A paper presented for The Continuing Professional Education Department of the College of Law on 18 July 2007

Equitable Defences to Mortgages

Published in Sydney by the Continuing Professional Education Department of the College of Law, 2 Chandos Street, St Leonards, NSW, Australia, 2065.

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

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ACKNOWLEDGEMENT

The presenter gratefully acknowledge the extensive assistance of Marcus Young of University Chambers in the preparation of this paper. Mr Young specialises in equity and commercial law. He is co-author, with the presenter, of the Lexis Nexis textbooks *The Essential Guide to Mortgage Law in NSW (2008) and The Essential Guide to Mortgage Law in Australia (2013).*

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A. Introduction

Equity has traditionally been moved to set aside mortgages, which would be against good conscience for a lender to enforce: as Mason J put it in *Commercial Bank of Australia Ltd v. Amadio*[1]

> Historically, courts have exercised jurisdiction to set aside contracts and other dealings on a variety of equitable grounds. They include fraud, misrepresentation, breach of fiduciary duty, undue influence and unconscionable conduct. In one sense they all constitute species of unconscionable conduct on the part of a party who stands to receive a benefit under a transaction which, in the eye of equity, cannot be enforced because to do so would be inconsistent with equity and good conscience.

This paper reviews the gamut of circumstances and heads under which Equity will set aside or grant other relief to mortgagors. Although they can be grouped under convenient headings the Courts continue to resist the urge to particularise violations. As Dixon J put it in *Yerkey v Jones*[2]

> Equities invalidating contractual obligations effectual at law often depend upon a combination of a large number of circumstances affecting the transaction and cannot be reduced to a series of syllogistic propositions.

B. Unconscionable dealing

1. The principle

Although all equitable defences are species of unconscionability when the expression *unconscionable dealing* is used it refers to a particular head of equity. This was described in the High Court case of *Blomley v Ryan*[3] by Kitto J:

> [8] This is a well-known head of equity. It applies whenever one party to a transaction is at a special disadvantage in dealing with the other party because illness, ignorance, inexperience, impaired faculties, financial need or other circumstances affect his ability to conserve his own interests, and the other party unconscientiously takes advantage of the opportunity thus placed in his hands.

[1] [1983] HCA 14
[2] [1939] HCA 3
[3] [1954] HCA 79

In *Amadio*[4] Mason J put it thus:

> [6] the … underlying general principle … may be invoked whenever one party by reason of some condition of circumstance is placed at a special disadvantage *vis-a-vis* another and unfair or unconscientious advantage is then taken of the opportunity thereby created. I qualify the word "disadvantage" by the adjective "special" in order to disavow any suggestion that the principle applies whenever there is some difference in the bargaining power of the parties and in order to emphasize that the disabling condition or circumstance is one which seriously affects the ability of the innocent party to make a judgment as to his own best interests, when the other party knows or ought to know of the existence of that condition or circumstance and of its effect on the innocent party.

Thus the bare elements of unconscionability are:

1. The weaker party suffers from some special disadvantage that prevents him or her from protecting their own interests

2. The stronger party knows of or should know of the special disadvantage

3. The stronger party takes unfair advantage of the weaker party

2. Special disadvantage

i) The weaker party is unable to judge for himself

Cited with approval in both *Amadio*[5] and *Blomley*[6] were the words of Lord Hardwicke in *Earl of Chesterfield v. Janssen*[7] in describing what constitutes a special disadvantage:

> … The essence of such weakness is that the party is unable to judge for himself.

Or as Mason put it in *Amadio*[8] the special disadvantage is*:*

> [6] … one which seriously affects the ability of the innocent party to make a judgment as to his own best interests.

ii) A high degree of disadvantage required

The disadvantage suffered by the weaker must be of a high degree. As Mason noted in *Amadio*[9] the principle is not triggered:

> [6] whenever there is some difference in the bargaining power of the parties …[rather] the disabling condition or circumstance [must be]… one which seriously affects the ability of the innocent party to make a judgment as to his own best interests.

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[4] [1983] HCA 14
[5] [1983] HCA 14
[6] [1954] HCA 79
[7] (1751) 2 Ves Sen, 125, at pp 155-156 (28 ER 82, at p100)
[8] [1983] HCA 14
[9] [1983] HCA 14

iii) Open categories of qualifying criteria

The list of what qualifies as disabling criteria is an open one. In *Blomley v Ryan*[10] Fullagar J noted:

> [9] The circumstances adversely affecting a party, which may induce a court of equity either to refuse its aid or to set a transaction aside, are of great variety and can hardly be satisfactorily classified. Among them are poverty or need of any kind, sickness, age, sex, infirmity of body or mind, drunkenness, illiteracy or lack of education, lack of assistance or explanation where assistance or explanation is necessary.

iv) Inequality of bargaining power

Inequality of bargaining power does not of itself constitute special disadvantage. As Mason noted in *Amadio*[11] the principle is not triggered:

> [6] whenever there is some difference in the bargaining power of the parties …[rather] the disabling condition or circumstance [must be]… one which seriously affects the ability of the innocent party to make a judgment as to his own best interests.

However His Honour went on to couch the test in terms of a *gross inequality of bargaining power*:

> [13] There are a number of factors which go to establish that there was a gross inequality of bargaining power between the bank and the respondents, so much so that the respondents stood in a position of special disadvantage *vis-a-vis* the bank in relation to the proposed mortgage guarantee.

It may be the Court have emphasised the difference between the position of the two parties to ensure that one of two weak parties is excluded from seeking relief against the other. Mason was in any event simply repeating the formula used by Fullgar J in *Blomley*[12] who noted (emphasis added):

> [9] The circumstances adversely affecting a party, which may induce a court of equity either to refuse its aid or to set a transaction aside, are of great variety and can hardly be satisfactorily classified… *The common characteristic seems to be that they have the effect of placing one party at a serious disadvantage vis-a-vis the other.*

[10] [1954] HCA 79
[11] [1983] HCA 14
[12] [1954] HCA 79

v) The facts in Amadio

The circumstances in *Amadio*[13] which qualified as establishing the requisite special disadvantage were summarized by Mason J as follows:

> [13] There are a number of factors which go to establish that there was a gross inequality of bargaining power between the bank and the respondents, so much so that the respondents stood in a position of special disadvantage *vis-a-vis* the bank in relation to the proposed mortgage guarantee. By way of contrast to the bank, the respondents' ability to judge whether entry into the transaction was in their own best interests, having due regard to their desire to assist their son, was sadly lacking. The situation of special disadvantage in which the respondents were placed was the outcome of their reliance on and their confidence in their son who, in order to serve his own interests, urged them to provide the mortgage guarantee which the bank required as a condition of increasing the approved overdraft limit of his company … from $80,000 to $270,000 and misled them as to the financial position of the company. Their reliance on their son was due in no small degree to their infirmities - they were Italians of advanced years, aged 76 and 71 respectively, having a limited command of written English and no experience of business in the field or at the level in which their son and the company engaged. They believed that the company's business was a flourishing and prosperous enterprise, though temporarily in need of funds.

