collins v Parker[24] that:

> "The expression "for the purpose of" has the meaning that the contract under consideration is entered into as an ordinary incident of the carrying on of the particular trade, business or profession then being carried on or proposed to be carried on."

In *St George Bank Limited v Trimarchi*[25] Dunford J held that:

[23] (1986) 7 NSWLR 104
[24] (1984) NSW Conv R #55-212 at 57,469
[25] [2003] NSWSC 151

"It is necessary to consider a submission … that Mr and Mrs Trimarchi were carrying on a business and are therefore denied relief by the operation of s 6 (2) of the Act. That subsection, so far as material, provides as follows:

> *"A person may not be granted relief under this Act in relation to a contract so far as the contract was entered into in the course of or for the purpose of a trade, business or profession carried on by the person or proposed to be carried on by the person, other than a farming undertaking ... to be carried on by him wholly or principally in New South Wales".*

It has been held that where the proprietors of a company give a guarantee to secure the debts of the company which carries on business, such proprietors are not prevented by the section from seeking relief under the Act because it is the company rather than themselves which is carrying on the business: *Toscano v Holland Securities Pty Limited* (1985) 1 NSWLR 145, *Australian Bank Limited v Stokes* (1985) 3 NSWLR 174. See also *Collins v Parker* (1984) NSW Conv R #55-212 at 57,469, *Coombs v Bahama Palm Trading Pty Limited* (1991) ASC #56-097 at 57,025.

The section refers to a contract entered into *"in the course of"*, or *"for the purpose of"* a business etc, carried on by the applicant. These loans were not entered into *"in the course of"* any business carried on by Mr and Mrs Trimarchi because they were not in the business of entering into loan agreements, and the question arises whether they were entered into *"for the purpose of"* a business carried on by them.

Even if Domenico Trimarchi is to be regarded as having a beneficial interest in 72-74 Bathurst Street, it cannot be said that in any real sense he was carrying on a business in relation to investment in that property. He had no say in its management, organisation, or control. Investment in that property and in the other properties was a business carried on by his son Anthony Trimarchi, and in a very subsidiary sense by Heather Trimarchi. But it cannot be said in any realistic sense of the word that Domenico Trimarchi was carrying on the business of investing in, and letting the property at 72-74 Bathurst Street. Furthermore, Lucia had no interest in that property at all.

In any event, in so far as the securities were given to secure the overdraft account of Anthony Trimarchi, the solicitors' practice was entirely a business carried on or to be carried on by him and in which Domenico and Lucia Trimarchi had no part. For these reasons, the defendants are not excluded from relief under the Act by reason of s 6(2)."

One example of a case where the s6(2) did exclude an application for relief under the Act is the decision of Davies AJ in *Westpac v Bagshaw & Anor*[26]

[26] [2000] NSWSC 650

> "The application for registration of the business name, Bagshaw Development Hire, was signed by both Mr and Mrs Bagshaw, each of whom was described as a person to be registered as carrying on business under that name…
>
> The *Contracts Review Act, 1980* is relied upon by Mrs Bagshaw. However, s 6(2) provides that a person is not entitled to relief under the Act *"in relation to a contract so far as the contract was entered into in the course of or for the purpose of a trade, business or profession carried on by him"*. The subject mortgage was entered into for the purpose of obtaining an advance for the purposes of the partnership business, Bagshaw Development Hire, and was used later as security for further advances and loans made by Westpac to Mr and Mrs Bagshaw for the purposes of Bagshaw Development Hire and other associated businesses in which Mr and Mrs Bagshaw were involved. Accordingly, the *Contracts Review Act* does not apply in the present circumstances."

9. Appellant jurisdiction

Despite the fact that relief under the Act is discretionary the Court of Appeal has not considered itself incompetent to substitute its own decision on what is unjust for that of the Judge at first instance. In *Beneficial Finance Corporation Limited v Karavas*[27] Samuels JA at 271 noted:

> "I can see no reason to attribute to the statutory criterion "unjust" any greater degree of complexity than is accorded to the common law concept of "negligent"… I must confess therefore I respectfully disagree with the view that this Court should be especially cautious about substituting a different opinion about the injustice of a contract from that reached by trial judge."

10. Federal Court jurisdiction

Justice Young heard the case of *Blacker v National Australia Bank Ltd*[28]after the Federal Court judge Katz J ruled he had no jurisdiction to consider the Contracts Review elements of the case. Young J cited without disagreement the ruling Katz relied on being Emmett J in *Murphy v Overton Investments Pty Ltd*[29]. Emmett J said at paragraph [246] that:

> "… s 7 of the Contracts Review Act simply does not purport to give power to or confer jurisdiction on the Federal Court to vary any land instrument. Indeed, it would be beyond the power of the Parliament of New South Wales to confer such jurisdiction on the Federal Court of Australia - see Re Wakim; Ex parte McNally (1999) 163 ALR 270. Accordingly, I do not consider that the Federal Court has jurisdiction to make an order under the Contracts Review Act, either in respect of the first strand of Mr and Mrs Murphy's claims or the second strand of their claims - see Smith v Smith (1986) 161 CLR 217 at 237-238 and 251."

[27] (1991) 23 NSWLR 256 (CA)
[28] [2000] NSWSC 805
[29] [2000] FCA 801 - 15 June 2000, unreported

Murphy however was appealed to the Full Court *Murphy v Overton Investments Pty Ltd*[30] which held that on the authority of the High Court in *Australian Securities and Investment Commission v Edensor Nominees Pty Ltd*[31] the Federal Court had the power to hear applications for relief under the Contracts Review Act pursuant to Section 79 of the Judiciary Act which provides:

> "The laws of each State or Territory, including the laws relating to procedure, evidence, and the competency of witnesses, shall, except as otherwise provided by the Constitution or the laws of the Commonwealth, be binding on all Courts exercising federal jurisdiction in that State or Territory in all cases to which they are applicable."

Branson J in the *Murphy* appeal holding:

> "In my view, s 7(1) of the Contracts Review Act is not a provision incapable of being "picked up" by s 79 of the Judiciary Act by reason of Ch III of the Constitution. I note that s 87 of the TPA, under which this Court is given a comparably wide discretion in formulating relief, has not been suggested in any of the authorities to offend against Ch III of the Constitution. Nor do I consider that s 7 of the Contracts Review Act falls outside the categories of State laws which the majority of the High Court in Edensor regarded as falling within the ambit of s 79."

C. Relationship to equitable defences

Contracts which are unconscionable will generally also be unjust (by s 4(1), "'unjust' includes unconscionable). Consequently the courts tend to find it unnecessary to deal with equitable defences if a case under the Act is made out. The quote below taken from *Pasternacki & Anor v Correy & Ors Matter*[32] per Hidden J is typical of the approach taken:

> "Counsel for Mrs Correy argued that the contract was unconscionable, applying the principles enunciated by the High Court in *Commercial Bank of Australia Limited v Amadio* (1982-3) 151 CLR 447… I find it unnecessary to determine this issue as I have concluded that Mrs Correy is entitled to relief upon the other basis argued, that is, the Contracts Review Act 1980."

Conversely there have been multiple cases where the court has found a mortgage was not unconscionable under the general law but was unjust for the purpose of the Act[33].

The relationship was discussed by *Australia and New Zealand Banking Group Limited v Karam*[34] in a judgement of the full court (Beazley JA; Ipp JA; Basten JA);

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[30] (2001) 112 FCR 182
[31] [2001] HCA 1
[32] [1998] NSWSC 288
[33] SH Lock (Australia) Ltd v Kennedy (1988) ATPR 40-859(CA); Melverton v Commonwealth Development of Australia (1989) ASC 55-921; Robinson v ANZ Banking Group Limited (1990) ASC 55-979; Beneficial Finance Corporation v Karavas (1991) 23 NSWLR 256 (CA); and Elders Rural Finance Ltd v Smith (1996) 41 NSWLR 296 (CA)
[34] [2005] NSWCA 344

> "Section 9(2) of the *Contracts Review Act* does not in terms adopt equitable concepts such as fraud, misrepresentation, breach of fiduciary duty, undue influence and unconscionable conduct. Rather, it identifies a range of considerations which may, in particular circumstances, fall within those categories, but need not. As McHugh JA noted in *West v AGC (Advances) Ltd* (1986) 5 NSWLR 610 at 621A-B:
>
> > "The *Contracts Review Act* 1980 is revolutionary legislation whose evident purpose is to overcome the common law's failure to provide a comprehensive doctrinal framework to deal with 'unjust' contracts."
>
> We do not take his Honour to have been restricting his consideration to common law principles, as opposed to equitable relief: rather, we take his Honour (with whom Hope JA agreed) to be adopting a position similar to that of Kirby P (in dissent in the circumstances of the case) that the discretion conferred on the Court under the Act "is not to be limited in its exercise by reference to the relief available under pre-existing law … relief should be framed by the Court freed from the pre-conceptions involved in earlier legal remedies for unconscionable contracts": at 616A-B. Nevertheless, the *Contracts Review Act* does not purport to rewrite common law and equity so that, where the Act is not available or not relied upon, established principles must be invoked."

