

Barclays Bank v O'Brien: an exercise in the happily illogical.

Marc Beaumont, discusses the potentially significant impact of the recent decision of the House of Lords in Royal Bank of Scotland v Etridge

The long-awaited decision of the House of Lords in *Royal Bank of Scotland v Etridge* has now been delivered. It has involved a re-interpretation of the principles in *Barclays Bank v O'Brien* and will become a first point of reference for all those wives and others - generically described as "sureties"- who have offered their homes in questionable and oppressive circumstances as security for a husband's business debt or liability, only to find that, on default, the lender has sought to enforce that liability by seeking to re-possess the family home.

The presumption of undue influence

The distinction between actual undue influence and class 2B presumed undue influence remains (Lord Nicholls supported by Lord Bingham). However, Lord Hobhouse with some support from Lord Clyde (paras 92-93) and Lord Scott (para 161) seems to have dissented on this in holding that the class 2B presumption be abolished, but that was not (apparently) the unanimous view despite his assumption that it was (paras 3, 107) and a number of dicta would have required to have been expressly disapproved or overruled if abolition of

the doctrine had been intended. But it is hardly satisfactory that a matter of such legal and practical importance should not be free of confusion in a judgment which purported to be clarifying the law.

The circumstances in which the presumption of undue influence arise are, according to Lord Nicholls, in essence a relationship of ascendancy and dependancy: (paras 8-9), or where one party has reposed trust and confidence in the other in relation to the management of the complainant's financial affairs (paras 10, 14), coupled with a transaction which calls for an explanation (para 14);

What is at play is subtle range of relevant factors such as:- (a) the personality of the parties; (b) their relationship; (c) the extent to which the transaction cannot be accounted for by the ordinary motives of ordinary persons in that relationship: (para 22); (d) all the circumstances of the case: (para 13), including the fact that the relationship of husband and wife affords an exceptional opportunity for abuse by a husband: (para 19);

The presumption of undue influence is capable of rebuttal by proof of the provision of advice from a third party such as a solicitor: (para 20). However this will not be so if the advice is demonstrably bad, or if the advice is good, but the effect of anterior undue influence is still present: (para 20). The presumption is equally rebuttable by proof that, in fact, there was no undue influence in operation: (per Lord Scott at paras 158, 160-161).

Manifest disadvantage

The Lords followed *National Westminster Bank v Morgan* [1985] AC 686 HL and *CIBC v Pitt* [1994] 1 AC 200 HL, in holding that in cases of alleged presumed undue influence, it is essential that it is also proved that the transaction was manifestly disadvantageous, but that it is not essential that this requirement is also proved in actual undue influence cases. If it were otherwise, every Christmas present by a child to a parent would fall to be set aside: (paras 12, 21-31). However, the test of “manifest disadvantage” was thought to be a confusing label and should be discarded (para 29). The correct test in this respect is: *whether the transaction constituted an advantage taken of the person subjected to the influence which, failing proof to the contrary, was explicable only on the basis that undue influence had been exercised to procure it*. In the context of a wife providing a guarantee of her husband’s business debts, generally such cases will not satisfy the test in the wife’s favour (para 30). “Wives frequently enter into such transactions. There are good and sufficient reasons why they are willing to do so...” (per Lord Nicholls at para 30). However, in an area of conceptual complexity, it is not understood why a shorthand label which everybody can remember was thought to be unhelpful.

Misrepresentation

Misrepresentation remains a discrete head of alleged invalidity. But a husband’s statement of (perhaps misplaced) optimism, exaggeration or hyperbole about his prospects is not actionable as misrepresentation (paras 32-

33). “Inaccurate explanation” and non-disclosure to the wife in breach of “an obligation of candour and fairness” to her are actionable, as is a statement which is “misleadingly incomplete:” (para 42). What is mere hyperbole or culpable inaccuracy was not further defined by Lord Nicholls. Such lack of definition will no doubt spawn fresh litigation on the subject.