3. Knowledge of the special disadvantage

i) Notice is required

The second element is that the stronger party must be on notice of the special disadvantage. It being trite that the stronger party cannot have a bad conscience if he is blissfully unaware of the circumstances that make the transaction unconscionable.

ii) Constructive notice is sufficient

In *Amadio*[14] Mason J stated:

> [21] In Owen and Gutch v. Homan[15], Lord Cranworth L.C. said: "... it may safely be stated that if the dealings are such as fairly to lead a reasonable man to believe that fraud must have been used in order to obtain" (the concurrence of the surety), "he is bound to make inquiry, and cannot shelter himself under the plea that he was not called on to ask, and did not ask, any questions on the subject. In some cases wilful ignorance is not to be distinguished in its equitable consequences from knowledge." The principle there stated applies with equal force to this case. The concept of fraud in equity is not limited to common law deceit; it extends to conduct of the kind engaged in by the respondents' son when he took advantage of the confidence and reliance reposed in him to induce his parents to enter into a transaction in order to serve his ends, thereby depriving them of the ability to make a judgment as to what is in their interests.

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[13] [1983] HCA 14
[14] [1983] HCA 14
[15] (1853) 4 HLC, at p 1035 (10 ER, at p 767)

> As we have seen, if A having actual knowledge that B occupies a situation of special disadvantage in relation to an intended transaction, so that B cannot make a judgment as to what is in his own interests, takes unfair advantage of his (A's) superior bargaining power or position by entering into that transaction, his conduct in so doing is unconscionable. And if, instead of having actual knowledge of that situation, A is aware of the possibility that that situation may exist or is aware of facts that would raise that possibility in the mind of any reasonable person, the result will be the same.

In the same case Wilson J stated:

> [22] The evidence does, however, demonstrate that there was no proper basis at all for any assumption that Mr. and Mrs. Amadio had received adequate advice from Vincenzo as to the effect of the document which Mr. Virgo [the bank officer] presented to them for their signature. Even if that were not the case, it would be difficult to accept as reasonable a belief that Vincenzo had successfully explained to his parents the content and effect of a document which embodied eighteen separate convenants of meticulous and complicated legal wording in circumstances where, to Mr. Virgo's knowledge, Vincenzo had himself never seen the document at the time when any such suggested explanation must have taken place. … Mr. Virgo simply closed his eyes to the vulnerability of Mr. and Mrs. Amadio and the disability which adversely affected them.

4. Unfair advantage must be taken

i) Fair contracts are not caught

The final element, that unfair advantage must be taken by the stronger party, is a necessary curtailment. Without it the law would effectively prevent persons with special disabilities from entering contracts (because they would be unenforceable).

ii) The onus is on the stronger party to prove unfair advantage not taken

Once the first two elements (1. that there is a special disadvantage, 2. that the lender has actual or constructive notice of it) have been established by the weaker party the onus of proof in relation to the third element falls on the stronger party who must prove he did not take unfair advantage. In *Amadio*[16] Deanne J noted:

> [12] Where such circumstances are shown to have existed [the first two elements], an onus is cast upon the stronger party to show that the transaction was fair, just and reasonable: "the burthen of shewing the fairness of the transaction is thrown on the person who seeks to obtain the benefit of the contract"

[16] [1983] HCA 14

iii) The relevance of consideration

It is not sufficient to show that there has been consideration moving from the stronger party. The doctrine is alternatively known as catching bargains. The court will therefore be concerned to see that the level of consideration moving from the lender was proportionate to the security. Even if the consideration was adequate the fact that it did not move to the weaker party will speak against the lender. In *Amadio*[17] Deanne J noted:

> [14] In most cases where equity courts have granted relief against unconscionable dealing, there has been an inadequacy of consideration moving from the stronger party. It is not, however, essential that that should be so… Notwithstanding that adequate consideration may have moved from the stronger party, a transaction may be unfair, unreasonable and unjust from the view point of the party under the disability. An obvious instance of circumstances in which that may be so is the case where the benefit of the consideration does not move to the party under the disability but moves to some third party involved in the transaction. Thus, it is established that the jurisdiction extends, in an appropriate case, to relieve a guarantor of the burden of a guarantee of existing and future indebtedness.

iv) Catching bargains

The jurisdiction of Equity to relieve against stronger parties *catching bargains* is not distinct head but rather another name for unconscionable dealing. The name itself however gives insight into the importance of the third element in the doctrine. In *Amadio*[18] Mason J stated:

> [2]… relief on the ground of "unconscionable conduct" is usually taken to refer to the class of case in which a party makes unconscientious use of his superior position or bargaining power to the detriment of a party who suffers from some special disability or is placed in some special situation of disadvantage, e.g., a catching bargain with an expectant heir or an unfair contract made by taking advantage of a person who is seriously affected by intoxicating drink.

v) Equitable fraud

Unconscionable dealing is a species of equitable fraud (see *Fisher & Lightwoods: Law of Mortgages*, Tyler Young & Croft, second Australian Edition page 352) and the relationship to the third element can be seen in the words of Lord Hardwicke in *Earl of Chesterfield v. Janssen*[19]:

> … in defining the fraud characterised as taking surreptitious advantage of the weakness, ignorance or necessity of another. The essence of such weakness is that the party is unable to judge for himself.

