benchtv
a benchmark production

Précis Paper

Unjust Contracts and Sham Agreements

Egan v Egan [2018] NSWSC 202

A very interesting discussion about the recent decision of *Egan v Egan* [2018] NSWSC 202 and how the NSW Supreme Court considered the various arguments raised by the parties.

Discussion Includes

- The *Contracts Review Act*
- *Egan v Egan* [2018] NSWSC 202
- Was the arrangement a sham?
- The equitable maxim of clean hands
- Was there a loan?
- The Contracts Review Claim
- Unconscionability and Undue Influence
- The Remedy
- Costs
- Take home lessons from *Egan v Egan*

Précis Paper

Unjust Contracts and Sham Agreements

Egan v Egan [2018] NSWSC 202

1. In this edition of BenchTV, Mandy Tibbey (Barrister – 8 Wentworth Chambers, Sydney) and Emily Graham (Barrister – 8 Wentworth Chambers, Sydney) discuss the *Contracts Review Act 1980* (NSW) and its application in the recent case of *Egan v Egan* [2018] NSWSC 202.

The *Contracts Review Act*

2. Under the *Contracts Review Act 1980* (NSW) ('the CRA'), if there is found to be an unjust contract existing between the parties, then the court can re-write that contract. This is a very wide power: see Mandy Tibbey, *Undoing unjust contracts: Developments in jurisprudence under the Contracts Review Act 1980* (NSW), Australian Bar Review, (2009) 32 Aust Bar Rev No 2 at 182.
3. Section 4 of the CRA states that "'unjust' includes unconscionable, harsh or oppressive, and 'injustice' shall be construed in a corresponding manner."
4. Section 9(2) of the CRA sets out a list of factors that are to be taken into account in determining whether a contract is materially 'unjust':

   (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.

The conduct of the parties can also be taken into account: ss 9(4), 9(5).

5. The section 9(2) checklist gives an indicator of the width of the term "unjust contracts". The definition is not exclusive. Any contract or contractual provision, not excluded by the provisions 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 CRA. This is an evaluative judgement that the courts need to make. The court shall not have regard to an injustice that was not reasonably foreseeable at the time the contract is made. The words of the section are "as at the time it was made" but are qualified by other sections.

6. The legislation moves away from general construction of contract principles because it allows the courts to look at the subjective intentions, conduct, and all of the circumstances of the parties.

7. In *West v AGC (Advances) Ltd (1986)* 5 NSWLR 610; NSW ConvR 55-306, McHugh J examined procedural and substantive injustices which may result in an unjust contract:

> 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.

8. The CRA can also apply to the conduct of non-parties to a contract. That is, someone who had a role in the contract or gained a benefit from the contract. The court can, accordingly, join them to the proceedings and they have an opportunity to be heard. The court can then make orders from that joinder. Further, the Minister or the Attorney General can join an action.

9. Under the CRA, the definition of a "contract" is very broad. It can consist of one single contract, a series of contracts, or a series of inter-related contracts that constitutes an arrangement.

10. It is important to be mindful of the applicable limitation periods under the CRA. Namely:

> 16 TIME FOR MAKING APPLICATIONS FOR RELIEF
>
> An application for relief under this Act in relation to a contract may be made only during any of the following periods:
>
> (a) the period of 2 years after the date on which the contract was made,
>
> (b) the period of 3 months before or 2 years after the time for the exercise or performance of any power or obligation under, or the occurrence of any activity contemplated by, the contract, and
>
> (c) the period of the pendency of maintainable proceedings arising out of or in relation to the contract, being proceedings (including cross-claims, whether in the nature of set-off, cross-action or otherwise) that are pending against the party seeking relief under this Act.

11. Variations can be made to land instruments and any consequential or ancillary relief. Relief can include orders for the payment of money, the setting aside of a document including a registered land instrument, supply of services, sale of property, and the enforcement of a charge.

