

17/85

O N A P P E A L  
FROM THE COURT OF APPEAL OF NEW ZEALAND

B E T W E E N:

THOMAS BRUCE HART Appellant

- AND -

JOSEPH O'CONNOR  
PAUL MICHAEL O'CONNOR  
and FRANCIS JOSEPH O'CONNOR Respondents

10 CASE FOR THE RESPONDENTS

RECORD

1. "THE CIRCUMSTANCES OUT OF WHICH THE APPEAL ARISES"

20 This is an appeal against two judgments of the Court of Appeal of New Zealand. The first was delivered on 5 May 1983 (Richardson, McMullin and Jeffries JJ). The Court made a declaration that an agreement for sale and purchase dated 1 September 1977 between the Appellant and Mr Jack O'Connor relating to a farm was rescinded for lack of capacity on the part of Jack O'Connor and for unfairness. The Court remitted the case to the High Court for determination of the amount of compensation to be paid to the Respondent. p.99

30 2. The second judgment appealed against was delivered on 20 July 1984 (Woodhouse P. Richardson and McMullin JJ). The Court upheld the award of compensation in the High Court by Cook J. for betterment arising from improvements carried out by the Appellant to the farm. The Court did not allow the Appellant's claim for the amount of the pure inflationary increase in the value of the farm. p.185

3. In 1977 Jack O'Connor, the then sole trustee of his father's estate, signed an agreement for the sale of the estate's farm to the p.985

Appellant, a neighbouring farmer. The father had died in 1911 and Jack O'Connor as the eldest of nine children had been appointed a trustee in 1926 along with his mother. She had died in 1950. The estate had not been distributed because the eight beneficiaries (all family members) agreed to Jack O'Connor and his brothers Joseph and Dennis farming the land for their own benefit. Jack was aged about 83 years in 1977. Joseph O'Connor and his sons, Paul and Frank, subsequently became the estate trustees and issued proceedings to have the sale agreement set aside.

10

4. It was held in the High Court and upheld in the Court of Appeal that Jack O'Connor lacked contractual capacity at the time he purported to sell to the appellant. The bargain was held by both Courts below to be unfair due to the method of fixing the price, the actual value fixed; the time given for payment, the difference in the relative bargaining positions of the parties and the lack of independent and competent advice. This was the case even although it was held not proved that the Appellant knew that Jack lacked contractual capacity.

20

5. The agreement was rescinded and an order made for possession of the farm to be passed back to the O'Connor estate. The Appellant had taken possession of the farm when the agreement was signed but had paid no part of the price. The order for possession was subject to the determination by the High Court of compensation payable to the Appellant.

30

6. The Appellant, without prejudice to this appeal, surrendered possession of the farm to the O'Connor Estate on 31st March, 1984. The estate has farmed the property since then. Compensation was paid to the Appellant in terms of the Judgment below at the time possession was re-taken.

40

7. ISSUES ARISING

The Respondents consider that out of the foregoing circumstances the following issues arise:

50

A. Whether a contract may be set aside by or on behalf of a party thereto who lacks mental capacity where such incapacity is not known to the other contracting party but:

- (i) such incapacity ought reasonably to have been known to the other contracting party, or,
- (ii) irrespective of actual or constructive knowledge by the other contracting party the contract was unfair to the party lacking capacity or those on whose behalf he purported to contract.

B. Whether the Appellant in this case ought reasonably to have known of the lack of contractual capacity of Jack O'Connor, in whose shoes the present Respondents stand.

C. Whether the contract in issue in this case was unfair to the O'Connor Estate of which the Respondents are now the trustees.

D. Whether the contract should be set aside as an unconscionable bargain as a separate ground of invalidity if for any reason it cannot be set aside on because of Jack O'Connor's lack of contractual capacity.

E. Whether this was a case where restitution in integrum was possible.

F. Whether upon the setting aside of the contract, the Respondents, as well as making a payment on account of betterment, were also obliged to make a payment reflecting the increase in the value of the land due purely to inflation.

8. RESPONDENTS' CONTENTIONS

In respect of the foregoing issues the Respondents' contentions are:

A. A party who has contracted without mental capacity or some appropriate person on his behalf may have the contract set aside in any one of the following circumstances:

- (i) if the other contracting person knew of his lack of capacity.
- (ii) if the other contracting party ought reasonably to have known of his lack of capacity.

(iii) if the contract is unfair to the party lacking capacity or those whom he represents.

B. While it is acknowledged that the evidence fell short of showing that the Appellant had actual knowledge of Jack O'Connor's lack of capacity the Respondents contend that the evidence showed that the Appellant ought reasonably to have known of such lack of capacity. Such constructive knowledge coupled with the lack of capacity gives the Court power to set aside the contract. 10

C. The contract in this case was unfair to the O'Connor Estate and this circumstance, coupled with the lack of capacity of Jack O'Connor, gives the Court power to set aside the contract.

