UNDUE INFLUENCE, MISREPRESENTATION AND THE DOCTRINE OF NOTICE

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In a series of modern cases, the English Courts have struggled with the problem of the undue influence or misrepresentation of third parties. Most of the cases have concerned women who have been persuaded or deceived into giving guarantees to financial institutions for the business debts of their sexual partners. In the recent case of *Barclays Bank p.l.c.* v. *O'Brien*,[1] the House of Lords made a fresh effort to tackle this difficult issue. Lord Browne-Wilkinson, with whom the other Lords agreed, attempted "to restate the law in a form which is principled, reflects the current requirements of society and provides as much certainty as possible."[2]

Lord Browne-Wilkinson's approach centred around the equitable doctrine of notice. He held that a lender would be unable to enforce its security if it had actual or constructive notice of the undue influence or misrepresentation to which the surety had been subjected by the principal debtor.[3] His Lordship went on to develop a set of guidelines indicating the circumstances in which a lender would be deemed to have notice.

Lord Browne-Wilkinson's analysis in *O'Brien* has the attractions of simplicity and

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1. [1994] 1 A.C. 180. See also *C.I.B.C. Mortgages plc* v. *Pitt* [1994] 1 A.C. 200, decided by the House of Lords on the same day, where the principles in *O'Brien* were applied.
2. At 195.
3. Lord Browne-Wilkinson stated (at 195) that the same result would follow if the wrongdoer had been acting as the agent of the lender. However, his Lordship stressed (*ibid.*) that such cases would be "of very rare occurrence." The issue of agency will not be considered in this article.

certainty. For this, and other reasons, it has been widely admired.[4] However, the convenience of his Lordship's conclusion does not preclude criticism of the method he employed to reach it. It is not open to a judge, even a Law Lord, to engage in legislation. Therefore, it was necessary for Lord Browne-Wilkinson to justify his approach on the basis of recognised legal principles. It will respectfully be submitted in this article that the principles relied upon by his Lordship, those underlying the equitable doctrine of notice, do not support the model which he proposed. This may lead to uncertainty in future cases involving different facts to those in *O'Brien*, with judges having to decide whether to accept Lord Browne-Wilkinson's model or to follow the logic of the doctrine of notice upon which his Lordship expressly relied.

I THE DOCTRINE OF NOTICE

It is important at the outset to determine precisely what Lord Browne-Wilkinson intended when he referred to "the doctrine of notice". It is arguable that this doctrine may take different forms when applied to a variety of legal problems. However, it is submitted that his Lordship clearly intended to apply the principles of notice originally developed by equity to determine priorities over unregistered land and now formulated in section 199 of the Law of Property Act 1925.[5] This conclusion becomes inevitable upon an examination of the manner

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4. See *e.g.* Dixon "The Special Tenderness of Equity: Undue Influence and the Family Home" [1994] C.L.J. 21, 21 hailing the speeches in *O'Brien* and *Pitt* as renewed proof of Lord Browne-Wilkinson's "master[y] of the judicial art".

5. Section 199(1) provides that a purchaser is not to be prejudicially affected by any instrument, matter, fact or thing, unless "(a) it is within his own knowledge, or would have come to his knowledge if such inquiries and inspections had been made by him as ought reasonably to have been made by him; or (b) in the same transaction with respect to which a question of notice to the purchaser arises, it has come to the knowledge of his counsel, as such, or of his solicitor or other agent, as such, or would have come to the knowledge of

in which Lord Browne-Wilkinson explains the doctrine throughout his speech.

His Lordship argued that the doctrine of notice "lies at the heart of equity." He continued as follows:

> Given that there are two innocent parties, each enjoying rights, the earlier right prevails against the later right if the acquirer of the later right knows of the earlier right (actual notice) or would have discovered it had he taken proper steps (constructive notice).[6]

Lord Browne-Wilkinson explained[7] that, in the present context, the surety is the person enjoying the "earlier right" (an equity against the principal debtor to set aside the guarantee for undue influence or misrepresentation)[8] and the lender is the acquirer of the later right (the right to enforce the guarantee). Thus, a lender would be unable to enforce a guarantee obtained through the undue influence or misrepresentation of the principal debtor if it had actual or constructive notice of the undue influence or misrepresentation.[9]

When Lord Browne-Wilkinson refers to "actual" and "constructive" notice, it is clear that he is invoking familiar and well-established equitable concepts. Indeed, this is an important aspect of the persuasiveness of his speech. His Lordship's project of establishing a

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his solicitor or other agent, as such, if such inquiries and inspections had been made as ought reasonably to have been made by the solicitor or other agent." On the equitable doctrine of notice, see generally Megarry and Wade *The Law of Real Property*, 5th ed., (London, 1984), pp. 142-153.