Constructive notice: when is the lender placed “on inquiry”

Astonishingly, Lord Nicholls held that the threshold test of constructive notice in *Barclays Bank v O’Brien* has been completely misunderstood by practitioners and judges in all the hundreds of cases decided since *O’Brien* (paras 44-49), including the Court of Appeal in a number of cases culminating in *Etridge* itself. The material passage in *O’Brien* contained an apparent dual test as follows:

“ Therefore in my judgment a creditor is put on inquiry when a wife offers to stand surety for her husband's debts by the combination of two factors: (a) the transaction is on its face not to the financial advantage of the wife; and (b) there is a substantial risk in transactions of that kind that, in procuring the wife to act as surety, the husband has committed a legal or equitable wrong that entitles the wife to set aside the transaction. “

It follows that unless the creditor who is put on inquiry takes reasonable steps to satisfy himself that the wife's agreement to stand surety has been properly obtained, the creditor will have constructive notice of the wife's rights.....”

Lenders have hitherto relied in scores of cases on the submission that factor (a) was not triggered where there was no indication at the outset that the transaction was not “on its face” to the wife’s financial disadvantage. This argument has permitted lenders who have taken no “reasonable steps” at all to recommend the taking of independent legal advice in cases where there

has been no provision of such advice whatsoever, to escape a finding of constructive notice. This will no longer happen.

Lord Nicholls held that in fact the true test is contained in the words: “*a creditor is put on inquiry when a wife offers to stand surety for her husband's debts*” and that the rest of the passage was the rationale for that test. So the test is that the lender is put on inquiry whenever a wife offers to stand surety for her husband’s debts. “That bare fact is enough” (para 84). Factors (a) and (b) are *reasons* for the main test not preconditions which have to be satisfied. It follows, apparently illogically, that where a wife offers to stand surety, the Bank is put on inquiry even if the transaction is on its face to her financial advantage.

A broader trigger test

The *O'Brien* test applies just as much to other cohabittees, to husband-victims of undue influence, to the parent/child relationship and to employer and employee, (as in *Credit Lyonnais v Burch* [1997] 1 All ER 144: para 84-87).

However, Lord Nicholls had to dilute even further the core test so as to accommodate these situations, concluding that:

“the only practical way forward is to regard Banks as ‘put on inquiry’ in every case where the relationship between the surety and the debtor is non-commercial. The creditor must always take reasonable steps to bring home to the individual guarantor the risks he is running by standing as surety. (para 87)”

Thus the test as to whether the lender is on inquiry in a wife case is that

“a creditor is put on inquiry when a wife offers to stand surety for her husband's debts” and in any other case is, “whether the relationship between the surety and the debtor is non-commercial.” In effect, the second test will subsume the first in a manner redolent of blanket judicial legislation. Indeed, Lord Nicholls acknowledged that this gives rise to a new broad principle that in any surety case, where the surety is an individual, the Bank will be on inquiry as to and affected by any impropriety committed by the debtor unless it takes the steps defined by the House of Lords: (paras 82-89).

It follows, however, that it is still good law that in a case of an innocuous joint application for finance by husband and wife, the lender is not put on inquiry: see *CIBC v Pitt* [1994] 1 AC 200. However, in a case where the wife becomes the surety of a Company whose shares are held by her and the husband, where her interest is a minority shareholding or (again, somewhat illogically) even if her shareholding is equal, the lender is still put on inquiry, even where the wife is also a Director of the Company or its Secretary: (para 49).

Mixed purposes cases

The disappearance of the two tier test in *O'Brien* does not assist in the resolution of a recurring problem in this area. What if the loan is required, say, as to 10 per cent for the husband's business purposes and 90 % for innocuous joint purposes ? Presumably the test in *Etridge* means that the Bank is still placed on inquiry and must take “reasonable steps,” regardless

of the decision in *Pitt* and that there is a risk that, paradoxically, a Charge securing a predominantly beneficial advance will not be enforceable. The House of Lords does not address this consequence.

Constructive notice: reasonable steps

The simplification and dilution of the test for constructive notice makes it even more critical than hitherto that the lender is able to go on to prove that it took “reasonable steps” to avoid being put on inquiry. The content of such steps has been re-defined and clarified. Lord Nicholls held that it is not necessary for the Bank *itself* to conduct a private interview with the wife. This is because the scope for allegations of misrepresentation arising from such meetings is very considerable. It therefore suffices for the Bank to require the wife to seek legal advice elsewhere. The lender *may* proffer advice itself at a personal meeting with the wife, but it is not obliged to do so.