CRA Claims

12. The range of matters in which CRA claims can arise is very broad and include any kind of contract including a Deed:

> Section 6(2) CERTAIN RESTRICTIONS ON GRANT OF RELIEF.
>
> 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 (including, but not limited to, an agricultural, pastoral, horticultural, orcharding or viticultural undertaking) carried on by the person or proposed to be carried on by the person wholly or principally in New South Wales.

13. If an individual enters into a contract, even if there are other contracts being entered into by businesses with which they are associated, if the contract being impugned has been entered into by individuals it may not be caught by that exemption. Legal costs agreements might even fall within the CRA. Similarly, guarantor matters like the *National Australia Bank Limited v Smith* [2014] NSWSC 1605 may be caught be the provision.

Egan v Egan [2018] NSWSC 202

14. In *Egan v Egan*, the plaintiff was the mother of the defendant and mortgagee on a mortgage that was lending money to the daughter. The daughter had relied extensively on her parents for guidance and support. Her marriage broke down and she was living in a house that her parents had bought her. When the relevant property was being purchased, the defendant and her parents attended the parents' solicitor's office. They were taken into a room, the documents had already been prepared, there was very little explanation given, and the plaintiff and defendant signed documents. The documents enabled the purchase of the

house and a mortgage that incorporated a Deed of loan. There was no independent legal advice given to the defendant.

15. Following the purchase, the defendant lived in the home with her children. Her father become sick and she moved in part-time to her parents' home. There was a family feud and she was evicted from her parents' home. Prior to the feud, there had been no overt request to make repayments on the mortgaged house. The plaintiff served a Notice pursuant to section 57(2)(b) of the *Real Property Act* on the defendant. The breaches identified in the Notice were (at [10]):

    (a) the failure to make repayments of principal and interest; and

    (b) being unable to pay her debts as they became due in contravention of clause 4.1(f) of the Deed of Loan.

    The notice required payment of the amount of $610,834.23 being repayments of principal and interest from 22 June 2006 until 22 September 2016.

16. This allowed acceleration of the mortgage and for the mortgage to be called in. Proceedings were commenced by the plaintiff seeking:

    (1) Possession of the property and

    (2) Repayment of approximately $918,000 (due to interest and default interest). The initial sum that was allegedly borrowed was $450,000.

17. The defendant engaged solicitors and filed a cross-claim pleading that the mortgage was a sham because there was never any intention between the parties to have an enforceable mortgage: it was entered into to protect the defendant from any claim from her husband in family law proceedings. It was argued that the mortgage was never intended to be enforced, and that was what had induced the defendant to sign the documents. The defendant also argued that the mortgage was unconscionable and there was undue influence in signing it.

18. The plaintiff argued that it was not a sham, and that they had always intended that the money lent was to be repaid. There were registered documents but there were no file notes, solicitors' file or recollection by the solicitor acting on the transaction.

<u>Was the arrangement a sham?</u>

19. The New South Wales Court of Appeal in *Lewis v Condon; Condon v Lewis* (2013) 85 NSWLR 99; [2013] NSWCA 204 at [57]-[70] considered that people ought to be able to rely on contracts as they appear on the public record and that anything that appears to be said a sham should be looked very carefully at. The Court stated at [62]:

    > The sham doctrine is thus one of those relatively rare doctrines in the law where legal meaning is given to a document by reference to a subjective intention… Other examples are a plea of non est factum at law and a claim for rectification in equity. All these doctrines "must necessarily be kept within narrow limits", for all subtract from the objective theory of contractual obligation, and if unchecked would cause "serious mischief": see Toll (FGCT) Pty Ltd v Alphapharm Pty Ltd [2004] HCA 52; (2004) 219 CLR 165 at [46]- [47].

20. And, as a sham arrangement is a rare occurrence (at [63]):

> ...Thus there is a "strong and natural presumption against holding a provision or a document a sham": *National Westminster Bank plc v Jones* [2001] 1 BCLC 98 at [59] (Neuberger J)". ...Because a finding of sham requires a finding of an intent to deceive, considerations associated with *Briginshaw v Briginshaw* [1938] HCA 34; (1938) 60 CLR 336 require a cautious approach...