D. That the contract can and should be set aside as an unconscionable bargain as a separate ground of invalidity if for any reason it cannot be set aside because of Jack O'Connor's lack of capacity. 20

E. That restitution in integrum was possible on a fair and reasonable basis in this case and there was therefore no bar to the setting aside of the contract on that ground.

F. That on the contract being set aside the Respondents have always accepted that they were obliged as an equitable condition of the primary relief which they sought to pay the Appellant a sum of money representing the betterment which he effected to their land. Their contention is however that there is no basis or justification for their having to pay in addition a sum representing the purely inflationary increase of the value of the land. 30 40

9. REASONS FOR CONTENTIONS

The Respondents now give their reasons for their contentions on each of the foregoing issues.

10. The first issue in substance is whether the judgment of Mr Justice McMullin in the High Court of New Zealand in Archer v Cutler [1980] 1 N.Z.L.R. 386 was rightly decided. That decision 50

was adopted by the Court of Appeal of New Zealand in the present case, now reported as O'Connor v Hart [1983] N.Z.L.R. 280, at page 290. The Respondents respectfully contend that Archer v Cutler was correctly decided.

10 11. It has never been in doubt as a matter of law that contractual incapacity coupled with actual knowledge thereof in the other party gives power to set aside a contract. In this case the Respondents argue that despite no proof of actual knowledge in the Appellant the Court has power to set aside because:

- (a) The Appellant ought reasonably to have known of Jack O'Connor's mental state.
- (b) The contract was unfair.

12. CONSTRUCTIVE KNOWLEDGE

20 The following are the primary authorities advanced by the Respondent in support of the proposition that as a matter of law constructive knowledge is sufficient:

New Zealand  
Donaghy v Brennan (1900) 19 N.Z.L.R. 289  
Stout C.J. 302-303

"knew or had reasonable grounds for believing that the party who had contracted with him was insane."

30 Archer v Cutler [1980] 1 N.Z.L.R. 386 at page 401

"Unless the other party either knows or ought in the circumstances to know that the party with whom he is dealing is of unsound mind"

Australia:  
Tremills v Benton (1892) 18 V.L.R. 607, 622 per Holroyd J.

"know or suspect"

40 Commercial Bank of Australia v Amadio (1983) A.L.J.R. 356 at pages 365 and 366 per Mason J. and 369 f.f. per Deane J.

England  
York Glass Co Ltd v Jubb (1925) 134 L T 36 per Warrington L.J. at page 41:

"knew or must be taken to have known"

13. On the facts of this case it is contended by the Respondents that the Appellant should be regarded as having constructive knowledge of Jack O'Connor's lack of mental capacity.

Cook J. in his judgment said:

10

p.56

'While one cannot but think that Mr Hart must have wondered how competent Jack might be to undertake business of any complexity,....."

14. Because of the acceptance by the present Appellant that the law was correctly laid down in Archer v Cutler when the case was heard by Mr Justice Cook, and because of the finding of unfairness by Mr Justice Cook, it was not necessary for Mr Justice Cook to come to any specific finding on the question of constructive knowledge.

20

p.108

The Respondents have therefore to a degree been disadvantaged by the fact that the present Appellant in the Court of Appeal without notice and at a late stage of the argument in that Court resiled or attempted to resile from the earlier acceptance that the law was correctly stated in Archer v Cutler.

30

15. In addition to the observation made by Mr Justice Cook in his judgment referred to in paragraph 13 above there are the facts that:

(i) Jack O'Connor was, as Hart must have known, elderly - about 83 years old at the relevant time.

(ii) That Jack O'Connor to Hart's knowledge was having to give up farming.

(iii) That Hart was a neighbour.

40

(iv) The terms of the contract itself ought to have put a reasonable and objective person in Hart's shoes on inquiry as to whether Jack O'Connor had sufficient mental capacity to deal with a transaction of the kind in question

Whether the contract in this case was as the Respondents contend, in fact unfair is dealt with as a separate issue below. The Respondents now give their reasons for contending that unfairness coupled with lack of capacity gives ground for setting aside. The primary authorities and other materials upon which the Respondents rely are:

10 New Zealand:

Archer v Cutler [1980] 1 N.Z.L.R. 386  
O'Connor v Hart [1983] N.Z.L.R. 280

England:

Imperial Loan Co Ltd v Stone [1892] 1 Q.B. 599  
per Lopes LJ  
York Glass Co Ltd v Jubb (1925) 134 L.T. 36  
per Pollock MR at page 39 and Sargant L.J.  
at page 43.  
20 Molton v Camroux (1848) 2 Exch. 487 and (1849)  
4 Exch. 17 154 E.R. 584 and 1107.