6. At 195.

7. At 195E-F.

8. For examples of the application of the doctrine of notice in relation to mere equities, see *Smith* v. *Jones* [1954] 1 W.L.R. 1089; *Allied Irish Banks* v. *Glynn* [1973] I.R. 188.

9. At 191C-E, 194G, 195F.

test requiring the lender to exercise reasonable care is significantly advanced by his appeal to "ordinary principles"[10] which lie "at the heart of equity".[11] If the analogy with the classic equitable doctrine of notice were not available, it would be difficult to explain why mere constructive notice, as opposed to actual knowledge or wilful blindness, should be sufficient to bind a lender with the personal wrongdoing of a third party.[12]

II WHEN WILL THE LENDER HAVE NOTICE?

As has been mentioned already, Lord Browne-Wilkinson felt that the lender would be bound by the rights of the surety if it had actual or constructive notice of those rights. Lord Browne-Wilkinson held[13] that a lender would be fixed with constructive notice if it had been aware (i) of a relationship between the surety and the principal debtor which gave rise to the risk of an equitable wrong[14] and (ii) that the transaction was "on its face not to the financial advantage" of the weaker party.[15] His Lordship was conscious that he might have been extending the law

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10. At 195.

11. *Ibid.*

12. For an exploration of the possibility that the application of the doctrine of notice was inappropriate, see Mee "An Alternative Approach to Third Party Undue Influence and Misrepresentation" (1995) 46 N.I.L.Q. (forthcoming).

13. At 196D-E.

14. Lord Browne-Wilkinson was satisfied (at 191) that "the risk of undue influence affecting a voluntary disposition by a wife in favour of a husband is greater than in the ordinary run of cases where no sexual or emotional ties affect the free exercise of the individual's will." The same principles would apply to unmarried couples (at 198) "if, but only if, the creditor is aware that the surety is cohabiting with the principal debtor." (See also *Massey* v. *Midland Bank p.l.c.* [1994] 2 F.L.R. 342). Lord Browne-Wilkinson also felt (*ibid.*) that a creditor would be put on inquiry if he was aware that "the surety reposes trust and confidence in the principal debtor in relation to his financial affairs".

15. The cases of *O'Brien* and *Pitt* note 1 *supra* were regarded by the House of Lords as falling on opposite sides of the line drawn by this test. In *O'Brien*, the wife had been induced by the fraudulent

but felt that his view accorded with the principles of notice because "if the known facts are such as to indicate the possibility of an adverse claim that is sufficient to put a third party on inquiry."[16]

III REASONABLE INQUIRIES

On a number of occasions in his speech, Lord Browne-Wilkinson referred to the fact that the lender would be "put on inquiry"[17] by an awareness of the circumstances discussed in the previous section. Assuming that the lender is put on inquiry, what inquiries should it make? Lord Browne-Wilkinson gave the following answer:

> Normally the reasonable steps necessary to avoid being fixed with constructive notice consist of making inquiry of the person who may have the earlier right (*i.e.* the wife) to see whether such right is asserted. It is plainly impossible to require of banks and other financial institutions that they should inquire of one spouse whether he or she has been unduly influenced or misled by the other. But in my judgment the creditor, in order to avoid being fixed with constructive notice, can reasonably be expected to take steps to bring

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misrepresentation of her husband to execute a second mortgage over the matrimonial home as security for the borrowing of a company in which the husband, but not the wife, had an interest. This transaction was regarded as, on the face of it, not to the financial advantage of the wife. On the other hand, in *Pitt*, the transaction induced by undue influence was a joint advance to a married couple secured upon the matrimonial home. Although the money was in fact used by the husband for his own purposes, on the face of the transaction it appeared that the wife was benefitting as much as her husband. Therefore the bank were treated as not having been put on inquiry.