Basten JA in *Perpetual Trustee Company Limited v Albert and Rose Khoshaba*[35] put the relationship between the Act and equitable defences as follows:

> "That is not to say that the Court is launched on an uncharted sea with no navigational guides, but rather that constraints which would preclude intervention according to established principles of legal or equitable doctrine, may not be decisive under the Act. Thus, while equity provides relief against the unconscientious conduct of the defendant, the Act may permit relief in circumstances where the conscience of the defendant is not affected. Similarly, a contract, or a provision thereof, may be unjust in circumstances where there was no pre-existing duty owed by, say, a lender to a borrower to act in a particular way."[36]

His comment regarding "circumstances where the conscience of the defendant is not affected" is particularly valid given the tendency for unjustness to be found in circumstances of which the lender was ignorant.

D. The two step process

It does not always follow that if the court finds a contract is unjust that the mortgagor will be entitled to relief. As Handley JA succinctly put it in *Child v Commonwealth Development Bank*[37]

[35] [2006] NSWCA 41
[36] at paragraph 115
[37] [2000] NSWCA 256

> "The grant of relief under the *Contracts Review Act* is a two-step process. See *Nguyen v Taylor* (1992) 27 NSWLR 48 at 55. The first step, under s 9, involves the court finding a contract or a provision in a contract to have been unjust in the circumstances relating to the contract at the time it was made. The second step, under s 7(1), permits the court to make such orders as it considers just."

Powell JA echoed this approach in *White v Illawarra Mutual Building Society Limited*[38]*:*

> "It will be apparent that, when an application for relief under the Act is made, two questions will, or may potentially, arise, they being:
>
> (a) whether it the circumstances relating to it at the time it was made, the relevant contract was, or some one or more of its provisions was or were, unjust; and
>
> (b) whether, and, if so, in what manner, the Court should exercise one or other of the powers conferred on it by s.7(1) of the Act."

E. Improvident circumstances

1. The golden thread

While the layman might imagine that the Act is primarily invoked when harsh clauses are sought to be enforced in fact the most typical litigation involves circumstances that are independent of the actual provisions of the actual contract in question. Thus a elderly widow who was tricked into obtaining a mortgage by a fraudster who absconded with the funds will raise her improvident circumstance as giving rise to the injustice, rather than the interest rate or other terms of the mortgage itself. This was noted Stein JA in *Pasternacki v Correy*[39]:

> "Cases under the Act must, of course, be determined on their own facts. However, there is a common thread which runs through authorities such as *Wynne*, *Hall*, *Melverton* and *Reisch*. This is the improvidence of the transaction to the plaintiff and the knowledge of the lender of this fact, or their failure to make inquiries having been put on notice."

As has been seen, as a result of *Perpetual Trustee Company Limited v Albert and Rose Khoshaba*[40]*,* the golden thread has been alloyed in as much as the lender no longer needs to have knowledge of or be put on enquiry of improvident circumstances (now it is sufficient for there to be improvident circumstances and the lender to have been content to lend on the value of the asset alone).

The pre-*Khoshaba* position (which required the lender to know or be put on notice of the improvidence) is evident in the following extract from the decision of Bell J in *IMB Society Limited v White & Ors*[41]:

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[38] [2002] NSWCA 164
[39] [2000] NSWCA 333
[40] [2006] NSWCA 41
[41] [2000] NSWSC 1085

> "Mrs White first met Mr Maggio around 1986. His son was involved in the same sporting pursuits as one of Mrs White's children …Around April 1992 Mr Maggio told Mrs White that he was involved in a commercial venture with an accountant named David Mansfield. He said that the pair of them were trying to raise money for a gold deal in the Philippines. He asked if Mrs White was interested in investing in the scheme…
>
> I am not of the view that the IMB had actual or constructive notice that the proposed loan was improvident. I do not consider that the IMB was under any obligation to ensure that Mrs White obtained independent legal advice concerning the transaction."

In *Perpetual Trustee Company Limited v Albert and Rose Khoshaba*[42] Spigelman CJ noted:

> "An important feature of this case is that no criticism has been directed to the terms and conditions of the loan and mortgage entered into between the parties. Nor has it been suggested that the Appellant received any advantage, direct or indirect, from the transaction other than that specified in the loan agreement itself. What is said to be unjust is the fact that the Appellant agreed to give a loan to the Respondents at their request in circumstances, not known to the Appellant, that funds advanced would be used for a dubious investment."

His Honour went on to find that while the lender was unaware of the dubious investment it was culpable because it was content to lend on the value of the asset.

2. The improvidence methodology

It is the task of the party seeking relief under the Act to establish that the taking of the loan was improvident and having established that proceed to show either:

1. The lender knew of the improvident circumstances
2. The lender was put on notice of the improvident circumstances
3. The lender was content to lend on the value of the asset and was thus recklessly indifferent to the existence of the improvident circumstances.

In showing the loan was improvident the borrower must not furnish the wisdom of hindsight. Rather the court must look at "the circumstances relating to the contract at the time it was made" (subsection 9(1) of the Act) as demonstrated in the following extract of the reasons given by Austin J in *State Bank v Lo*[43]

> "Counsel for Mr and Mrs Lo submitted that the mortgages and the term loan were improvident transactions. He said that if independent advice had been sought, the only sensible advice would have been that they should not enter into those transactions. This was because they did not have the cash flow to service their debt to the Bank, and the proceeds of the insurance claim were at that stage uncertain and in any event, should not be expended before they were received. I disagree. At the time the transactions were entered into, the

[42] [2006] NSWCA 41
[43] [2000] NSWSC 1191

> borrowings were well within the value of the securities and as far as the evidence goes, there were grounds for Mr and Mrs Lo to expect a favourable outcome on the insurance claim within a reasonably short time."

F. What is *unjust in the circumstances*

1. The section 4 definition

Section 4 of the Act defines unjust as:

> "unjust" includes unconscionable, harsh or oppressive, and "injustice" shall be construed in a corresponding manner.

However in *West v AGC (Advances)Ltd*[44], McHugh JA said

> "The definition of 'unjust' in s4 is not exclusive. It is in my opinion a mistake to think that a contract or one of its terms is only unjust when it is unconscionable, harsh or oppressive. Contracts which fall within any of those categories will be 'unjust'. But the latter expression is not limited to the so-called 'tautological trinity'. The *Contracts Review Act,* 1980 is revolutionary legislation whose evident purpose is to overcome the common law's failure to provide a comprehensive doctrinal framework to deal with 'unjust' contracts...

2. Procedural and substantive injustice

In *West v AGC (Advances)Ltd*[45], McHugh JA said

> "…a contract may be unjust in the circumstances existing when it was made because of the way it operates in relation to the claimant or because of the way in which it was made or both. Thus a contractual provision may be unjust simply because it imposes an unreasonable burden on the claimant when it was not reasonably necessary for the protection of the legitimate interests of the party seeking to enforce the provision... . In other cases the contract may not be unjust per se but may be unjust because in the circumstances the claimant did not have the capacity or opportunity to make an informed or real choice as to whether he should enter into the contract... . More often, it will be a combination of the operation of the contract and the manner in which it was made that renders the contract or one of its provisions unjust in the circumstances. Thus a contract may be unjust under the Act because its terms, consequences or effects are unjust. This is substantive injustice. Or a contract may be unjust because of the unfairness of the methods used to make it. This is procedural injustice. Most unjust contracts will be the product of both procedural and substantive injustice.

3. A high threshold is required

In *Younan & Anor v Beneficial Finance Corporation Ltd*[46] Mahoney JA observed that:

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[44] (1986) 5 NSWLR 610, 620-1
[45] (1986) 5 NSWLR 610, 620-1
[46] (C of A, unreported, 21 November 1994),

> "a contract is not to be interfered with lightly or for idiosyncratic reasons…the definition of 'unjust' includes terms involving a high level of injustice. To an extent, that confirms, I think, that the reason which will justify interference must be of significant weight."

In *Blacker v National Australia Bank Ltd*[47] Young J reminded himself:

> "I must bear in mind that the CRA is remedial legislation which should be widely construed. However, I must also look for a high level of injustice and must bear in mind the public interest in maintaining certainty of contract."

4. The contract at the time it was made

In *Beneficial Finance Corporation Limited v Karavas*[48] Samuels JA stated (at page 269):

> "Accordingly, the court, guiding itself by the signposts provided in s9, and paying heed to the prescription in s7(1), will first ascertain what were the circumstances 'relating to the contract at the time it was made'."