[17] [1983] HCA 14
[18] [1983] HCA 14
[19] (1751) 2 Ves Sen, 125, at pp 155-156 (28 ER 82, at p100)

5. Relief

Relief available to the weaker party is subject to the usual axioms of equity including limiting the relief to that required to make the stronger party's actions conscionable and conversely requiring the weaker party to do equity. In relation to mortgages this typically requires that the benefit obtained by the discharge of earlier mortgages to be acknowledged by the mortgagor. In *Amadio*[20] Deane J stated:

> [26] The concept underlying the jurisdiction to grant the relief is that equity intervenes to prevent the stronger party to an unconscionable dealing acting against equity and good conscience by attempting to enforce, or retain the benefit of, that dealing. Equity will not, however, "restrain a defendant from asserting a claim save to the extent that it would be unconscionable for him to do so. If this limitation on the power of equity results in giving to a plaintiff less than what on some general idea of fairness he might be considered entitled to, that cannot be helped" … Where appropriate, an order will be made which only partly nullifies a transaction liable to be set aside in equity pursuant to the principles of unconscionable dealing.

It is this perceived shortcoming which the Contracts Review Act 1980 purports to address.

C. Undue influence

1. The General Principle

The general rule was summarized in *Yerkey v Jones*[21] by Dixon J who stated:

> [20]…where there is a relation of influence and the dominant party is the person by or through whom an instrument operating to his advantage is obtained from the other, the instrument is voidable.

The words *to his advantage* import a requirement that the transaction be one which is lopsided in favour of the dominant party.

2. Application to loan transactions

When a surety alleges undue influence to avoid a mortgage it is typically not the undue influence of the lender that is usually the basis of the defence. Rather it is the undue influence of the borrower - of which the lender was on notice. In *Amadio*[22] Mason J stated:

> [12] It is to be hoped that the respondents' amended statement of claim does not find its way into the precedent books. It leaves much to be desired. It alleges unconscionable conduct and alternatively undue influence on the part of the bank. It does not, as it might have done, allege undue influence on the part of the respondents' son Vincenzo, with notice on the part of the bank.

[20] [1983] HCA 14
[21] [1939] HCA 3
[22] [1983] HCA 14

This was spelled out in *Yerkey*[23] by Dixon J who stated (emphasis added):

> [20]… [the] rule is that where there is a relation of influence and the dominant party is the person by or through whom an instrument operating to his advantage is obtained from the other the instrument is voidable *even as against strangers who have become parties to the instrument for value if they had notice of the existence of the relation of influence or of the circumstances giving rise to it*. Thus, a guarantee procured by a principal debtor in favour of his creditor from a niece residing with him who had not long come of age and whose guardian he had been was set aside on the ground that a relation of influence existed. The creditors, who gave no consideration to the guarantor, except the forbearance from calling up her uncle's debt, knew her defenceless position.

In the High Court case of *Bank of New South Wales v Rogers*[24] Stark J noted:

> [2] The inference of undue influence operates not only "against the person who is able to exercise the influence", but "against every volunteer who claimed under him, and also against every person who claimed under him with notice of the equity thereby created, or with notice of the circumstances from which the court infers the equity. But ... it would operate against no others; it would not operate against a person who is not shown to have taken with such notice of the circumstances under which the deed was executed" (*Bainbrigge v. Browne*[25]).

3. Relationship to unconscionable dealing

Undue influence is a separate doctrine to unconscionable dealing. In *Morrison v Coast Finance Ltd*[26]Davey JA (at 713) noted:

> The equitable principles relating to undue influence and relief against unconscionable bargains are closely related, but the doctrines are separate and distinct… A plea of undue influence attacks the sufficiency of consent; a plea that a bargain is unconscionable invokes relief against an unfair advantage gained by an unconscientious use of power by a stronger party against a weaker.

In *Amadio*[27] Mason J stated:

> [2] Although unconscionable conduct … bears some resemblance to the doctrine of undue influence, there is a difference between the two. [With undue influence] the will of the innocent party is not independent and voluntary because it is overborne. [With unconscionable conduct] the will of the innocent party, even if independent and voluntary, is the result of the disadvantageous position in which he is placed and of the other party unconscientiously taking advantage of that position.

[23] [1939] HCA 3
[24] [1941] HCA 9
[25] (1881) 18 Ch. D., at pp. 196, 197
[26] (1965) 55 DLR (2d) 710
[27] [1983] HCA 14

> There is no reason for thinking that the two remedies are mutually exclusive in the sense that only one of them is available in a particular situation to the exclusion of the other. Relief on the ground of unconscionable conduct will be granted when unconscientious advantage is taken of an innocent party whose will is overborne so that it is not independent and voluntary, just as it will be granted when such advantage is taken of an innocent party who, though not deprived of an independent and voluntary will, is unable to make a worthwhile judgment as to what is in his best interest.

4. First issue: was there a relationship of influence?

The first issue is determining whether there is a relationship of influence. A relationship of influence is either:

(a) Presumed - because the law recognizes certain relationships as automatically being relationships of influence. Relationships of influence recognised by the law include; solicitor and client, doctor and patient, guardian and ward. Or,

(b) Is established - by the weaker party leading evidence that he reposed trust and confidence in the stronger party. In these cases the onus of establishing the influence sits with the weaker party.

In High Court case of *Johnson v Buttress*[28] Dixon J (at 134) described both categories:

> This burden is imposed upon one of the parties to certain well-known relations as soon as it appears that the relation existed and that he has obtained a substantial benefit from the other. A solicitor must thus justify the receipt of such a benefit from his client, a physician from his patient, a parent from his child, a guardian from his ward, and a man from the woman he has engaged to marry…But while in these and perhaps one or two other relationships their very nature imports influence, the doctrine which throws upon the recipient the burden of justifying the transaction is confined to no fixed category. It rests upon a principle. It applies whenever one party occupies or assumes towards another a position naturally involving an ascendancy or influence over that other, or a dependence or trust on his part. One occupying such a position falls under a duty in which fiduciary characteristics may be seen. It is his duty to use his position of influence in the interest of no one but the man who is governed by his judgment.

In relation to the test for established relationships of influence ((b) above) Chief Justice Dixon in the High Court decision of *Jenyns v. Public Curator*[29] stated:

> [28] We are not here dealing with any of the traditional relations of influence or confidence - solicitor and client, physician and patient, priest and penitent, guardian and ward, trustee and cestui que trust. It is a special relationship set up by the actual reposing of confidence. It is therefore necessary to see the extent and nature of the confidence reposed and whether it involved any ascendancy over the will of the person supposedly dependent on the confidence.