16. At 197.

home to the wife the risk she is running by standing as surety and to advise her to take independent advice.[18]

One must ask why Lord Browne-Wilkinson's analysis was not complete as soon as he had decided that it was "plainly impossible" to require of banks that they make inquiry about undue influence or misrepresentation. As Lord Browne-Wilkinson himself explained, a person (or his agent) will only have constructive notice of a matter if he "*would have discovered it* had he taken proper steps."[19] This is the essence of constructive notice: it is knowledge which a person is deemed to have because, if they had made reasonable inquiries and inspections, they would have acquired that knowledge. If it is indeed "impossible" to require certain inquires to be made, it would seem that *a fortiori* they cannot be categorised as proper or reasonable. Mere suspicions are not relevant unless one may take "proper steps" to find out the truth. Therefore, it appears to follow that a lender would, in fact, be under no obligation to do anything before accepting a guarantee in the circumstances outlined by Lord Browne-Wilkinson.[20]

This conclusion may be avoided if one does not interpret the word "impossible" too literally. It seems clear that some of the inquiries which might be effective to reveal the existence of undue influence or misrepresentation would be extremely unpalatable for the lender. It might be necessary to pry into sensitive aspects of a personal relationship, with the

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17. At 196D, 196E, 197C, 197D, 198F and 199C.

18. At 196.

19. See passage quoted as text to note 6 *supra*, emphasis supplied. His Lordship's approach reflects that of section 199(1) of the Law of Property Act 1925 quoted in note 5 *supra*.

20. Note the view of Fry J. in *Hunt* v. *Luck* [1901] 1 Ch. 45, 53 that "it is surely unreasonable to apply the doctrine that a man has constructive notice of a fact which he could have discovered by inquiry to a fact which he could not so discover."

prospect of offending customers by the implication that they or their spouses are guilty of wrongdoing. Of course, on standard notice principles, the test of reasonableness is an objective one and it is not possible to escape constructive notice if one has neglected certain inquiries for reasons of personal expedience.[21] To make sense of the rest of Lord Browne-Wilkinson's speech, one must make the assumption that there are certain inquiries which, despite their inconvenient nature, it would be proper or reasonable for a lender to make in the situation under discussion. One could then understand Lord Browne-Wilkinson's guidelines (discussed in the next section) as providing the lender with an alternative, less onerous, method of avoiding constructive notice.

The problem with this rationalisation is that it is not easy to identify inquiries which would be effective to reveal the existence of third party undue influence or misrepresentation. Presumably, the lender could seek additional information about the relationship between the principal debtor and the surety which might show that it was a *de facto* relationship of influence which would therefore attract the presumption of undue influence. This would involve delicate questions concerning the division of responsibilities within the marriage, the respective business experience (and intelligence?) of the parties and the manner in which decisions affecting the family finances were made. Questions designed to show up any application of undue pressure would be of doubtful utility, since normally the pressure which induced the transaction would suffice to prevent a truthful answer to the direct question: "Have you been pressurised into signing this document?" Misrepresentation as to the nature of the transaction may be a different matter, since, in theory, a lender could ask the surety to explain her understanding of the guarantee before she signs it. Other misrepresentations (*e.g.*

21. See *Northern Bank* v. *Henry* [1981] I.R. 1 (insufficient inquiries made because it suited lender to rush security into place).

in relation to the future prospects of the principal debtor's business) would be more difficult to uncover, partly because the lender is often as badly deceived as the surety.[22] On the whole, it is easier to see how the type of inquiries under consideration could create offence than to see how they could actually reveal to the lender the presence of undue influence or misrepresentation.

The difficulty in identifying appropriate inquiries suggests that Lord Browne-Wilkinson's approach to the doctrine of notice rests on dubious empirical foundations. In an important category of case, no inquiries which could sensibly have been suggested would have revealed the type of undue influence or misrepresentation which took place. Indeed, it is arguable that this category includes all cases except those which, like *O'Brien* itself, turn on the surety's ignorance of the nature of the transaction. In cases where reasonable inquiries would have been ineffective, it is submitted that, as a matter of logic, the lender can never be regarded as having constructive notice. Therefore, a failure to take Lord Browne-Wilkinson's "reasonable steps" would be irrelevant and the lender should be permitted to enforce its security.