Fridman 1963 L.Q.R. 502, 509-516

Hudson Mental Incapacity in the Law of Contract and Property in The Conveyancer January and February 1984 Volume at page 32.  
Halsbury 4th Edition Volume 16 Equity paragraph 1223 and Volume 30 Mental Health paragraph 1006.  
Goff & Jones Law of Restitution 2nd Edition 343.

30 Canada:

Wilson v The King [1938] 3 D.L.R. 433 477.  
Hardman v Falk [1955] 3 D.L.R. 129  
Canadian Abridgement 2nd Edition Volume 7  
at page 286.

Australia:

Gibbons v Wright (1954) 91 C.L.R. 423, 444.

Scotland:

40 Gloag Law of Contracts 2nd Edition page 92  
Loudon v Elder's Curator (1923) S.L.T. 226  
(O.H. Lord Blackburn)  
Walker Law of Contracts page 52

Roman Dutch Law:

Molyneux v Natal Land Co [1905] A.C. 555  
(Privy Council) at page 561

Ireland:

50 Grelish v Murphy [1946] IR 35, 49-50 Gavan Duffy  
J.  
Buckley v Irwin [1960] N.I. 98 McVeigh J.  
Rooney v Conway (1982) NILR Bulletin of  
Judgments 5.

RECORD

America:  
Contracts by Calamari & Perillo 2nd  
Edition 1977 page 252  
American Law Institute Restatement  
Contracts 2nd Edition (1979) page 41.  
Murray on Contracts (1974) pages 22 ff

17. The Respondents submit that the foregoing authorities each to a greater or lesser extent all support the proposition that where the unsoundness of mind of one contracting party is not known to the other the contract can only stand if fair; or, putting the matter conversely, can be avoided if unfair. 10

18. The Respondents respectfully adopt what Sargant L.J. said in York Glass Co v Jubb at page 43 in respect of the enforcement of contracts against persons lacking contractual capacity:

"I have looked through a number of cases and I have not found a single case in which a contract has in fact been binding except where the contract was an ordinary reasonable contract" 20

19. In principle, even if an opposite party to a contract neither knew nor ought to have known that the other party lacked capacity, the contract unless entirely reasonable and fair should be capable of avoidance because: 30

- (i) This approach accords best with the principles of equity.
- (ii) This approach harmonizes with the law on the setting aside of unconscionable bargains.
- (iii) This approach is a sensible and fair compromise between the extremes of holding all contracts by those lacking capacity to be void and holding a contract by a party lacking capacity binding, irrespective of its terms and the circumstances in which it was entered into unless there is actual or constructive knowledge of such incapacity in the other party. 40
- (iv) Such an approach is unlikely to have any detrimental effect on the security of contractual relationships



generally and the party of sound mind has the protection of the doctrine of restitutio in integrum.

RECORD

20. UNFAIRNESS ON THE FACTS

The Respondents contend that the contract in issue in this case was in fact unfair to the O'Connor estate of which the Respondents are now the trustees.

10 21. There have been concurrent findings of fact as to:

(a) Price inadequacy and favourable terms of sale to Appellant.

Cook J. p.83. et seq  
McMullin J. p.111 to p.118.

pp 83-84  
pp 111 to  
p 118

(b) Lack of independent advice, indeed, Henderson's advance (he was the sole advisor) was not disinterested or sound.

20 Cook J. p.62 to p.66  
McMullin J. p.115 and p.123.

pp 62 to 66  
p 115, p 123

(c) Inequality of bargaining power. Jack, aged 83 was ill and incapacitated. The Respondent was much younger and more vigorous.

Cook J. p.66 to p.68  
McMullin J. p.115 and p.123.

pp 66 to 68  
p 115, p 123

22. In addition to the foregoing the Respondents rely on the following points of unfairness:

30 (a) There was experienced conveyancing evidence that the method of fixing the price was at the lowest unusual and at the highest extraordinary.  
R.E. Wylie 269.276 P.G. Hill 745-747

pp 269 to  
p 270  
pp 745-747

In any event the opportunity to obtain the best price was thrown away.

Cook J. p.77 and p.84.  
McMullin J. p.116

p 77 & p 84  
p 116

40 (b) Both the Appellant and Jack were led to believe that Joseph and Dennis consented to a sale - in fact they did not.

Cook J. p.75.

p 75

(c) The loss of opportunity to Paul and Frank O'Connor to purchase the farm, which was sold out of the family after nearly 100 years. In spite of the terms of the Will.

p 940

23. UNCONSCIONABLE (UNFAIR) BARGAIN

In the event of the Appellant successfully arguing that the contract cannot be set aside for lack of capacity, the Respondents contend that the transaction constitutes an unconscionable bargain and should be set aside on that ground.