21. Leeming JA opined that accordingly, a *Briginshaw*-type standard would need to apply in order for the Court to be satisfied that a sham had been entered into by the parties. Leeming JA relied on *Raftland Pty Ltd as trustee of the Raftland Trust v Commissioner of Taxation* [2008] HCA 21 at [36] to support the proposition that the Court needs very strong evidence to support the existence of a sham arrangement.

22. In *Egan*, Davies J could not be so satisfied that there was a sham even though he considered the defendant to be a good, reliable witness who made appropriate concessions. Even so, the heavy onus was not able to be discharged.

<u>The equitable maxim of clean hands</u>

23. Estoppel by convention was raised by the defendant who argued that the plaintiff was estopped from relying on the mortgage and the Deed of loan. The estoppel argument was related to the defendant's sham argument due to the fact that: if the document was agreed by all parties to be something that was never intended to be enforced, then the plaintiff should not be permitted to rely on it now as the defendant had been induced to enter into the agreement by those representations.

24. Ultimately, the Judge's findings meant that the estoppel argument fell away. Davies J held at [69]:

> Although I have found that the defendant fails to show that the arrangement was a sham, the defendant may have had difficulty in being able to rely on the personal equity because of the equitable maxim of clean hands...

25. If Davies J had found that it was a sham agreement, then he would have found that the mortgage should not be set aside because of the clean hands maxim. Davies J held that as a matter of public policy, it was being suggested that this was a mere device that ensured that a husband would not be able to make a claim that he would otherwise be entitled to make under the family law provisions. Davies J held that this should not be permitted to give effect.

<u>Was there a loan?</u>

26. In *Egan*, the Court also considered whether there was, in fact, a loan. There was a registered mortgage that referred to an annexure but the Deed of loan itself was not registered. Accordingly, the Court had to consider whether there was a default that allowed the plaintiff to issue a valid Notice. The Court looked at whether there was any ambiguity in the Deed of acknowledgement of debt and held that there was no ambiguity.

27. In relation to determining whether it was a mere debt rather than something that ran against the land, the Court ultimately found that the Deed of acknowledgement of debt was incorporated into the mortgage, that there was no ambiguity, and therefore there was default.
28. The defendant also argued that there had been no money passed directly to the defendant which was consistent with the home being a gift. In relation to this argument, the Court found that the terms of the loan were incorporated into the mortgage and therefore enforceable.

The Contracts Review Claim

29. Notwithstanding the Court's finding against the defendant on the argument that the Deed was not a loan, the sham mortgage arrangement, and the Court's construction of the mortgage and Deed of loan, the Court did make some findings in favour of the defendant in her cross-claim, pursuant to the *Contracts Review Act*.
30. The relevant matters taken into account by Davies J pursuant to section 9(2) of the CRA included:
    - The lack of independent legal advice;
    - That the terms of the mortgage were quite onerous because they required repayments to be made immediately and it was clear that the defendant had no capacity to make the repayments;
    - That the defendant had no prior experience in property transactions;
    - There was an imbalance in power: her father was an actuary, her mother worked, but the plaintiff was not particularly educated or experienced; and
    - That the plaintiff was extremely close to her parents and accepted their guidance and wisdom.
31. Davies J found that a solicitor would have pointed out to her that she would have almost immediately been in default at [95]:

    > A solicitor's obligation is not simply to explain the legal effect of documents but to advise of the obvious practical implications of the client's entry into the transaction the subject of the advice: Provident Capital Ltd v Papa (2013) 84 NSWLR 231; [2013] NSWCA 36 at [80], [120]-[122].