5. Hard bargains are not unjust

A hard bargain is only unjust, and prone to be re-written, if the lender knew or had reason to suspect at the time the contract was made that the borrower could not comply with them.

In *Conley v Commonwealth Bank of Australia*[49] Heydon JA held:

> "The repayment provisions were not unconscionable, harsh or oppressive. They were very burdensome. They were in a sense unreasonable, because of the plaintiff bank's complete discretion in relation to interest levels. They amounted to a hard bargain, because they strongly preferred the interests of the plaintiff bank to those of the defendant. But it cannot be said that they showed no regard for conscience or that they displayed that type of unreasonableness which is harsh or oppressive. That is because the circumstances which might trigger their truly catastrophic consequences as reflected in the outcome of these proceedings, though reasonably foreseeable, were not sufficiently likely to justify that characterisation."

In *Baltic Shipping Company v Dillon*[50] Gleeson CJ stated:

> "The general policy of the law is that people should honour their contracts. That policy forms part of our idea of what is just".

In *Esanda Finance Corp Ltd v Tong*[51] Handley JA observed:

> "…a contract is not unjust merely because it was not in someone's interest to enter into it, or because a person is unable to pay the debt when called upon to do so, or because its enforcement will lead to the loss of a home."

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[47] [2000] NSWSC 805
[48] (1991) 23 NSWLR 256 (CA)
[49] [2000] NSWCA 101
[50] (1991) 22 NSWLR 1
[51] (1997) 41 NSWLR 482 at 491

6. Inequality of bargaining power

Section 9(2)(a) flags as a material consideration in determining whether a contract is unjust "whether or not there was any material inequality in bargaining power between the parties to the contract". In mortgage cases (because there is always inequality of bargaining power) this is only given weight in special circumstances.

In *Greater Building Society Limited v Ljubisa Ristic*[52]Newman AJ noted:

> "..material inequality in bargaining power between an institutional lender and an individual will rarely be of significance, as the courts recognise that the terms of contracts of that nature are generally fixed and there is usually little room for negotiation: Commonwealth Bank of Australia v Cohen (unrep, SCNSW, Cole J, 22/7/88). For inequality to have effect, one needs to identify "extreme" inequality, such as in Elders Rural Finance v Smith (1996) 41 NSWLR 296 (in that case Elders were more than a financier and were significantly involved in the evaluation of the business opportunity for which investment funds were sought)."

In *St George Bank Limited v Trimarchi*[53] Dunford J found:

> "There was clearly material inequality in bargaining power between the plaintiff on the one hand and the defendants on the other. This is normally the case where a person seeks to borrow money from a bank or finance institution to pay off an existing debt, as was the case here, but this consideration was aggravated in the present case by reason of the fact that whatever little bargaining power the defendants had, including the mere power to apply for or refuse the loan, was exercised without their knowledge, and behind their backs, by Anthony Trimarchi whose interests were different to theirs."

In *Greater Building Society Limited v Ljubisa Ristic*[54] Newman AJ noted:

> "..the scope for prior negotiation, whilst a reason the court may give for the grant of relief, is of no significance if the contract is otherwise fair and reasonable: Commonwealth Bank of Australia v Cohen (unrep, SCNSW, Cole J, 22/7/88)."

[52] [2001] NSWSC 1052
[53] [2003] NSWSC 151
[54] [2001] NSWSC 1052

7. Departure from loan guidelines

There is no authority for the proposition that a lender departure from its own internal guidelines creates injustice. However it can be evidence that the terms of the contract in the circumstances were unjust. In *Conley v Commonwealth Bank of Australia*[55] Heydon JA held:

> "As the Master said, a breach of lending guidelines by itself would not bring the matter within the *Contracts Review Act*. But the existence of lending guidelines … suggests that there was a level beyond which, as the plaintiff bank's experience had taught it, it was not prudent to lend. … The defendant's income was at no stage large. Whether the matter is looked at in gross or net terms, … the quantum of the loans was very high from April 1991 on. For these reasons, the provisions for repayment in place after April 1991 imposed conditions which were unreasonably difficult to comply with if reasonably foreseeable events came to pass."

The distinction was emphasized in *St George Bank Ltd v Trimarchi*[56]by Mason P when he wrote:

> "The appellant seeks to construe these remarks as if his Honour were stating that the departure from the loan conditions and the bank policies were in themselves directly significant to the resolution of the issues thrown up by s9 of the Act. This was not the point that the judge was making. The loan conditions and internal policies were, however, strong evidence (if evidence was needed) of normal and appropriate lending practice, nonetheless so because the internal policies of the bank were designed for the bank's own protection."

This point was made again by Spigelman CJ in *Perpetual Trustee Company Limited v Albert and Rose Khoshaba*[57]:

> "… departure from the guidelines …[is] a relevant consideration in the determination of 'justness' …[but] such departure …[is] not, of itself, entitled to significant, let alone determinative weight… at least in a case where the departure from the guidelines is not evidence of departure from prudent lending practice."

[55] [2000] NSWCA 101
[56] [2004] NSWCA 120 at 44
[57] [2006] NSWCA 41

8. Lender under no obligation to give financial advice

The lender has been consistently found to be under no obligation to give financial advice. In *Drury v Stone*[58] Fitzgerald JA noted with approval (Powell JA, Beazley JA agreeing):

> "The trial judge also found, and the appellant accepted, that it was not the bank's function to advise the appellant on the commercial merits of the transactions entered into by her or the company, and that she was well aware of the purpose of the mortgage and that there was a risk that she would lose her house if the business failed."

In *Blacker v National Australia Bank Ltd*[59] Young J held:

> "The plaintiffs' case was that they should never have entered into the transaction or the contract as they could not reasonably ever have profited by it. They considered that the bank had the expertise and that it had carried out the necessary checks and that, because the bank had approved the loans, it was safe to proceed.
>
> The plaintiffs seek to set aside the personal covenant in the mortgage and to be paid compensation of $857,000. If these orders were made, the plaintiffs would be put back in the same position as if the transaction had not been entered into...
>
> There were no threats or force used to make the …[plaintiffs] enter into the… mortgage. The terms of that contract were not oppressive. Even accepting that there was inequality of bargaining power, this was not a case of an illiterate or otherwise disabled couple making a contract that was forced upon them. They may have been only basically educated… but this does not seem to me to be enough to show that there was procedural injustice in bringing about the contract. The contract itself was not one that could be said to be substantively unjust.
>
> Thus, the claim must fail."

However *Elders Rural Finance Ltd v Smith*[60] was an appeal from Bryson J who granted relief under the Act to people who owned a rural property, and then borrowed to purchase a further rural property. Bryson J ordered that the borrowers be relieved from any interest or legal fees in connection with their loan, a sum totalling $415,724. The Court of Appeal dismissed the appeal with Handley, JA[61], summarising the case as follows:

> "...in practical terms there was not a realistic possibility of achieving the necessary transformation in the productivity… It was not beyond all possibility that the projection would be realized; but they would be realized

[58] [2000] NSWCA 45
[59] [2000] NSWSC 805
[60] (1996) 41 NSWLR 296
[61] at page 307

> only in an extraordinary combination of favourable circumstances which did not happen and which was not realistically likely to happen, still less continue for years.
>
> The Smiths 'were utterly out of their depths in making a projection of this kind' and had no 'appreciation overall of its commercial implications'. They knew it would be a 'tough operation' and 'a very hard road', but they saw Elders' readiness to advance money to them to go into the transaction as a recommendation. In this they were 'extremely naïve', and Elders did not give, and did not intend to give, any such recommendation.
>
> There was a gross disparity between the positions of Elders and the Smiths. Elders was protected by its securities and so details of projections and their feasibility were not of critical importance to it. On the other hand, the Smiths incurred risks without any real understanding of what they were doing and stood to lose … only way of life they knew, if the project failed. As the judge said: 'There was extreme inequality in the likelihood of successful outcomes."

9. Mortgages by parents to guarantee children's debts

Most cases brought and most cases granted relief involve a third party loan[62]. However the fact a mortgage is given to secure another party's debts, even where that party is son or daughter does not of itself make the mortgage unjust. The Court of Appeal made this clear in *Davey v Challenger Managed Investments*[63] per Handley JA (Hodgson JA and Grove J agreeing):

> "The Court has no way of knowing how many business ventures financed by parents in this way are successful for the benefit of the community and all concerned. Courts only ever see the cases where the business has failed and the mortgages are enforced. The Court might be doing a disservice to the community if it treated age and pensioner status as disabling parents from helping their children in this way. The law has not taken that step, and under ordinary principles the appellants have no proper claim for relief."