24. The Respondents contend that whether the circumstances are considered on the narrower basis used in Cresswell v Potter and Fry v Lane, or on the broader basis used in K. v. K., and in Archer v Cutler, the transaction amounted to an unfair/unconscionable bargain. 10

25. This equitable doctrine has a long history. See classical case of Earl of Aylesford v Morris (1873) 3 Ch.App Cas. 484 at 490. Recently discussed in K. v. K. [1976] 2 N.Z.L.R. 31, Grant v Grant [1979] 1 N.Z.L.R. 66 at 70. 20  
Moffat v Moffat [1984] 1 N.Z.L.R. 600 at 604, The Commercial Bank of Australia v Amadio (1983) 57 A.L.J.R. 358, Cresswell v Potter [1978] 1 W.L.R. 255.

26. Where the relative bargaining positions of the parties are such as to raise the presumption of unconscionable bargain, the onus of proof is on the benefitting party to show the fairness, justness and reasonableness of the transaction. 30

27. The key point which brings the doctrine into play is a marked inequality in the bargaining positions of the parties: Riki v Codd [1980] 1 N.Z.C.P.R. 242 249.

28. It is the result of the transaction rather than the motives prompting it which are relevant - Fry v Lane (1899) 40 Ch.D 312 at 324. Kay J. 40

29. The Respondents submit that there was in this case a substantial inequality in the bargaining positions and the appellant did not and cannot show that the transaction was fair, just and reasonable.

30. In support of the submission that this transaction was an unfair/unconscionable bargain, the Respondents rely on the various factual matters in 50

paragraphs 21 and 22 above dealing with unfairness.

RECORD

31. RESTITUTION

The Respondents contend that this is a case where restitution was possible.

32. That Restitution has been ordered and assessed by the Courts, and has been effected.

10 Supplementary Judgment of Cook J. dated 16th December 1983.

p 151

33. That any complications in the way of restitution arising from the passage of time and the Appellant's extended occupation of the farm are, to a large degree, of the Appellant's own making. To deny setting aside as a result of such factors is to allow the Appellant to improve his position by his own unjustified decision to defend.

20 34. The Court of Appeal found that restitution was possible and went on to remit the case back to the High Court to determine the amount of compensation to be paid to Mr. Hart.

P.137, 142 McMullin J.

pp 137-142

35. This was done by the High Court. The Court's order was implemented on 31st March 1984.

30 36. No exact Restitution in Integrum is necessary. The Court should "do what is practically just, though it cannot restore the parties precisely to the state they were in before the contract".

Erlanger v New Sombrero Phosphate Co (1873)  
3 App. Cas. 1218, P.1278 - Lord Blackburn.  
Stanley Stamp Co v Brodie (1914) 34  
N.Z.L.R. 129, 168 C.A. per Edwards J.  
Spencer v Crawford [1939] 3 All E.R. 271,  
279, 288 H.L.

40 37. This is not a case where restitution is impossible for example because:

- (a) Property totally changed in character.
- (b) Rights of third parties have intervened.
- (c) Financial adjustments cannot be made.

The Court was perfectly capable of fairly assessing all factors that required compensation, and has in fact done so.

p. 125

38. Early notice of challenge to the contract, which was maintained throughout, was given to the Appellant. A Caveat was lodged against the farm land title in February 1978. The Appellant chose to resist the challenge and in the event, failed.

10

39. INFLATIONARY INCREASE IN VALUE

The Respondents contend that upon the setting aside of the contract they are not obliged to make a payment reflecting the increase in the value of the farm due purely to inflation but only a payment on account of betterment.

40. The Appellant is only entitled to compensation for the increase in value of the land brought about by the improvements he has made to it.

20

41. A distinction must be made between active and passive factors effecting changes in value. Inflation is a passive factor occurring regardless of the identity of the owner of the farm, and is an incident of ownership.

42. Because on setting aside the contract is regarded as void ab initio the Respondents owned the farm throughout. They were never paid for it, and are entitled to the inflationary increase in value which runs with the land.

30

p. 151  
p. 185

43. The Respondents respectfully adopt the reasons for declining to include pure inflation expressed in the supplementary judgment of Cook J. in the High Court delivered on 16 December 1983 and in the second judgment of the Court of Appeal.

40

J.L.D. WALLACE  
Counsel for the Respondents

No.56 of 1984

IN THE PRIVY COUNCIL

---

ON APPEAL

FROM THE COURT OF APPEAL OF NEW ZEALAND

---

BETWEEN:

THOMAS BRUCE HART

Appellant

- AND -

JOSEPH O'CONNOR

PAUL MICHAEL O'CONNOR

and FRANCIS JOSEPH O'CONNOR Respondents

---

CASE FOR THE RESPONDENTS

---

ALLEN & OVERY  
9, Cheapside,  
LONDON EC2V 6AD

Solicitors for the Respondents