Asset Lending

32. If the defendant had not made the repayments then, at any time, the mortgagee could have found her to be in default and commenced proceedings. Without independent legal advice, the defendant was not appraised of all the inherent risks in signing the documents. Further, asset lending is something to be looked at very seriously by the courts. At [97] Davies J found that:

    > In all of those circumstances, the plaintiff must have known that the defendant would be likely to default under the terms of the Deed of loan and the mortgage almost immediately. In those circumstances, there was not at the time the mortgage was entered into, to the knowledge of the plaintiff, any reasonable expectation that the repayments required under the Deed of loan would be

> able to be made. That would mean that the only way the loan could be repaid would be by a sale of the property. That is what is classically described as "asset lending" ...

33. Asset lending is where a lender realises that the borrower does not have sufficient income or assets to be able to repay a loan or mortgage except by sale of the asset over which the mortgage is being entered into. Where a lender is relying on that asset as being what enables the mortgagee to lend the money, the mortgagee does not have sufficient regard to the means of the borrower to repay a loan or a mortgage. This can be taken into account by a court when assessing whether it is an unjust contract.
34. There was evidence before the Court that the plaintiff was very aware of the financial circumstances of the defendant. Davies J took this into account. The mortgagee must have known that the defendant could not make immediate, full payments on the mortgage. Under the terms of the contract, the defendant had been in default from the beginning of the contract. The terms of the mortgage clearly provided that there be monthly repayments, the interest rate was clear, and the term of the loan - so the appropriate repayment was ascertainable from the terms of the contract. As the terms were held to be incorporated into the terms of the contract, it was held that they were operative and it was not necessary to serve the Notice.

Intra-family arrangements

35. Within a family there may be an "understanding" that documents not be given their full force and effect. Within a case like this, it can rebound very badly where, at a later time, someone can insist on the letter of the law.

Unconscionability and Undue Influence

36. The defendant claimed that the contract, mortgage and Deed of loan were unconscionable in that there was a *Blomley v Ryan* [1956] HCA 81 special disability arising from the cumulative factors in this case. The facts that the defendant was impecunious, had two small children, no ability to earn an income, had been so close to her parents, and that her parents were more versed in property transactions amounted to such a special disability. At [110] Davies J considered that in the light of his determination that the contract was unjust, it was not necessary to consider these matters.
37. The bar to prove that a contract is unjust is not as high as unconscionability and undue influence so it did not need to be considered. The presumption that operates between parents and children of undue influence was operative and proven on the evidence but did not need to be considered or applied in equity because it was determined under the CRA.

The Remedy

38. Ultimately, Davies J found that the mortgage and the Deed of loan were unjust pursuant to the *Contracts Review Act*. Under the CRA, the Court has an enormous discretion. Finding that

a contract is unjust can lead a Court to decide to make no change to a contract, or it can be set aside in full or in part, or the term of the loan or interest rate could be changed.

39. The plaintiff argued that, at least, the principal $450,000 should be repaid and interest paid from the date that the default Notice was issued. The defendant argued that because no independent legal advice had been received, the Court should set aside the document in full.

40. The Judge ultimately decided that the defendant had had the benefit of living in the property and the making of other payments by her family. Davies J decided that the principal $450,000 should be repaid and that interest should run from the date of the default Notice but it should be capitalised and added as a sum onto the principal amount and due one month after his judgment was handed down. Davies J found that the term of the loan should continue to run at [109]:

> The parties will be ordered to execute an amended deed of loan which varies the time interest commences to be charged on the principal sum and provides for the first instalment of principal and interest to be payable one month after the date final orders are made to give effect to this judgment. There should be no variation to the principal sum owing under the existing Deed nor to the term of the loan. Taking into account the terms of s 19 of the Act, the parties will be ordered to execute and register a variation of the mortgage which will incorporate the amended deed of loan. The costs of these documents should be equally borne by the parties.

Costs

41. Davies J in *Egan v Egan (No. 2)* [2018] NSWSC 282 held at [32] that "there be no order as to costs on either the statement of claim or the cross-claim to the intent that each party should bear her own costs of the proceedings." The defendant had not been successful in her sham argument but the defendant was left in possession of the property. The defendant had made an offer that was withdrawn after five days and the Court considered this quick withdrawal to be unreasonable.