[28] [1936] HCA 41; (1936) 56 CLR 113
[29] [1953] HCA 2; (1953) 90 CLR 113

In the High Court case of *Bank of New South Wales v Rogers*[30] there was hybrid. The evidence established a parent-child relationship between a child and uncle. Once that had been established a presumption of influence was applied. This was explained by McTiernan J who noted:

> The facts are fully stated and discussed in the judgment of the learned judge, and I shall therefore refer only to the more outstanding features of the case. The respondent, who is a spinster, was born in 1868, and was therefore of mature age in the years 1930-1932 when the transactions took place which were challenged in the action. Her mother died when she was a child and her father in 1891, when she was twenty-three years of age. She then went to live with her uncle, C. L. Gardiner, and resided with him until he died in the year 1938, at the great age of ninety-four years. She lived as a member of her uncle's family, and was attached and grateful to him. The home appears to have been a comfortable one; the ordinary domestic help was available to its inmates. In 1923, when Mrs. Gardiner died, the respondent took charge of the house. She was an intelligent woman with a will of her own, not an aggressive woman, or one who yielded too easily, but in matters of business she relied upon and followed her uncle's advice without question. In short, there can be no doubt that Gardiner stood in *loco parentis* towards the respondent, and therefore in the special class of relationship from which undue influence is presumed unless rebutted.

5. Second issue: was the transaction at undervalue?

The next issue for determination is whether the transaction was at undervalue or without consideration. This will determine the onus of proof in relation to the third issue. This was put by Isaacs J in the High Court decision of *Watkins v Coombs*[31] as follows:

> It is not the law, as I understand it, that the mere fact that one party to a transaction who is of full age and apparent competency reposed confidence in, or was subject to the influence of, the other party is sufficient to cast upon the latter the onus of demonstrating the validity of the transaction. Observations which go to that extent are too broad. The first thing to ascertain in such a case is the true character of the transaction impeached. Is it a gift to the "confidant" of importance? If so, the burden at once is cast on the confidant to satisfy the Court that the transaction was free from "undue influence" but was the free outcome of the donor's uninfluenced will… Is it an ordinary sale for full value? If so, no such burden rests on the "confidant" but the party impeaching it has to show affirmatively the exercise of undue influence.

In the above statement His Honour introduces two variables, these are:

(a) Whether the weaker a party is *of full age and apparent competency*

(b) Whether the transaction was at undervalue

[30] [1941] HCA 9; (1941) 65 CLR 42
[31] (1922) 30 CLR 180 at 193-4

Both are capable of reversing the onus, creating the following outcomes:

Status of weaker party	**Consideration for transaction**	**Onus of proof in relation to the third issue**
Full age and apparent competency	Ordinary sale for full value	With the weaker party
Full age and apparent competency	Gift or inadequate consideration	With the stronger party
Minor or apparently incompetent	Ordinary sale for full value	With the stronger party
Minor or apparently incompetent	Gift or inadequate consideration	With the stronger party

Isaacs J seems to leave open the possibility that a transaction for full value can be impeached, but this is doubtful. Generally the authorities make reference to advantage or even lack of consideration in such transactions. See the emphasis in the extract below which Isaacs quoted with approval immediately afterwards.

6. Third issue: was the influence that existed undue?

After the statement extracted above Issacs J in *Watkins v Coombs*[32] went on to quote Lord Shaw in *Poosathurdi v. Kanappa Chettiar*[33] in which he said:

> It is a mistake… to treat undue influence as having been established by a proof of the relations of the parties having been such that the one naturally relied upon the other for advice, and the other was in a position to dominate the will of the first in giving it. Up to that point influence alone has been made out. Such influence may be used wisely, judiciously and helpfully. But… more than mere influence must be proved so as to render influence, in the language of the law, undue. It must be established that the person in a position of domination has used that position to *obtain unfair advantage for himself, and so to cause injury to the person relying upon his authority* or aid. And where the relation of influence, as above set forth, has been established, and the second thing is also made clear, viz., that the bargain is with the influencer and in itself unconscionable; then the person in a position to use his dominating power has the burden thrown upon him, and it is a heavy burden, of establishing affirmatively that no domination was practiced so as to bring about the transaction, but that the grantor of the deed was scrupulously kept separately advised in the independence of a free agent. These general propositions are mentioned, because, if laid alongside of the facts of the present case, then it appears that one vital element—perhaps not sufficiently relied on in the Court below, and yet essential to the plaintiff's case—is wanting. It is not proved as a fact in the present case that the bargain of sale come to was unconscionable in itself, or constituted an advantage unfair to the plaintiff; it is, in short, not established as a matter of fact that the sale was for undervalue.

[32] (1922) 30 CLR 180 at 193-4
[33] (1919) L.R. 47 I.A., 1; 43 Madras, 546

Thus issue three consists in the stronger party proving that the weaker party was independently advised and acted as a free agent – without his will being overborne. There does however, in this quote and others, appear to be a suggestion that if the transaction is for full consideration then that is exculpatory. In High Court case of *Johnson v Buttress*[34] Dixon J (at 134) stated:

> When they stand in such a relation [of influence], the party in the position of influence cannot maintain his beneficial title to property of substantial value made over to him by the other as a gift, unless he satisfies the court that he took no advantage of the donor, but that the gift was the independent and well-understood act of a man in a position to exercise a free judgment based on information as full as that of the donee…
>
> The facts which must be proved in order to satisfy the court that the donor was freed from influence are, perhaps, not always the same in these different relationships, for the influence which grows out of them varies in kind and degree… When he takes from that man a substantial gift of property, it is incumbent upon him to show that it cannot be ascribed to the inequality between them which must arise from his special position.

Presumably it would be impossible to so prove in the case of a minor or other mentally incapable person. This was suggested in *Fisher & Lightwoods: Law of Mortgages*, Tyler Young & Croft, second Australian Edition page 343, where the learned authors opined:

> In a transaction with the person under whose influence the child is or is supposed to be (that is, in a transaction with religious, medical or other advisers, but not with a banker…); or in a transaction with a person who… is likely to have an advantage over him, the child is entitled to be relieved from the consequences as against the grantee and the volunteers claiming under the grantee, and all other persons who claim with notice of the equity or with notice of the circumstances under which it arose.