In *Challenger Management Investment Limited & 1 Or v Davey*[64] two elderly ladies mortgaged their homes to secure business loans by their son's start up company. Cripps AJ held:

> "The relationship between Beryl Davey and Gladys Crees on the one hand and their children on the other did not give rise to a presumption in law of undue influence, but even if it did, both received independent legal advice and Challenger had no notice, actual or constructive, to the contrary….
>
> In accordance with my findings I would not characterise the contracts entered into by Mrs Davey and Mrs Crees as being relevantly "unjust"

[62] Of the 15 reported decisions since 1999 to the date of this paper where relief was granted under the Act and not overturned on appeal 12 of them involved third party loans.
[63] [2003] NSWCA 172
[64] [2002] NSWSC 430

> within the meaning of the *Contracts Review Act* 1980 (NSW). A contract is not unjust simply because it is not, or might not be, in the parties financial interest to enter into it. If that were so, it would apply to almost all guarantees and mortgage transactions entered into by parents to facilitate loans to and advancement of their children."

Lender's should however note that it will usually be necessary in order to lend safely to require the parent-mortgagors to obtain independent legal advice and financial advice. The danger increases when the parents are from a non-English speaking or elderly or both. In *Davey v Challenger Managed Investments*[65]per Handley JA (Hodgson JA and Grove J agreeing) the court held:

> "Although the appellants submitted that they were in positions of special disadvantage this was not the case. They were not illiterate and English was their first language. They were in full possession of their faculties, and although they were elderly they were in general good health. A mortgage and a guarantee are well known transactions in the community and Mrs Crees had entered into a similar transaction for the benefit of her son only a few months earlier.
>
> The transaction involved guarantees and mortgages to secure a cash advance for the benefit of the children … As Hodgson JA said during argument, the appellants had a relationship with the real borrowers that made it reasonable for the appellants to give them assistance. The appellants had, to the knowledge of the lender, obtained legal advice which has been found by the trial Judge to be both independent and competent… If, contrary to the views expressed above, the appellants were in some position of special disadvantage, the lender did not have actual or constructive notice of this.
>
> Independent legal advice was desirable, if not necessary, in this case to ensure that the appellants, who were volunteers, understood the transactions and their implications, and, with an appropriate understanding, executed the security documents freely and voluntarily. They received such advice before they executed the documents. The appellants were seen together, in the absence of the children... The appellants suggested that each of them should have been interviewed separately, but Mr Grellman was not aware of any conflict of interest, or even the possibility of such a conflict, and there was no need for separate interviews.
>
> The children should probably never have asked the appellants to hazard their homes in this business venture, but misrepresentation or undue influence on their part have never been alleged. The age and status of the appellants as pensioners did not deprive them of the legal capacity to do what they did. If the business had been successful the children would have been launched on a business career and the mortgages would have been discharged."

[65] [2003] NSWCA 172

Where the precautions alluded to in *Davey* are not taken the lender can be in grave danger of losing their loan. This is particularly so where to the lender's knowledge the real borrower is in financial difficulty at the time the mortgage is given.

In *Melverton v Commonwealth Development Bank of Australia*[66] Hodgson J held (underlining added):

> "… the plaintiff did not have the opportunity to make an informed and real choice in the matter. Furthermore, in my view this was an improvident transaction because the plaintiff had no interest in Cenco and had no assets or income from which she could possibly pay the bank, and the home which was being given as security was the only significant asset which she and her husband had. …
> In the case the bank knew that the plaintiff and her husband were Terrence's parents. It knew that they had no apparent interest in Cenco and that the position of Cenco involved some risk. The bank knew that the plaintiff and her husband were entering into a transaction which, considered objectively, involved a certain amount of risk, in circumstances where their son must have been anxious for them to do so."

In *Higgs and Ors v Thompson bht The Protective Commissioner and Ors*[67] Johnson J in finding a mortgage unjust and setting it aside noted:

> There are a number of features of …[the application form] which… are clearly false. [The father] is described as a *"semi retired investor"*, which does not accord with his occupation as described elsewhere in evidence. … There is a telling representation in another document clearly prepared by …[the daughter]. According to this document … [The father] is certifying … that his current gross income is $75,000.00 per annum. The true facts were that [The father's] income … was $435.00 a fortnight.
>
> I am satisfied [the daughter] was the driving force behind the loan to be used by her …[She] took a series of steps, including, I am satisfied, the provision of false information relating to [The father], no doubt to facilitate the grant of mortgage which was in her interests. … I return, at this point, to the evidence of Dr Rosenfeld. It is the fact that [the father] executed the mortgage and signed a series of documents which, prima facie, give the appearance of comprehension and understanding of the legal commitment which he was making. However, Dr Rosenfeld has expressed the opinion, which I accept, that Mr Thompson had an impaired reasoning … at the time of signing relevant documents…
>
> If I apply the opinion of Dr Rosenfeld to the objectively known facts of an 88 year old man mortgaging his home to provide financial support to his entrepreneurial daughter in circumstances of likely financial risk, I find ready confirmation of a likely lack of realisation by [the father] of the level of risk involved.

[66] (1989) NSW Conv R 55 – 484 at 58,515
[67] [2006] NSWSC 920

> There is no evidence from [The father] before the Court. However, that omission is well explained (for the purposes of the rule in *Jones v Dunkel* (1959) 101 CLR 298)... [The father], now 92 years of age, resides in a nursing home. He is dependent on nursing staff for daily activities. He usually presents mild to moderate confusion as a result of dementia due to Alzheimer's disease."

In *Pasternacki v Correy*[68]the Court of Appeal confirmed a finding of injustice and the trial judge's decision to set aside the mortgage in its entirety. In this case the lender made no effort to determine what the son-borrower was going to do with the money or why he needed it quickly for a short term at high interest rates. The other relevant circumstances were described by Stein JA as follows:

> "Mrs Correy was born in Italy in 1928. There she completed her schooling and trained as a nurse. She met her husband in Naples and married in 1947. He was a medical practitioner. They immigrated to Australia in the late 1940s and settled near Wollongong, where she worked as a nurse in various hospitals until 1991. She is an aged pensioner and her husband died in April 1993, only one year before the events the subject of the appeal.
>
> The Correys had two sons. The eldest, Henry, was born in 1948. The other son, Carlo, was born in 1955. Mrs Correy and her husband lived in the same family home at Corrimal from 1960. Apart from an old car, the house is her only asset. In 1994, the respondent was living alone in the home, although she maintained regular contact with both sons, to whom she was devoted.
>
> Henry claimed to have some business interests in a popular music group. He told his mother that he was anticipating profits amounting to millions of US dollars from record sales.
>
> On Sunday 15 May 1994 Henry paid his mother an unexpected visit. He asked for her help since he needed to send money to a European record company 'for taxation' so that he could receive his return on the record sales. He told his mother that he had found a lender but needed her to provide a guarantee. When she hesitated Henry said that Dad would have helped him. He told his mother that if she did not help him, he would go to 'a close friend of the family to ask to be a guarantor, or even the Mafia'. The respondent said that her son was desperate. Because of his desperation and because she did not want her personal affairs to go outside the home, she agreed with Henry's request to be a guarantor."

In *St George Bank Ltd v Trimarchi & Anor*[69] the parents mortgaged their properties at the behest of their solicitor son. The son was later struck off the roll and imprisoned. The key findings included that the parents had no real appreciation of the transaction they were entering into. The bank never took pains to independently contact them or ensure they were

[68] [2000] NSWCA 333
[69] [2004] NSWCA 120

independently financially or legally advised. Per Mason P (Sheller JA, Cripps AJA agreeing):

> "…the appellant sought to make much of the absence of any finding that it knew either that the respondents had not obtained independent advice or of the unfair tactics of Anthony Trimarchi. However, the absence of such a finding is not to be confused with a finding that the appellant was not on notice of either or both of these matters. … It was certainly the case that the appellant took no steps to follow through on compliance with its internal policies and the conditions of the loan as regards the respondents [which amoung other things required independent legal advice]. On the contrary, it left everything up to Anthony Trimarchi… as indicated above… s9 of the Act does not require the party seeking to enforce a contract to be on notice of the circumstances rendering it unfair."

10. Mortgages by wives to guarantee husband's debts

The well known equitable defenses available to wives (*Yerkey v Jones*[70]and *Garcia v National Australia Bank*[71]*)* often fail due to the lender's lack of notice of the wife's circumstances. Theoretically relief available under the Contract's Review Act is broader than under the general law however all reported decisions where a finding of injustice under the Act is made also make a parallel finding under *Yerkey, Garcia* or *Amadio* has also been made. A notable exception is *State Bank of NSW v Hibbert*[72] where Garcia was ruled out because the parties were in a defacto relationship rather than married.

The essence of the equitable defences as with the Contracts Review Act reasoning is that when the lender suspects the wife may be a full or partial volunteer it is necessary to ensure she obtains not only independent legal advice but also financial advice so that she can determine the extent of the potential liability and the likelihood the mortgage will be called up.