42. The plaintiff had issued a Calderbank offer saying that if the defendant sold the property, paid the principal sum, and the plaintiff's costs that they would settle the proceedings. Davies J agreed with the defendant that that would leave her in the position of being both without the property and paying costs : so the result in the proceedings had left her in a better position . In CRA matters, due it its wide discretion, it is hard to pitch an offer of compromise or a Calderbank letter.

Take home lessons from *Egan v Egan*

43. If a legal practitioner becomes aware of capacity or cognition issues, then they should be aware that anything that someone signs can later be impugned. Independent legal advice must be obtained before entering into documents which may have an impact on their welfare, or benefit, or may not be to their advantage.

44. The court will also look at the quality of this independent legal advice too. In *Mighell & Anor v Gargoura & Ors* [2009] NSWSC 248, the solicitor was on an incentive-basis rather than a salary so he had an incentive to sign people up to these contracts. In that case, although legal advice had been given, it was very poor.

45. In *Elders Rural Finance Ltd v Smith* (1996) 41 NSWLR 296; (1997) NSW ConvR 55-806; BC9605711, Elders were asset lending. Bryson J found that the borrowers did not realise how dangerous their loan was and at [95] stated that a "solicitor's obligation is not simply to explain the legal effect of documents but to advise of the obvious practical implications of the client's entry into the transaction the subject of the advice".

46. Therefore, it is essential for legal practitioners to carefully explain the effect of any document and file note any advice given in case of any difficulty down the track.

47. Similarly, in family arrangements where formal legal documents are entered into, care needs to be taken to ensure that the legal effect is known: what is written in a contract must reflect the intention of the parties and be congruent with what is understood by them.

BIOGRAPHY

Mandy Tibbey

Barrister – 8 Wentworth Chambers, Sydney

Mandy was admitted as a lawyer in 1987 and called to the Bar in 2004. Her practice is primarily in the areas of equity including wills and probate, commercial and administrative law. Mandy is a part-time Senior Legal Member of NCAT in the Commercial and Consumer, Guardianship and Administrative and Equal Opportunity Divisions and former Chair of the Women Barristers' Forum.

Emily Graham

Barrister – 8 Wentworth Chambers, Sydney

Emily was admitted as a lawyer in 2010. She was called to the NSW Bar in 2016. Her main practice areas include public and administrative law, equity, defamation and tort law. Emily volunteers as a Judicial Officer as part of the Disciplinary Committee of Rugby Australia.

BIBLIOGRAPHY

Focus Case

Egan v Egan [2018] NSWSC 202

Benchmark Link

https://benchmarkinc.com.au/benchmark/insurance/benchmark_05-03-2018_insurance.pdf

Judgment Link

http://www.austlii.edu.au/cgi-bin/viewdoc/au/cases/nsw/NSWSC/2018/202.html?context=1;query=egan v egan;mask_path=

Cases

West v AGC (Advances) Ltd (1986) 5 NSWLR 610; NSW ConvR 55-306

Lewis v Condon; Condon v Lewis (2013) 85 NSWLR 99; [2013] NSWCA 204

Briginshaw v Briginshaw [1938] HCA 34; (1938) 60 CLR 336

Raftland Pty Ltd as trustee of the Raftland Trust v Commissioner of Taxation [2008] HCA 21

Blomley v Ryan [1956] HCA 81

Egan v Egan (No. 2) [2018] NSWSC 282

National Australia Bank Limited v Smith [2014] NSWSC 1605

Mighell & Anor v Gargoura & Ors [2009] NSWSC 248

Elders Rural Finance Ltd v Smith (1996) 41 NSWLR 296; (1997) NSW ConvR 55-806; BC9605711.

Legislation

Contracts Review Act 1980 (NSW)

Real Property Act 1900 (NSW)

Other

Mandy Tibbey, *Undoing unjust contracts: Developments in jurisprudence under the Contracts Review Act 1980* (NSW), Australian Bar Review, (2009) 32 Aust Bar Rev No 2 at 182