Many authorities suggest that the way to rebut the presumption of undue influence is to show that the weaker party was independently advised. In relation the probity of such advice Chief Justice Dixon in the High Court decision of *Jenyns v. Public Curator*[35] stated:

> It will be seen that what his Honour had in mind was the rebuttal of influence by proof of free and independent volition, not by proof of complete comprehension of the nature and consequences of the transaction. On this view the jury displaced the effect in favour of the curator of their first answer by finding that the transaction was the outcome of the free and independent will of Mrs. Jenyns… The finding that she did not sufficiently understand the transaction, relating as it does to matters of general reasoning and business wisdom and acumen, as opposed to facts known to the donee in virtue of his position and not disclosed, is not enough by itself to invalidate the gift.

[34] [1936] HCA 41; (1936) 56 CLR 113
[35] [1953] HCA 2; (1953) 90 CLR 113

The case law was canvassed by Gillard J in *Union Fidelity Trustee Co v Gibson* [1971] VR 573 (at *577—8)* who noted:

> Although there is no rule of law that where such a relationship exists the donor should have independent advice at the time of making the gift in order to rebut the presumption *(Kali Bakhsh v Ram Gopal Singh* (1913), 30 TLR 138; *Haskew u Equity Trustee Executor & Agency Co Ltd* [(1918) VLR 634]; *Inche Noriah's Case,* supra; *Bank of New South Wales v Rogers* (1921)65 CLR 42; *Tufton v Sperni* [(1952) 2 TLR 516], and, particularly if the court is of opinion that independent advice would not have had any effect on the transaction *(Linderstam v Barnett,* (1915), 19 CLR 528; *Barr u Union Trustee Co of Aust Ltd* [1923] VLR 236, 29 ALR 67, or that the gift was trifling or of a simple character *(Rogers' Case,* supra, at p 87), nevertheless independent advice is an important factor in determining whether the gift is the pure voluntary and well understood act of the donor. This is particularly so if the gift should be of a large sum of money *(Rhodes v Bate,* supra; *Haskew's* Case (1919), 27 CLR 231, at p 235; 25 ALR 350; *Johnson v Buttress* (1936) 56 CLR 113, at p 120; [1936] ALR 390), or the circumstances of the relationship, however proper the court may regard them, strongly suggest that the donor was in a position of grave inequality in relation to the donee (see *Allcard v Skinner* [(1887) 36 Ch D 145]; *Powell v Powell* [[19001 1 Ch 243]; *Lancashire Loans v Black* [1934] 1 KB 380; [19331 All ER Rep 201; *Zamet v Hyman* [[1961] 3 All ER 933], or where the transaction may be of a complicated character (see *Rogers' Case,* at p 87). The Privy Council in *Incite Noriah's Case,* supra, pointed out that the donee may rebut the presumption in any manner open to him on the facts which enables him to persuade the court that the gift was really the spontaneous act of a party, comprehending what he did and as a result of his own free will. But it is undoubtedly true that in many authorities the presence or absence of independent advice has had a great influence on the court's decision on this vital question. If the donor, however, should receive independent advice, and either misunderstands the advice or is given possibly erroneous advice whereby he fails to appreciate or realize the financial implications and the detriment to himself involved in the gift, a court of equity will not set aside the gift if the donor otherwise understood the nature of the transaction and acted therein in the full exercise of his will: *[Jenyns v Public Curator* (1953) 90 CLR 113].

7. Actual undue influence

There is another species of undue influence that focuses not on the ongoing relationship between the parties (whether presumed by law established by evidence) but rather on the singular transaction itself. Here the stronger party engineers the reposing of trust by the weaker party for the purpose of effectuating the impugned transaction. This was described in High Court case of *Johnson v Buttress*[36] by Dixon J (at 134):

> The basis of the equitable jurisdiction to set aside an alienation of property on the ground of undue influence is the prevention of an unconscientious use of any special capacity or opportunity that may exist or arise of affecting the alienor's will or freedom of judgment in reference to such a matter. The source of power to practise such a domination may be found in no antecedent relation but in a particular situation, or in the deliberate contrivance of the party. If this be so, facts must be proved showing that the transaction was the outcome of such an actual influence over the mind of the alienor that it cannot be considered his free act.

8. Husband and wife cases, generally

The matrimonial relationship is not one of those special categories recognised by the law as setting up a presumption of undue influence. As was said by Dixon J in *Yerkey v Jones*[37]:

> [14] The reason for excluding the relation of husband and wife from the category to which the presumption applies is to be found in the consideration that there is nothing unusual or strange in a wife from motives of affection or even of prudence conferring a large proprietary or pecuniary benefit upon her husband… But in the relations comprised within the category to which the presumption of undue influence applies, there is another element besides the mere existence of an opportunity of obtaining ascendancy or confidence and of abusing it. It will be found that in none of those relations is it natural to expect the one party to give property to the other.

On ordinary principles the relationship would therefore only qualify where there is either:

(a) Established by the evidence to be a relationship of influence, or

(b) Actual undue influence in relation to the specific transaction.

However in addition to the standard principles, as a hangover from days gone by when the property dispositions of married women were governed by special rules, there are special rules. These were introduced by Dixon J in *Yerkey v Jones*[38]:

> [15] But while the relation of a husband to his wife is not one of influence, and no presumption exists of undue influence, it has never been divested completely of what may be called equitable presumptions of an invalidating tendency.

[36] [1936] HCA 41; (1936) 56 CLR 113
[37] [1939] HCA 3
[38] [1939] HCA 3

Those special presumptions are what has been called the rule in Yerkey/Garcia.