G. Borrower understanding

Nearly all Contracts Review Act pleadings assert the mortgagor did not understand what they were signing, or if they understood the legal implications of the mortgage, that they did not understand the nature of the risk they were taking and the likelihood of it going bad.

1. The general law approach

The traditional judicial attitude to attempts to avoid contracts on the basis that their contents was not fully understood was spelled out by the High Court in the 1948 decision of *Wilton v Farnworth*[73] per Chief Justice Latham:

> "Where a man signs a document knowing that it is a legal document relating to an interest which he has in property, he is in general bound by the act of signature… He may not trouble to inform himself of the contents of the document, but that fact does not deprive the party with whom he deals of the rights which the document gives to him. In the absence of fraud or some

[70] (1939) 63 CLR 649
[71] (1998) 194 CLR 395
[72] [2000] NSWSC 628
[73] [1948] HCA 20; (1948) 76 CLR 646 (14 September 1948)

> other of the special circumstances of the character [(equitable defences)], a man cannot escape the consequences of signing a document by saying, and proving, that he did not understand it. Unless he was prepared to take the chance of being bound by the terms of the document, whatever they might be, it was for him to protect himself by abstaining from signing the document until he understood it and was satisfied with it. Any weakening of these principles would make chaos of every-day business transactions."

2. Under the Contract's Review Act

Under the Act (and particularly in the wake of *Perpetual Trustee Company Limited v Albert and Rose Khoshaba*[74]*,* mortgagors are held to a far less rigerous standard. They can go into a mortgage contract with their eyes wide open (understanding it is a mortgage, knowing the interest rate and term) and still be entitled to claim relief. The lender in such cases loses their loan because the borrower labours under a special disability (for example lack of commercial sophistication and naivety) which makes the lender's reliance on the asset value of the security alone unjust.

3. When the mortgagors know they are signing a mortgage

In the foundation case of *West v AGC (Advances) Ltd & Ors*[75] the knowledge of the mortgagors seemed to be pivotal in the decision of the majority not to find injustice. Per McHugh JA with Hope JA agreeing (underlining added):

> "Hodgson J made a critical finding that Mrs West "was well aware that she was giving a mortgage over her property, and that (AGC) could have recourse to that property in order to recoup its loan in the event of default"

In decising not to follow *West* in *Perpetual Trustee Company Limited v Albert and Rose Khoshaba*[76] Spigelman CJ noted:

> *"West* is now 20 years old. When the Parliament adopts so general, and inherently variable, a standard as that of 'justness', Parliament intends for courts to apply contemporary community standards about what is just. Such standards may vary over time, particularly over a period of two decades."

The change in attitude did not begin with *Khoshaba* as early as 1991 (*5 years after West*) in *Beneficial Finance Corporation Limited v Karavas*[77] in upholding the trial judge's finding of injustice and granting of relief Meagher JA (with whom Samuels agreed) noted[78]:

> "As to the non est factum claim, what the parents of the three principals, and what Mr and Mrs Williams, said in evidence may be broadly summarised thus: they did not know they were mortgaging their properties, they did not know that as a consequence of the mortgages their residences might be sold in the event of the business failing and (in at least one case) that they did not know what a mortgage was. His Honour found this issue against the

[74] [2006] NSWCA 41
[75] (1986) 5 NSWLR 610
[76] [2006] NSWCA 41
[77] (1991) 23 NSWLR 256 (CA)
[78] At page 275

> defendants; according to him (and the evidence amply demonstrates the accuracy of his finding) the defendants' evidence on this issue was false, and possibly consciously so. His Honour found that each of the mortgagor-guarantors well knew that he was putting his property "on the line" in the event of the business failing. Further, His Honour found that they knew there was some risk of failure."

In *Pasternacki & Anor v Correy & Ors*[79] the loan was set aside in its entirety (this decision being upheld on appeal[80]) but not before Hidden J was obliged to sit through cross-examination whereby the mortgagor falsely claimed she did not know she was pledging her house as security. His Honour finding:

> "I have already referred to the evidence of Mrs Correy … she denied that …she understood that she was making her home available as security for a loan. Even Mr Antonopolous' warning that if the loan were not paid on time she might lose her home, she said, did not "connect to" her at the time. She claimed that she realised that the house was mortgaged only later … I cannot accept this evidence… I am satisfied that at the time she signed the necessary documents… Mrs Correy knew that she was borrowing the sum involved on behalf of her son, and providing her home as security for that loan."

4. When they sign false applications to procure the loan

Unlike equity, which requires clean hands it is possible for a borrower who has deliberately mislead the lender to claim relief under the Act. In *Permanent Mortgages Pty Ltd v Michael Robert Cook and Karen Cook*[81] Patten AJ granted relief under the act despite the mortgagor knowingly signing false document to procure the loan. His Honour holding:

> "Whether I should hold the mortgage unjust in this case involves a balancing exercise. On the one hand are the circumstances that the Defendants speak English as their first language; were experienced borrowers; had the services of a solicitor; were extremely anxious to obtain the loan; and were prepared to sign false statements and procure false certificates. On the other hand, the beneficial nature of the Code indicates that it was intended to protect the unsophisticated and meagrely educated, such as the Defendants, from their own foolishness. Given the means of the Defendants and their credit history, the Plaintiff, in my view, was aware, or would have been aware, had it made the most perfunctory of enquiries, that the Defendants were not capable of servicing the loan even at the lower rate of interest and could only satisfy their obligations by selling the mortgaged property…"

5. Experience and education of the mortgagor

The experience and education of the mortgagor is a factor in determining whether the mortgage is unjust. In *Blacker v National Australia Bank Ltd*[82] Young J held:

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[79] [1998] NSWSC 288
[80] Pasternacki v Correy [2000] NSWCA 333
[81] [2006] NSWSC 1104
[82] [2000] NSWSC 805

> "… this was not a case of an illiterate or otherwise disabled couple making a contract that was forced upon them. They may have been only basically educated… but this does not seem to me to be enough to show that there was procedural injustice in bringing about the contract."

The Court of appeal in *Elkofairi v Permanent Trustee Co Ltd*[83] per Beazley JA (Santow JA and Campbell AJA agreeing) overturned the trial judge and set aside a mortgage (as it applied to a wife). Her Honour noting that:

> "The appellant's educational background, her inability to read or write English or to understand other than the most basic spoken English and her difficult domestic circumstances were such that the appellant was in a special position of disadvantage in the sense explained in *Blomley v Ryan*. However, none of those matters were known to the respondent. Accordingly, it is necessary to consider whether there were any other features of the transaction which made it unconscientious for the respondent to enter into this transaction with the appellant given the circumstances in which her execution of the contract was procured.
>
> This case does not fit neatly into either of the factual scenarios presented in *West* and in *Smith*. However, it is characterised by two significant features. First, it was a substantial loan, security for which was the appellant's only asset – her interest in the property. The debt to asset ratio was almost 75%. Secondly, the respondent knew that the appellant had no income nor other assets. None was disclosed on the loan application. The only confirmation the respondent had that the payments under the loan would be met was the series of letters from the accountant, which only related to Mr Elkofairi, and which contained no particulars of Mr Elkofairi's income and included a disclaimer *"as to the accuracy of the information"* provided. The consequence was, as submitted by the respondent's counsel, that the respondent was content to lend on the value of the security only. In my opinion, these factors taken in consideration with the matters to which I have referred [to], are sufficient to make the contract unjust in the circumstances in which it was made."

6. Independent legal advice

The court's have repeatedly insisted that injustice is not established merely because the lender has not required the borrower to obtain legal advice. In *West v AGC Advances Ltd*[84] per McHugh JA noted:

> "It is important to bear in mind that it is the contract or its provisions which must be unjust … If a defendant has not been engaged in conduct depriving the claimant of a real or informed choice to enter into a contract and the terms of the contract are reasonable as between the parties, I do not see how that contract can be considered unjust simply because she had no independent legal advice …"

[83] [2002] NSWCA 413
[84] (1986) 5 NSWLR 610 at 621-622

Given that in most instances the court disbelieves English speaking mentally competent mortgagors when they say they did not know they were signing a mortgage, or what a mortgage was (see "When the mortgagors know they are signing a mortgage" above) requiring a mortgagor obtain legal advice is of less utility than might be imagined. Lender's should certainly not regard it as a panacea with regard to potential Contracts Review Act liability. What is more often at issue is the mortgagor's understanding of the risks involved in the proposed transaction. To address this the mortgagor is more likely to need independent financial advice.