IV THE SHIFT TO REASONABLE STEPS

It is now necessary to consider the "reasonable steps" prescribed by Lord Browne-Wilkinson. His Lordship felt that "for the future"[23] a creditor will have taken the steps necessary to avoid constructive notice if "it insists that the wife attend a private meeting (in the absence of the husband) with a representative of the creditor at which she is told of the extent of her

22. See the facts of *Massey* note 14 *supra*.

23. Lord Browne-Wilkinson felt (at 196) that past transactions would "depend on the facts of each case". *Cf.*

liability as surety, warned of the risk she is running and urged to take independent legal advice."[24] Lord Browne-Wilkinson went on to explain that there might be exceptional cases "where a creditor has knowledge of further facts which render the presence of undue influence not only possible but probable."[25] To be safe in such cases, the creditor would have to insist that the surety be separately advised.

It is immediately obvious that there has been a shift in focus from the "inquiries and inspections" appropriate to the knowledge-based doctrine of notice to the duty-based language of "reasonable steps". Clearly the lender will not necessarily find out anything by taking these steps; instead it will reduce the likelihood of the surety entering the contract due to undue influence or misrepresentation. As a matter of elementary principle, a person will have constructive notice of matters which he would have discovered had he made proper inquiries. Why can a lender who has failed to make the proper inquiries nonetheless avoid constructive notice by taking Lord Browne-Wilkinson's reasonable steps?

The simple answer is that the area of third party undue influence and misrepresentation is an unusual sphere for the application of the equitable doctrine of notice. The doctrine normally operates to reconcile competing rights which have arisen from two separate transactions. In such a case, the equity to set aside the first transaction will, of course, have come into existence before the second transaction takes place. In the situation under discussion in this article, there is only one transaction, that which is being attacked on the grounds of undue influence or misrepresentation. When the lender is considering whether to enter into the contract of guarantee, the surety's equity to set aside that transaction has not yet come into being.

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the comments of Steyn L.J. in *Massey* note 14 *supra*, 346.

24. At 196.

Thus, what Lord Browne-Wilkinson may have been suggesting[26] is that it is possible for the lender, as it were, to move the goal-posts: to change the set of facts to which the doctrine of notice will apply. Equity would require him to make troublesome inquiries before contracting with a vulnerable surety who is getting no obvious benefit from the transaction. Therefore he may take the alternative decision to contract only with a somewhat different class of vulnerable surety, one to whom the transaction has been explained at a private meeting and who has been urged to seek independent advice. If such a surety still wishes to proceed with the contract, the lender can argue that it would no longer be reasonable to require it to make inconvenient inquiries since the risk of undue influence or misrepresentation is now significantly lower.

This argument appears to be the only way to reconcile Lord Browne-Wilkinson's approach with the basic principles of notice. However, when the legal problem is presented in this more complex way, it becomes difficult to accept the detailed nature of Lord Browne-Wilkinson's guidance. For example, his Lordship appeared to assume that, subject to exceptional cases, it would be fatal to the lender's case if it failed to conduct its interview

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25. At 197.

26. One could make the alternative argument that Lord Browne-Wilkinson was, in substance, imposing a duty on the lender not to contract with a vulnerable surety without taking reasonable steps to reduce the risk of an equitable wrong taking place. The lender could therefore be held liable on the basis of a failure to discharge its duty irrespective of whether there were any reasonable inquiries which would have revealed the existence of the undue influence. This may have been the view of Lord Browne-Wilkinson's speech taken by Bamforth in a paper entitled "Constructive Notice after *O'Brien*", discussed in Wilkinson's review of a Chancery Bar Association Seminar "The Uninformed Surety: Victim or Victor?" [1994] Conv. 349, 350-351. However, in disposing of the Court of Appeal's "special equity" theory, Lord Browne-Wilkinson clearly rejected (at 193C-F, 195B-E) the possibility of a direct duty owed by the lender to the surety. Moreover, it is surely impermissible to discount his Lordship's repeated references to the doctrine of notice and to suggest that he intended to introduce an entirely different principle under the cover of the one which he purported to explain and apply.

with the surety in the absence of the principal debtor. Similarly, as emerges from a comparison of Lord Browne-Wilkinson's speeches in *O'Brien* and in the sister case of *C.I.B.C.* v. *Pitt*,[27] the protection afforded in relation to surety transactions does not extend to cases where money is advanced jointly to husband and wife.[28]