9. Husband and wife cases, where the wife is a volunteer

i) The Yerkey/Garcia principle

In cases where the wife is a volunteer, that is she gained nothing from the transaction a special principle applies. This means in practice she is a guarantor for the husband or for a third party at his request. These principles were;

(a) extrapolated by Cussen J in *Bank of Victoria Ltd v Mueller*[39] in 1925,

(b) adopted by Dixon J in *Yerkey v Jones*[40] in 1939,

(c) applied by Young J in *Garcia v National Australia Bank Ltd*[41] in 1993,

(d) considered but rejected by the House of Lords in *Barclays Bank v O'Brien*[42] in 1994

(e) reaffirmed by the High Court in *Garcia v National Australia Bank Limited*[43]in 1998

The ratio of the High Court in Garcia is made unequivocal by the joint judgement given by Gaudron, Mchugh, Gummow and Hayne JJ with whom Callinan J agreed (Kirby J dissenting in favour of the approach in Barclays) and is stated thus:

> [31] *Yerkey v Jones* begins with the recognition that the surety is a volunteer: a person who obtained no financial benefit from the transaction, performance of the obligations of which she agreed to guarantee. It holds, in what we have called the first kind of case, that to enforce that voluntary transaction against her when in fact she did not bring a free will to its execution would be unconscionable. It holds further, in the second kind of case, that to enforce it against her if it later emerges that she did not understand the purport and effect of the transaction of suretyship would be unconscionable (even though she is a willing party to it) if the lender took no steps itself to explain its purport and effect to her or did not reasonably believe that its purport and effect had been explained to her by a competent, independent and disinterested stranger.

ii) Case one – where there has been undue influence

Case one, being (taken from the quote above):

> [31] … to enforce that voluntary transaction against her when in fact she did not bring a free will to its execution would be unconscionable

Does not seem to be an expansion of general principles of undue influence (see above).

[39] [1925] VLR 642
[40] [1939] HCA 3
[41] (1993) NSW ConR ¶ 55-662
[42] [1994] 1 AC 180
[43] [1998] HCA 48

iii) Case two – where there has been a failure to effectively explain the nature of the transaction

Case two, being (taken from the quote above):

> [31]… to enforce it against her if it later emerges that she did not understand the purport and effect of the transaction of suretyship would be unconscionable (even though she is a willing party to it) if the lender took no steps itself to explain its purport and effect to her or did not reasonably believe that its purport and effect had been explained to her by a competent, independent and disinterested stranger.

Can be seen as a separate principle. It has even been considered not a species of undue influence. In *Yerkey* Latham J noted:

> [20] Thus, in my opinion, the defence of *non est factum* fails, and the other defences fail so far as they are based upon the general law as to undue influence, fraud, innocent misrepresentation, mutual or unilateral mistake. Accordingly the case for Mrs. Jones must depend upon some special rules applying to a wife who becomes a surety for her husband. The rule relied upon is a rather vague and indefinite survival from the days when a married woman was almost incapable in law and when the courts of equity gave her special protection in relation to transactions affecting her separate property. Perhaps the principle relied upon is stated in the form most favourable to the defendant in *Halsbury's Laws of England*, 2nd ed., vol. 15, p. 282. It appears at the end of a discussion of fraud and undue influence and is in the following words: "Further, where creditors of the husband procure the wife's signature to a security for his debt through the agency of the husband, they must, in order to succeed in an action on the security, be in a position to prove that a proper explanation of the effect of the document was given to the wife." This rule cannot be made to fit into any systematic statement of the principles relating to fraud, misrepresentation or undue influence, but there is authority to support it.

The majority in *Garcia* justified it as follows:

> [23]… The [second]… case is not so much concerned with imbalances of power as with lack of proper information about the purport and effect of the transaction.
>
> [31] … And what makes it unconscionable to enforce it in the second kind of case is the combination of circumstances that:
>
> (a) in fact the surety did not understand the purport and effect of the transaction;
>
> (b) the transaction was voluntary (in the sense that the surety obtained no gain from the contract the performance of which was guaranteed);
>
> (c) the lender is to be taken to have understood that, as a wife, the surety may repose trust and confidence in her husband in matters of business and therefore to have understood that the husband may not fully and accurately explain the purport and effect of the transaction to his wife; and yet
>
> (d) the lender did not itself take steps to explain the transaction to the wife or find out that a stranger had explained it to her.

****

> [33] It will be seen that the analysis of the second kind of case identified in *Yerkey v Jones* is not one which depends upon any presumption of undue influence by the husband over the wife. As we have said, undue influence is dealt with separately and differently. Nor does the analysis depend upon identifying the husband as acting as agent for the creditor in procuring the wife's agreement to the transaction. Rather, it depends upon the surety being a volunteer and mistaken about the purport and effect of the transaction, and the creditor being taken to have appreciated that because of the trust and confidence between surety and debtor the surety may well receive from the debtor no sufficient explanation of the transaction's purport and effect. To enforce the transaction against a mistaken volunteer when the creditor, the party that seeks to take the benefit of the transaction, has not itself explained the transaction, and does not know that a third party has done so, would be unconscionable.

The majority quoted with approval Cussen J in *Bank of Victoria Ltd v Mueller*[44] who drew his inspiration from a comparison with equity's treatment of gifts made by a mistaken donor:

> In the first place, it is obvious that a large benefit is conferred both on the creditor and the debtor, which, so far as any advantage to the guarantor is concerned, is voluntary, though no doubt 'consideration' exists so far as the creditor is concerned, so soon as forbearance is in fact given or advances are in fact made. It is, I think, to some extent by reference to the rule or to an extension of the rule that, in the case of a large voluntary donation, a gift may be set aside in equity if it appears that the donor did not really understand the transaction, that such a guarantee may be treated as voidable as between the husband and wife.

There is clear guidance for lenders wishing to avoid application of this rule in the judgement of Dixon J in *Yerkey* cited with approval by the majority in *Garcia*:

> [36] If the creditor takes adequate steps to inform her and reasonably supposes that she has an adequate comprehension of the obligations she is undertaking and an understanding of the effect of the transaction, the fact that she has failed to grasp some material part of the document, or, indeed, the significance of what she is doing, cannot, I think, in itself give her an equity to set it aside, notwithstanding that at an earlier stage the creditor relied upon her husband to obtain her consent to enter into the obligation of surety. The creditor may have done enough by superintending himself the execution of the document and by attempting to assure himself by means of questions or explanation that she knows to what she is committing herself. The sufficiency of this must depend on circumstances, as, for example, the ramifications and complexities of the transaction, the amount of deception practised by the husband upon his wife and the intelligence and business understanding of the woman. But, if the wife has been in receipt of the advice of a stranger whom the creditor believes on reasonable grounds to be competent, independent and disinterested, then the circumstances would need to be very exceptional before the creditor could be held bound by any equity which otherwise might arise from the husband's conduct and his wife's actual failure to understand the transaction.