7. Independent financial advice

Where a mortgagor is labouring under a special disability or is potentially so labouring the lender can be under an obligation to ensure the mortgagor understands the financial aspects of the proposed transaction. This was the basis for the decision in *Pasternacki & Anor v Correy & Ors*[85] where Hidden J held (underlining added):

> "Certainly, it should have been clear to … [the lender] that the transaction may well have been improvident from Mrs Correy's point of view. I appreciate that this case is different from cases such as *Karavas* and *Wynne,* where the lender had material from which the improvidence of the transaction was demonstrable. Here nothing was known about Henry Correy's capacity to meet his mother's liability, because nobody asked him. The circumstances were such as to put Mr Smith on enquiry. Indeed, I strongly suspect that it was his misgivings about this very matter which led to his drafting the letter exhibit 1. However, all he did was to refer Mrs Correy to Mr Antonopolous for conventional legal advice about the mortgage, without suggesting that she obtain advice about her son's financial circumstances and his business. Nor did he ascertain whether she had received such advice before the transaction was brought to finality later in the afternoon of 18 May. Indeed, it was obvious that she had not. <u>It was apparent in this case that Mrs Correy needed guidance as to the financial wisdom of the contract, not just its legal effect</u>."

In *Beneficial Finance Corp Limited v Karavas*[86] with Kirby P expounded:

> "The appellant says that this result will have a highly undesirable effect on freedom to contract. The decision will send a signal, so it was implied, that, at least in circumstances similar to the present, a financier will have to ensure that guarantors and family mortgagors receive proper, independent advice on the financial wisdom of the transaction which they have agreed to support. Necessari1y, this would import a cost component which, inevitably, would have to be borne by the borrowing public. It would necessitate delay. In some cases it would impede risk-taking and this at a time when the public interest might be better served in entrepreneurial activities which necessarily involve the hiking of risks….

[85] [1998] NSWSC 288
[86] (1991) 23 NSWLR 256 at 277

> In these circumstances, It is clear that, just as the court must consider such issues when a claim for relief is made to it, necessarily those entering into contracts to which the Act applies must order their affairs against the possibility that, later the Act may be invoked."

H. Lender knowledge

1. The general rule

As a general rule the Court will not hold against a lender circumstances of which it had no knowledge. This was spelled out in *Davey v Challenger Managed Investments*[87]by Handley JA (Hodgson JA and Grove J agreeing):

> "If there was any unfairness the lender was not responsible for it, and had no notice, actual or constructive, of that unfairness. As a general rule the Court will not grant relief under the Act against a party who is in that position. See *Esanda Finance Corporation Ltd v Tong* (1997) 41 NSWLR 482."

2. The existence of exceptions

That there are potentially exceptions has long been recognised. In *Beneficial Finance Corp v Karavas*[88] Meagher JA said:

> "There is jurisdiction under the Act to make orders in favour of a party to a contract who proves that at the date of the contract he suffers from a relevant disability even though the other party to the contract is unaware of that disability, although in general it would be unsound to exercise the jurisdiction in those circumstances ...
>
> The reason for this view is that it is hardly just to deprive an innocent person of valuable property, of which contractual rights are a species. Nevertheless, such a jurisdiction undoubtedly exists. In the present case, for example, it is made quite clear from s9(2)(i) of the Act that relief may be granted if a finding is made that a party to a contract did not understand "the provisions and their effect" of a contract."

In *St George Bank Ltd v Trimarchi & Anor*[89]*p*er Mason P (Sheller JA, Cripps AJA agreeing):

> "..a transaction may be unjust even though one party to it was not privy to or on notice of (all of) the circumstances rendering it unjust (see eg *Collier v Morlend Finance Corporation (Vic) Ltd* (1989) 6 BPR 13,337, *Esanda Finance Corporation Ltd v Tong* (1997) 41 NSWLR 482). Of course, the state of mind of the "innocent" party is relevant to the unjustness calculus and to the discretionary remedial response."

[87] [2003] NSWCA 172
[88] 1991 23 NSWLR 256 at 277
[89] [2004] NSWCA 120

3. Constructive notice exception

If the known circumstances are such that the lender ought to suspect something untoward then it can be held accountable. This occurred in Pasternacki v Correy[90] with Hidden J finding:

> "I did find that the circumstances were such that they knew or should have known that Mrs Correy was under some emotional pressure from her son. However, I did not find that they understood Henry Correy's financial position and business prospects to be precarious. Rather, I found that they were ignorant of his situation and, in the circumstances, were put on enquiry."

The Court of Appeal agreed[91] holding per Stein JA:

> "There was ample evidence to justify a conclusion that Mr Smith (and Mr Pasternacki) knew or ought to have known that the mortgage was improvident to Mrs Correy. They knew that she was an aged pensioner. They were aware of the extreme urgency of the matter so far as Henry was concerned. They knew that the respondent did not have the ability to repay the loan, unless she sold her home. They knew that she was under emotional pressure from her son. They knew nothing about Henry's capacity to repay the loan, because, as his Honour observed, nobody asked him. They were ignorant of his situation in circumstances which put them on inquiry."

In *Teachers Health Investments Pty Ltd v Wynne*[92] Beazley JA said (underlining added):

> "In this case, the mortgage document itself was unexceptional. However, the respondent was cajoled and bullied into entering into the mortgage by the principal debtor. Whilst she understood the nature and effect of the mortgage she did not know, at the time she entered into it, that it was an improvident transaction. She had no knowledge of or advice as to the principal debtor's ability to service the loan … save for the false information he gave her that he could do so. … Although the appellant was not aware of the history of the relationship between the parties or of the principal debtor's conduct in obtaining the mortgage, <u>it knew, or had the information in its possession to enable it to know, that this mortgage was sheer folly when looked at from the ability of the principal debtor to make the interest payments</u>. The only part of the transaction which was not folly was the extent of the security. The appellant was well protected in this regard. In the circumstances, I am of the opinion that the contract was unjust within the meaning of the *Contracts Review Act* 1980."

The same theme was present in *Permanent Mortgages Pty Ltd v Michael Robert Cook and Karen Cook*[93] where Patten AJ held:

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[90] [1999] NSWSC 119
[91] [2000] NSWCA 333
[92] (1996) NSW Conv R 55 – 785 at 56,033
[93] [2006] NSWSC 1104

> "…the beneficial nature of the Code indicates that it was intended to protect the unsophisticated and meagrely educated, such as the Defendants, from their own foolishness. Given the means of the Defendants and their credit history, the Plaintiff, in my view, was aware, or would have been aware, had it made the most perfunctory of enquiries, that the Defendants were not capable of servicing the loan even at the lower rate of interest and could only satisfy their obligations by selling the mortgaged property"

4. The Khoshaba exception

In *Perpetual Trustee Company Limited v Albert and Rose Khoshaba*[94], the court held that where the lender is engaged in *asset lending* it cannot be regarded as an innocent party (regardless of its ignorance of the circumstances which make the loan unjust from the mortgagor's point of view). Spigelman CJ holding:

> "In my opinion the Appellant cannot be regarded as an innocent party of the kind referred to in the authorities. Again I place particular reliance on the indifference of the Appellant and its representatives to the purpose of the loan, indicating that it was content to proceed on the basis enforcing the security."

Basten JA agreed noting:

> "To engage in pure asset lending, namely to lend money without regard to the ability of the borrower to repay by instalments under the contract, in the knowledge that adequate security is available in the event of default, is to engage in a potentially fruitless enterprise, simply because there is no risk of loss. At least where the security is the sole residence of the borrower, there is a public interest in treating such contracts as unjust, at least in circumstances where the borrowers can be said to have demonstrated an inability reasonably to protect their own interests."

I. Lender behavior

1. The normal rule

The general rule is that the lender must have done something unfair. In *West v AGC (Advances) Ltd & Ors*[95] *p*er McHugh JA (Hope JA agreeing):

> "Under this Act, a contract will not be unjust as against a party unless the contract or one of its provisions is the product of unfair conduct on his part either in the terms which he has imposed or in the means which he has employed to make the contract."

This was reaffirmed in *White v Illawarra Mutual Building Society Limited*[96]per Powell JA:

[94] [2006] NSWCA 41
[95] (1986) 5 NSWLR 610
[96] [2002] NSWCA 164

> "As a general rule, a contract will not be unjust as against a party unless the contract or one of its provisions is the product of unfair conduct on his part either in the terms which he has imposed or in the means which he has employed to make the contract (*West v. AGC (Advances) Ltd.* supra at 622)."

The decision of Spigelman CJ *Perpetual Trustee Company Limited v Albert and Rose Khoshaba*[97]*,* contains a troubling paragraph:

> "Plainly, the conduct, whether by act or omission, of the party resisting a finding of unjustness under the Act is highly relevant, and will often be determinative. However, the scope of relevant circumstances is not confined to what the person resisting an order under s7(1) did or did not do and knew or ought to have known."

Taken in isolation this would seem to suggest that some loans will be set aside in circumstances where the lender was ignorant anything was amiss and did everything reasonably prudent to ensure everything was in order and did nothing culpable. However read in context it refers to the entirety of the circumstances which make the loan unjust. His Honour clearly maintains the requirement that the lender have done something culpable before relief will be ordered against it:

> "In my opinion the Appellant cannot be regarded as an innocent party of the kind referred to in the authorities. Again I place particular reliance on the indifference of the Appellant and its representatives to the purpose of the loan, indicating that it was content to proceed on the basis enforcing the security."