This kind of trade-off, whereby vulnerable sureties are given a degree of protection in return for other concessions to lenders, is what one might expect if the legislature were to impose a duty of reasonable care on lenders. Within the equitable doctrine of notice, the question is not whether the lender has complied with a generalised code of good conduct. Rather, the issue is whether it could have found out about the particular equitable wrong which took place by means of inquiries which, taking into account any other steps it may have taken, were reasonable in all the circumstances. Less violence would be done to the doctrine of notice if Lord Browne-Wilkinson's guidelines could be seen as a code of conduct likely to avoid the lender being fixed with constructive notice, even if in some cases lesser steps would suffice and in others greater steps would be necessary.

In this respect, an interesting gloss was put on *O'Brien* by Steyn L.J. in the more recent case of *Massey* v. *Midland Bank p.l.c.*.[29] Steyn L.J. distinguished between "the law enunciated, as opposed to the guidance offered, in *Barclays Bank* v. *O'Brien*".[30] The learned judge went on to argue that:

> The guidance ought ... not to be mechanically applied. The relief is after all equitable

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27. Note 1 *supra*.

28. See note 15 *supra*.

29. Note 14 *supra*.

30. *Ibid.*, 345.

relief. It is the substance that matters.[31]

It appears from the decision in *Massey* that a lender will not suffer for a failure to carry out the prescribed ritual if it has taken alternative steps,[32] or is aware of facts, which make it pointless to follow Lord Browne-Wilkinson's steps to the letter.[33] It remains to be seen whether, on a more general level, the dicta in *Massey* will facilitate an escape in future cases from the straitjacket within which the *O'Brien* guidelines confine the doctrine of notice.

V CONCLUSION

Lord Browne-Wilkinson's approach was expressly founded on the doctrine of notice. However, it is extremely difficult to reconcile his Lordship's approach with the axiom that a person can only be regarded as having constructive notice of matters which he could have discovered through reasonable inquiries. A rationalisation, which is convincing only in fact-situations similar to that in *O'Brien* itself, is that Lord Browne-Wilkinson's reasonable steps

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31. *Ibid.*, 347.

32. The lender in *Massey* had not conducted a private interview with the vulnerable surety but had instead insisted that she consult an independent solicitor. Steyn L.J. felt (at 347) that, since the surety had received independent advice, the objective of Lord Browne-Wilkinson's guidance had been achieved.

33. It would appear that Lord Browne-Wilkinson's "reasonable steps", perhaps conditioned by the facts of *O'Brien*, are effective primarily to combat those forms of undue influence and misrepresentation which turn on the vulnerable surety being ignorant of the nature of the transaction. What if the type of equitable wrong relied upon to vitiate the transaction would not have been affected by the taking of the reasonable steps? It is submitted that in such a case the lender may nonetheless be fixed with constructive notice of the wrongdoing if it fails to take the reasonable steps. This is because, when confronted with the vulnerable surety, the lender was obliged to make inconvenient personal inquiries (which one assumes would have revealed the equitable wrong). Since the situation was not transformed by the taking of the reasonable steps, the failure to make the direct inquiries leaves the lender with constructive notice of what it

operate to change the scenario to which the doctrine of notice is applied, thus making it reasonable for the lender to refrain from making inconvenient direct inquiries which (one must be willing to assume) would have uncovered the undue influence or misrepresentation.

A second criticism which has been ventured is that, like undue influence, equitable notice exists in a "world of doctrine, not of neat and tidy rules."[34] The rigid theoretical structure erected by Lord Browne-Wilkinson in *O'Brien*, without parliamentary planning permission, is out of place in this undeveloped landscape. While his model depends, to an extent, on the facts of each case, it simply does not do so in the manner required by the doctrine of notice.

It is respectfully submitted that, despite the favourable reception which it has generally been accorded, Lord Browne-Wilkinson's legal analysis fails to achieve a satisfactory balance between policy and principle. Assuming that the Lords wished to improve the position of vulnerable sureties, it appears that they might have chosen a theoretical route which involved trampling less on basic equitable principles.

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would have found out through those inquiries.

34. *Per* Lord Scarman in *National Westminster Bank p.l.c.* v. *Morgan* [1985] A.C. 686, 709.