[44] [1925] VLR 642 at 649

This was reinforced by Gaudron, Mchugh, Gummow And Hayne JJ in *Garcia*[45] who wrote:

> [41] As is apparent from what was said in *Yerkey v Jones* the creditor may readily avoid the possibility that the surety will later claim not to have understood the purport and effect of the transaction that is proposed. If the creditor itself explains the transaction sufficiently, or knows that the surety has received 'competent, independent and disinterested' advice from a third party, it would not be unconscionable for the creditor to enforce it against the surety even though the surety is a volunteer and it later emerges that the surety claims to have been mistaken.

iv) When is the wife a volunteer?

If the husband controls all the business decisions the wife will be held to be a volunteer even if she is on paper a director or shareholder of the borrower and despite the fact she looks to the husband for her financial succor. In *Armstrong v CBA*[46] Hamilton J noted:

> [33] Although Mrs Armstrong was from 1978 the holder of 25 per cent of the shares in Investments, there is no evidence of her having gained anything from any transaction that was guaranteed. There is not even any evidence of her having benefited or gained from her shareholding in Investments. That company was, to use the words of McHugh JA in Warburton, "the 'pup' of her husband". It is conceded by the Bank that it was controlled by Mr Armstrong. Although she was a shareholder and director she played no part in its management or running; she was excluded by her husband from this as from all his other business affairs. There is no evidence that any dividend was ever declared by the company and paid to her. The only thing she ever received from the company was the unit at Tweed Heads, in the sense that it was transferred to her by Investments. This was for a consideration stated in the transfer to be $104,000. It is clear she did not pay that sum of money to the company. That does not mean that the $104,000 was not paid. However, the form of the transaction with the company is not in evidence nor are the company's books of account relating to the transaction. It is no part of the business of companies to make gifts. There is no doubt that the transfer was procured by Mr Armstrong, on terms dictated by him. In my view it is not established that the transfer to her of the Tweed Heads property was a benefit conferred on her by Investments (rather than by Mr Armstrong), much less a benefit conferred by Investments on her as a shareholder. The Bank says that it relies upon the lifestyle which Mrs Armstrong enjoyed and her husband's generosity in transferring to her the Queenscliff property, a half share in the Blakehurst property and the Tweed Heads property; these, it says, were benefits she obtained through Investments and which, together with the holding of 25 per cent of the shares, meant that she was not a volunteer. I do not accept these arguments. It seems to me that in actual fact it is not demonstrated that she received anything from Investments rather than from her husband. Mrs Armstrong, when asked how the purchase price of the properties transferred to her was paid, replied that her husband "arranged it". From the evidence I infer that whatever benefits Mr Armstrong conferred on her were conferred on her as a wife and not as a shareholder in or in any way by reference to

[45] [1998] HCA 48
[46] [1999] NSWSC 588

> Investments. The shareholding of 25 per cent may not have been insubstantial or nominal in amount, but was insubstantial or nominal in the sense that Mrs Armstrong in fact exercised no rights and received no benefits by reference to her shareholding (cf Commonwealth Bank of Australia v Khouri [1998] VSC 128 [65]). The conclusion to which I have come is that Mrs Armstrong derived no real benefit from the transactions and was a volunteer in relation to them.

This liberal view of what constitutes a volunteer was not inconsistent with the facts in *Garcia*[47] where the High Court upheld the trial judge, noting

> [7] [The trial Judge, Young J] found that although the appellant was a director of Citizens Gold and was recorded as being a shareholder of the company he was not satisfied, on the whole of the evidence, that the companies were "anything more than Mr Garcia's creation and that he was in complete control of them" and he accepted the appellant's evidence that she was not directly involved in Citizens Gold (or the other companies associated with her husband).

The trial judge further observed that in *Warburton v Whiteley*[48] there was even a suggestion Kirby P at 58,286 and McHugh JA at 58,288 that the onus is on the bank to show the wife is not a volunteer.

D. Duress

1. Physical duress

If the mortgagor has been threatened with physical violence to induce the giving of the security the Court will set aside the transaction. See *Barton v Armstrong*[49] where Armstrong threatened to kill Barton.

2. Economic duress

Hard bargaining is considered by the courts to be quite legitimate. The court intervenes only when a two stage test is satisfied. This was described in *Crescendo Management v Westpac*[50] by McHugh JA as follows:

> ... whether any applied pressure induced the victim to enter into the contract and ... whether the pressure went beyond what the law is prepared to countenance as legitimate?
>
> … Pressure will be illegitimate if it consists of unlawful threats or amounts to unconscionable conduct. But the categories are not closed. Even overwhelming pressure, not amounting to unconscionable or unlawful conduct..., will not necessarily constitute economic duress.

[47] [1998] HCA 48
[48] (1989) 5 BPR 11,628
[49] [1976] AC 104
[50] (1988)19 NSWLR 40 at 46

The issue of economic duress was discussed in *Australia and New Zealand Banking Group Limited v Karam*[51] Beazley JA, Ipp JA, Basten JA gave a joint judgment in which they stated:

> [61] How the doctrine of economic duress fits with the equitable doctrines is unclear. The reference to "unlawful" conduct, read in context of the earlier authorities, was originally a reference to unlawful detention of goods. Concepts of 'illegitimate pressure' and 'unconscionable conduct', if they do not refer to equitable principles, lack clear meaning, outside, possibly, concepts of illegitimate pressure in the field of industrial relations. Mason and Carter in Restitution Law in Australia (1995 at [540]), referring to Professor Beatson, The Use and Abuse of Unjust Enrichment (1991, OUP) state:
>
> > "Professor Beatson has criticised the use of the blackmail analogy in the area of economic duress, and questioned the capacity of the courts to impose judicial control on threats of lawful termination of contract. The only three categories he would allow are threats made maliciously and without any interest whatsoever; threats in the context of a protected relationship, namely one of dependency or a fiduciary relationship; and threats made in a public law context where principles of fairness and rationality apply. There is much to be said for keeping to those better trodden and more carefully tended paths, rather than rushing down broader paths that beckon but which may in the end lead to a tangled wilderness of single instances."
>
> The authors also express a doubt that "the notion of unconscionability will prove of much assistance".
>
> [66] The vagueness inherent in the terms "economic duress" and "illegitimate pressure" can be avoided by treating the concept of "duress" as limited to threatened or actual unlawful conduct. The threat or conduct in question need not be directed to the person or property of the victim, narrowly identified, but can be to the legitimate commercial and financial interests of the party. Secondly, if the conduct or threat is not unlawful, the resulting agreement may nevertheless be set aside where the weaker party establishes undue influence (actual or presumptive) or unconscionable conduct based on an unconscientious taking advantage of his or her special disability or special disadvantage, in the sense identified in Amadio…

It thus seems clear that attempts to stretch the concept of duress beyond unlawful threats and into something resembling a doctrine providing relief where bargaining power is unequal – have been rejected.