2. Advising on the wisdom of the loan

There seem to be no cases where the lender has actually advised on the wisdom of the loan but there are two authorities, one of them Court of Appeal, where the borrowers have been simpletons and the lenders were the only parties with the capability to determine the wisdom of the venture, and the borrowers reposed trust in the lender's decision to lend.

Elders Rural Financial v Smith[98]per Handley JA said (at 309):

> "… it [*Elders*] was closely and directly involved in the compilation of the financial projections which were crucial to the decision to lend. To its knowledge it was the only party who ever evaluated those projections, or was in a position to do so."

A similar conclusion was reached in another farmer case, *Kyabram Property Investments Pty Ltd and Anor v Murray and Anor*[99]where Shaw J held:

> "I conclude on the basis of the whole of the evidence that the defendants were under an element of real and tangible disadvantage in making a

[97] [2006] NSWCA 41
[98] (1996) 41 NSWLR 296
[99] [2004] NSWSC 298

judgment as to what was in their own best interests. Not only did they lack the requisite financial expertise but also lacked relevant documentation that would have indicated the likely trading results of this property. I have not overlooked that fact that it was proposed to grow a different class of crops in reliance upon the irrigation of the property.

I conclude that the lender failed to adequately analyse the past financial data and the projections of the future. Yet it was in a far better position to do so than the defendants. I find that the plaintiffs entered into arrangements that, at a practical level and having regard to objective considerations, were not capable of fulfilment. Warning bells should have been ringing. The plaintiffs were adequately protected in the sense that they had adequate security to facilitate the repayment of the loans if the properties had to be sold but the defendants were vulnerable.

Whilst the law cannot protect all of those entering into commercial transactions from foolishness, as I have indicated, in my opinion there are sufficient special circumstances in the present case so as to allow and require a declaration that the agreements entered into between the plaintiffs and the defendants were obtained in circumstances of unfairness and unconscionability, and that they should, so far as the agreements relate to the West Garawan property, be set aside subject to the observations I now make about interest."

3. Departing from prudent lending practice

A departure from prudent lending practice can either substantively (in the case of *Conley* see below) or procedurally (in the case of *Khoshaba* see below) make the mortgage unjust.

In *Conley v Commonwealth Bank of Australia*[100] Heydon JA held:

> "As the Master said, a breach of lending guidelines by itself would not bring the matter within the *Contracts Review Act*. But the existence of lending guidelines for home loan applications, many no doubt secured by first mortgage, suggests that there was a level beyond which, as the plaintiff bank's experience had taught it, it was not prudent to lend. In oral argument the plaintiff bank accepted that there might be such experience, but would not make any admissions on the subject. Mr McBurnie in effect agreed that the home loan application 30% guideline applied to gross income. Hence it would have been correspondingly higher where net income was concerned. The defendant's income was at no stage large. Whether the matter is looked at in gross or net terms, and whether the matter is looked at in terms of a surplus after allowing for all other outgoings or not, the quantum of the loans was very high from April 1991 on."

Spigelman CJ in *Perpetual Trustee Company Limited v Albert and Rose Khoshaba*[101] said:

> "… departure from the guidelines …[is] a relevant consideration in the determination of 'justness' …[but] such departure …[is] not, of itself,

[100] [2000] NSWCA 101
[101] [2006] NSWCA 41

> entitled to significant, let alone determinative weight… at least in a case where the departure from the guidelines is not evidence of departure from prudent lending practice."

His Honour went on to find that a failure to enquire after the purpose of the loan was such a departure and entitled the borrower's to have the loan set aside.

4. Asset lending

Asset lending has been objectionable for some time as the following chain of cases makes clear. Asset lending alone is not enough it must be to someone suffering under a special disability, asset lending to a property developer remains unobjectionable.

In *Teachers Health Investments Pty Ltd v Wynne*[102] Beazley JA held (underlining added):

> "Although the appellant was not aware of the history of the relationship between the parties or of the principal debtor's conduct in obtaining the mortgage, it knew, or had the information in its possession to enable it to know, that this mortgage was sheer folly when looked at from the ability of the principal debtor to make the interest payments. <u>The only part of the transaction which was not folly was the extent of the security. The appellant was well protected in this regard</u>. In the circumstances, I am of the opinion that the contract was unjust within the meaning of the *Contracts Review Act 1980*."

In *Pasternacki v Correy*[103] Stein JA said (underlining added):

> "Indeed, one likely scenario is that …[the lender] deliberately chose not to ask Henry any questions about his business affairs and his financial ability to repay the loan because of the answers which he might receive. <u>The …[lender was] concerned only to have adequate real estate as security</u>. Over and above that, the evidence… made it plain that they were unconcerned."

In *Elkofairi v Permanent Trustee Co Ltd*[104] per Beazley JA (Santow JA and Campbell AJA agreeing) the court held (underlining added):

> "This case does not fit neatly into either of the factual scenarios presented in *West* and in *Smith*. However, it is characterised by two significant features. First, it was a substantial loan, security for which was the appellant's only asset – her interest in the property. The debt to asset ratio was almost 75%. Secondly, the respondent knew that the appellant had no income nor other assets. None was disclosed on the loan application. The only confirmation the respondent had that the payments under the loan would be met was the series of letters from the accountant, which only related to Mr Elkofairi, and which contained no particulars of Mr Elkofairi's income and included a disclaimer "as to the accuracy of the information" provided. The

[102] (1996) NSW Con R 55-785
[103] [2000] NSWCA 333
[104] [2002] NSWCA 413

> consequence was, as submitted by the respondent's counsel, that the respondent was content to lend on the value of the security only. In my opinion, these factors taken in consideration with the matters to which I have referred in para 53, are sufficient to make the contract unjust in the circumstances in which it was made."

In *Permanent Trustee Australia Limited & 1 Or v Mary Gusevski & 1 Or* [105] Newman AJ held (underlining added):

> "There are of course here marked differences between the situation which pertained to Mrs Elkofairi and the present first defendant. Most important to these distinctions is the fact that the first defendant here speaks English as her native language and indeed obtained her Higher School Certificate. Not only that, she had worked for an insurance company as a pay clerk. Not only that, as I have found, the provisions of the mortgage and her responsibilities under the loan were explained to her by Mr Joukadour. Thus it is that the question of whether the first defendant is entitled to relief pursuant to the Contracts Review Act 1980 turns upon the failure of Mr Thomas, on behalf of the plaintiffs', to properly investigate the first defendant's financial situation at the time when the loan was approved. There being, in my view, nothing unfair in the terms of either the loan agreement or the mortgage conditions the question is whether there has been, to use McHugh JA's description in West's case, a procedural injustice in this case.
>
> In making this determination it is important to bear in mind that, like Mrs Elkofairi's situation, the second plaintiff was prepared to lend on the value of the security only in this case."

In *Perpetual Trustee Company Limited v Albert and Rose Khoshaba*[106] Spigelman CJ held (underlining added):

> "On the information actually available to the Appellant, a husband and wife – one with a $43,000 per annum income and the other a pensioner – borrowed $120,000 for, as far as the Appellant cared to know, immediate expenditure. Enforcing a security against the personal residence of such borrowers should not be treated as if it were the first resort. That is what, on paper, the Appellant can be described as having done.
>
> This conclusion is reinforced by the Appellant's concomitant failure to verify or follow up, in the way identified by Rolfe DCJ, other details in the loan application. I do not suggest that the matter can be approached, as his Honour appeared to do, on the basis that the Appellant should be fixed with the knowledge it would or may have acquired if the Guidelines had been observed. However, the other failures, such as not verifying employment and income and not ensuring documents were properly executed, reinforce the conclusion that the Appellant was prepared to act on the basis of adequate security alone.

[105] [2005] NSWSC 1281
[106] [2006] NSWCA 41

> Where the security is the family home of a low income earner and a pensioner, this posture on the part of a lender is entitled to significant weight against the lender in the determination of unjustness."

In *Perpetual Trustee Company Limited v Albert and Rose Khoshaba*[107] Basten JA held (underlining added):

> "To engage in pure asset lending, namely to lend money without regard to the ability of the borrower to repay by instalments under the contract, in the knowledge that adequate security is available in the event of default, is to engage in a potentially fruitless enterprise, simply because there is no risk of loss. At least where the security is the sole residence of the borrower, there is a public interest in treating such contracts as unjust, at least in circumstances where the borrowers can be said to have demonstrated an inability reasonably to protect their own interests."