E. Misrepresentation

Where a mortgagor was induced to enter into a mortgage by a misrepresentation the mortgagor may seek to have the transaction set aside. This is subject to doing equity and in particular repaying any benefit received (usually the amount of a previous mortgage discharged with the proceeds of the loan). There is however authority for the proposition that where a Torrens title mortgage has been registered equity will not intervene – see *Fisher & Lightwoods: Law of Mortgages*, Tyler Young & Croft, second Australian Edition

[51] [2005] NSWCA 344

page 359. The learner authors also there opined that there may be statutory entitlements to damages.

F. Mistake

The defence of mistake must be framed as *non est factum* (unless it is the common mistake of both parties and therefore void under the common law). For this defence to succeed the documents signed must be fundamentally different from what the mortgagor thought he was signing. This is difficult to establish where the mortgagor is of sound mind. Moreover the indefeasibility provisions Torrens title legislation makes this plea ineffective where the mortgage has been registered (but see personal equities below).

G. Fraud

A forged mortgage is a nullity at law. An unregistered forged mortgage is therefore ineffectual. However a registered forged mortgage acquires indefeasible and cannot be impeached except in the case of fraud to which the mortgagee has been a party.

H. Personal equities

If there has been a forgery of a mortgage that is subsequently registered the mortgagor, while unbound by the personal covenants, cannot prevent the mortgagee from exercising rights *in rem* against the land. One exception to this rule is the defence of *personal equities*. The principle was explained in the case of *MMLI v Gosper*[52] by Kirby P who stated:

> The casebooks are full of instruction that the concept of indefeasibility of registered title must be qualified by the personal obligations which the registered proprietor of an interest (in this case the appellant) is bound to respect. That registered proprietor is "... exposed to claims in personam. These are matters not to be overlooked when a total description of his rights is required": *Frazer v Walker*[53]. The registered proprietor is "... subject to a personal obligation by which he may be bound in personam to deal with his registered title in some particular manner": see Street J in *Mayer v Coe*[54]; approved in *Breskvar v Wall*[55]; see also, *Bahr v Nicolay*[56]; cf *Logue v Shoalhaven Shire Council*[57]. It is therefore misleading to portray this case as one in which a decision for the respondent derogates from the system of title by registration which is the essence of the system of registered title to land which is established by the Real Property Act 1900.

If the mortgagor is a stranger to the mortgagee then the mere fact that mortgage is forged is insufficient to create an in personam right. However if the mortgagee had previous dealings with the mortgagor and/or had custody of the certificate of title then the court will examine and enforce the obligations of that relationship. In *MMLI v Gosper*[58] Mahoney JA stated:

> It is proper to accept that, on the existing state of the authorities, the mere fact of forgery of the instrument does not establish a "personal" equity. It is therefore

[52] (1992) ANZ ConvR 27
[53] [1967] 1 AC 569 at 580
[54] [1968] 2 NSWR 747 at 754
[55] (1971) 126 CLR 376
[56] [No 2] (1988) 164 CLR 604 at 613, 637, 654
[57] [1979] 1 NSWLR 537 at 543, 563
[58] (1992) ANZ ConvR 27

necessary to determine whether there is anything in the facts, other than the fact of the forgery of the document, which gives rise to such an equity against the company.

The circumstances leading to the registration of the forged variation of mortgage are relevantly as follows. On 20 April 1982, Mrs Gosper was registered as proprietor of the land. On 29 January 1982, Mrs Gosper granted a mortgage to Mercantile Mutual Insurance Ltd to secure $205,000: that mortgage was registered on 20 April 1982. … On 11 March 1988, the forged variation of mortgage purported to be executed. The ostensible parties were Mrs Gosper and Mercantile Mutual Life Insurance Co Ltd… the forged variation of mortgage were registered on 29 March 1988. …Mercantile Mutual Life Insurance Co Ltd held the certificate of title subject to the ordinary obligations affecting a mortgagee having possession or custody of a certificate of title in those circumstances. Mercantile Mutual Life Insurance Co Ltd then produced the certificate of title to the Registrar-General for the purpose of procuring that the forged variation of mortgage be registered. … It was therefore necessary, in order that the forged variation of mortgage be registered, that Mercantile Mutual Life Insurance Co Ltd produce the certificate of title to the Registrar-General. But that company had no authority to produce or otherwise use the certificate of title for such a purpose. …

It is not necessary to consider, for this purpose, whether the company, as mortgagee, acted negligently or without proper care in so using the certificate of title… The proper conclusion is, in my opinion, that the company used the certificate of title in breach of its obligations to Mrs Gosper and that its use of it in that way was a necessary step in securing the registration of the forged variation of mortgage… If that company had produced the certificate of title to allow, for example, Mr Gosper to procure a transfer of ownership to himself, it would, in my opinion, have acted in breach of its obligations in relation to the possession and custody of the certificate of title. There is, I think, no difference in principle for this purpose in its producing the certificate of title for the purpose of procuring the registration in its favour of the forged variation of mortgage. In my opinion where the registration of a forged instrument has been produced by such a breach by the new owner, that is sufficient to create, in the relevant sense, a "personal equity" against the new owner. … But the obligations of a mortgagee, whether strictly fiduciary or not, are in my opinion such that the mortgagee should not be allowed to retain a benefit procured by an act which constitutes a breach of such obligations. For this reason I am satisfied that the forged variation of mortgage should be set aside.

Kirby P reached the same conclusion holding:

It cannot be doubted that in circumstances such as the present, where a legal relationship existed between the parties immediately prior to registration, the court may examine their pre-registration positions in equity and is not forbidden from doing so by the state of the register. Where equity so requires, the court may restore the parties to those pre-registration positions and order the register to be amended accordingly.

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