5. Ignorance of the loan purpose

The ignorance of the purpose of the loan was focused upon in *Khoshaba's* case. As of and by itself it is not significant, rather it tends to show that the lender was engaged in pure asset lending. One can imagine therefore a case where the profit and loss figures of the mortgagor are carefully scrutinised to ensure the loan is affordable but the loan purpose is not enquired after – not being an example of asset lending it would not be unjust. In *Perpetual Trustee Company Limited v Albert and Rose Khoshaba*[108] Spigelman CJ held:

> "In my opinion, the purpose for which a loan is advanced is a relevant circumstance. This is confirmed by s9(2)(l) which includes, amongst the matters to which a court shall have regard in determining whether a contract is unjust: "The commercial or other setting, *purpose* and effect of the contract."
>
> The purpose of a loan is a concern of a lender, because it is usually a material consideration in determining whether the particular lender is able to service and repay the loan. The Appellant's own Guidelines confirm the relevance of this matter, both in identifying the requirement that the purpose be specified and in the structure of the Guidelines themselves. In detail not necessary to be set out, the Guidelines specify quite distinct criteria, including different maximum amounts of loans, for different kinds of purposes to which the loans will be applied."

Later His Honour noted:

> "The conflicting considerations are finely balanced. Had the Appellant or its representatives made any inquiries about the purpose of the loan I would have allowed the appeal. I do not mean to suggest that the Appellant had to determine that the proposed investment was reasonable and capable of servicing the loan. It is the indifference, suggesting that the Appellant was

[107] [2006] NSWCA 41
[108] [2006] NSWCA 41

content to proceed on the basis of enforcing the security, which I find determinative."

J. Determining relief

1. General principles

In *Esanda Finance Corporation Ltd v Tong*[109] Handley JA observed:

> "Section 7 gives the Court powers to grant civil remedies to remove unjust. These powers are neither penal nor disciplinary, and should not be exercised for such purposes. Once injustice to the weaker party has been remedied, the Court should not further interfere with the rights of the parties. Interference beyond that point will cause injustice to the other party, and is not authorised by the section. This question was considered in SH Lock (Australia) Ltd v Kennedy (1988) 12 NSWLR 482 at 487, where Samuels JA said:
>
> > If the Court were now to vary the contract of guarantee by reducing the amount of the respondent's liability it would not be relieving the respondent from the consequences of injustice, but punishing the appellant for having brought about an injustice … I do not consider that this would be an authorised use of the powers which the Act provides: see the opening words of s 7(1).
>
> Similarly, Priestley JA said (at 492, 493-494):
>
> > … Once the Court finds a contract unjust … it is faced with the next and quite separate task, for which the Act provides less guidance: the relief the court is empowered to give is, if it considers it just to do so, to make appropriate orders "for the purpose of avoiding as far as practicable an unjust consequence or result". As I understand s 7(1), wide though the court's powers are to find a contract unjust, the remedies it may grant in respect of such injustice are strictly limited to avoiding an unjust consequence or result of the unjust contract …"

Where the money has gone to a third party the court's general reaction is to set aside the whole loan. In *Pasternacki v Correy*[110] Justice Hidden J gave a separate decision on relief and his findings were not overruled on appeal:

> "The plaintiffs contend that I should do no more than defer enforcement of the mortgage during Mrs Correy's lifetime, so that she might continue to occupy the home. This is a course which was taken in a number of cases: *Melverton v Commonwealth Development Bank of Australia* (1989) NSW Conv R 55-484, *National Australia Bank Ltd v Hall* (supra), *Reisch v Commonwealth Bank of Australia* (Simos J, unreported, 13 March 1998). That course, it was submitted, would be an adequate remedy and would

[109] (1996-1997) 41 NSWLLR 482 at 489
[110] [1999] NSWSC 119

> have the added benefit of ensuring that Henry Correy himself could not inherit the property.
>
> For Mrs Correy, it was argued that the mortgage should be set aside. Simply to allow her to occupy the home during her lifetime would deprive her of the ability to realise her asset, which she might need to do in later life. Her counsel pointed out that there is no evidence of her testamentary intentions and, in any event, the order proposed by the plaintiffs would disinherit her other son, Carlo, who is innocent of any wrongdoing.
>
> I have not found this question easy to resolve. For the reasons I have given, the behaviour of Mr Smith in this transaction could fairly be described as reckless, but the power to grant relief under the Act must not be used in a penal or disciplinary manner: *Esanda Finance Corporation Ltd v Tong* (1997) 41 NSWLR 482 per Handley JA at 489. Counsel advanced the two options which I have outlined, and no intermediate course was suggested in argument. I was initially attracted to the plaintiffs' proposal but, upon reflection, I do not believe that that is the appropriate course… the plaintiffs' proposal would effectively deprive Mrs Correy of her only asset and, in reality, she would have no redress against anyone.
>
> I have come to the conclusion that Mrs Correy is entitled to the relief which she seeks, whereby her home is freed of the encumbrance upon it and she is relieved of her personal liability under the mortgage. The mortgage should be set aside and such ancillary orders should be made as are necessary."

2. Borrower must repay benefit

Where the borrower has obtained a benefit from the loan (as opposed to a third party absconding with all of it) the court will require the borrower to repay that benefit. For example in *State Bank of NSW v Hibbert*[111] Bryson J held (underlining added):

> "In my judgment the court should grant Mrs Groom relief under the Contracts Review Act against the mortgage over her interest in the house and against her personal liability as a guarantor, and should refuse to enforce any of the provisions of the mortgage against Mrs Groom and against her interest in the house, and should make an order under para 7(1)(d) requiring the execution of an instrument which varies the mortgage so as to release her interest from the Bank's security and terminates her personal obligations. <u>This order should be made on terms that she pays to the Bank the sum of $7962.81</u>."

In the case of *Permanent Mortgages Pty Ltd v Michael Robert Cook and Karen Cook*[112] which caused a big stir at the time (and was reported of the front page of the Financial Review) the benefit received by the mortgagors meant the value of the successful Contracts Review Act defence was puny, per Patten J (underlining added):

[111] [2000] NSWSC 628
[112] [2006] NSWSC 1104

> "Consistently with what I have said, I think the Defendants should, so far as possible, be returned to the position they were in as at April 2003. To that end, they should, in my opinion, be relieved of the costs and expenses incurred in respect of the credit provided by the Plaintiff and the principal should be reduced to the sum which was actually applied for their benefit, namely, the discharge of their outstanding debts. On that basis, seemingly, I should relieve the Defendants of the obligation to pay to the Plaintiff such portion of the principal secured by the subject mortgage or payable under the Credit Contract as is represented by items 8, 9, 10 and 13, totalling $13,627.50, listed in paragraph 36 above. I would also relieve the Defendants from payment of interest at a rate exceeding simple interest of 8.8% pa, and of any obligation to pay the Plaintiff's costs and expenses following default. It is not appropriate, in my opinion, to set aside the mortgage as this would result in the Defendants obtaining a benefit from the transaction they seek to impugn and would result in injustice to the Plaintiff."

3. Allowance for discharged mortgages

Consistent with the above principal if the unjust mortgage refinanced a just mortgage then credit must be given for the amount of the payout figure on the old mortgage plus interest. If only half the mortgage is unjust (for example a wife's half) then an adjustment should be made accordingly. In *Elkofairi v Permanent Trustee Co Ltd*[113] per Beazley JA (Santow JA and Campbell AJA agreeing) the court held:

> "In my opinion, credit should be given in respect of the St George mortgage. That mortgage has not been impugned and the ANZ mortgage must therefore be taken to have been subsumed by it. However, the appellant's interest should not to be taken to be the equivalent of a 100% interest in the relevant benefit. Conceptually, her interest is in one half of the benefit, as it derives from her interest as joint tenant with Mr Elkofairi in the Castle Hill property. That she is 100% liable under that encumbrance is not to the point. If the jointure were severed, her position vis a vis her husband, as the respondent must be taken to know, is effectively a half interest. That, therefore, is the benefit which she must bring to account, so as to discharge her, but not her husband, from the mortgage. That sum should bear interest. I accept that a rate of 7.5% should be applied."

4. Interest adjustment

In some cases where the mortgage is found to be unjust it is not set aside in its entirety but is instead re-written. There is a trend in cases where the interest rate is especially high for the court to require the principal to repaid but to reduce the interest rate to a much lower level. For example in *Cash King v Satchithanantham*[114] Bell J after finding the loan was unjust held:

> "Mrs Satchithanantham, by her amended cross-claim in each proceeding seeks that the mortgage and the loan which it secured, be set aside pursuant to the powers conferred under s 7 of the CRA. I am not of the opinion that it

[113] [2002] NSWCA 413
[114] [2006] NSWSC 1303

would be just to so order. Monies have been advanced under each agreement and those monies have not been repaid. I am persuaded that it is appropriate to grant relief to Mrs Satchithanantham pursuant to s 7(1)(c) and (d) varying provisions of the loan agreements and the mortgages with respect to the interest component and the total of the fees and charges."

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