If it suffices for the Bank to delegate the advice-giving function, it necessarily follows that the Bank is generally entitled to rely on a Solicitor’s certificate or confirmation that advice has been given to the wife.

But this will not be so if:- (a) the Bank has actual notice that the Solicitor has not duly advised the wife, or (b) the Bank has knowledge of facts from which it ought to have realised that the wife has not received appropriate advice (para 57). This might be the case where a wife signs an unlimited guarantee: (per Lord Hobhouse at para 112).

Past transactions

Lord Griffiths then defined the notion of “reasonable steps” in very considerable detail. In all cases arising from transactions before the House of Lords decision of 11.10.01, reasonable steps will be taken if the solicitor sent to the Bank confirmation to the effect that he advised the wife as to the risks she was running by standing as surety (paras 80, 168). This is a stricter basis for escape for the lender than hitherto, because the mere involvement of a Solicitor who sends a certificate to the lender was formerly held to be sufficient as giving rise to a reasonable assumption on the part of the lender that such advice had been given: see *Bank of Bank of Baroda v Rayarel* [1995] 2 FLR 376. Reliance by the lender on this fiction is not now sufficient (per Lord Scott at para 168). However Lord Scott, apparently unsupported on this by any of his brethren, would hold that a lender which is merely told that a solicitor is instructed to advise the wife, but is not told that that has been done, is entitled to assume that it has been done (para 171). The mere witnessing by the solicitor of the execution of the documents will not be enough: (per Lord Hobhouse at para 115).

Future transactions

In all future cases (ie: transactions after 11.10.01), the Bank must now also take certain minimal action *itself*, notwithstanding the reliance on a third party solicitor (paras 79-80). Passivity is not now sufficient. This action is as follows:- (a) The Bank must take steps to check directly with the wife the

name of the solicitor she wishes to act for her; (b) It should communicate directly with the wife, informing her that for its own protection it will require written confirmation from a solicitor, acting for her, to the effect that the solicitor has fully explained to her the nature of the documents and the practical implications they will have for her; (c) She should be told that the purpose of this requirement is that thereafter she should not be able to dispute that she is legally bound by the documents once she has signed them; (d) She should be asked to nominate a solicitor whom she is willing to instruct to advise her, separately from her husband, and act for her in giving the necessary confirmation to the Bank. She should be told that, if she wishes, the solicitor may be the same solicitor as is acting for her husband in the transaction; (e) If a solicitor is already acting for the husband and the wife, she should be asked whether she would prefer that a different solicitor should act for her regarding the Bank's requirement for confirmation from a solicitor; (f) The Bank should not proceed with the transaction until it has received an appropriate response directly from the wife; (g) the Bank must provide the solicitor with the financial information about the husband's business that the solicitor needs for the purpose of advising the wife. Lord Nicholls held that it should become routine practice for Banks, if relying on confirmation from a solicitor for their protection, to send to the solicitor the necessary financial information. What is required must depend on the facts of the case. Ordinarily this will include information on the purpose for which the proposed new facility has been requested, the current amount of the husband's indebtedness, the amount of his current overdraft facility and the amount and terms of any new facility. If the

Bank's request for security arose from a written application by the husband for a facility, a copy of the application should be sent to the solicitor; (h) The Bank will need to obtain the consent of the husband to this circulation of confidential information. If this consent is not forthcoming, the transaction will not be able to proceed and such lack of consent may sound an alarm bell that the husband has acted improperly (para 114) making it necessary for the Bank to insist that the wife receives legal advice from a solicitor independent of the husband (para 190); (i) If the Bank believes or suspects that the wife has been misled by her husband or is not entering into the transaction of her own free will, the Bank must inform the wife's solicitors of the facts giving rise to its belief or suspicion; (j) The Bank should *in every case* obtain from the wife's solicitor a written confirmation to the effect that the solicitor has fully explained to her the nature of the documents and the practical implications they will have for her.

Clearly, this scheme imposes on Banks a much higher burden in future cases, given that in the past (eg: see *Bank of Bank of Baroda v Rayarel* [1995] 2 FLR 376 at 386), the mere involvement of a Solicitor giving rise to an assumption that advice had been duly given, was sufficient to dispel any finding of constructive notice. Such a mere assumption will no longer suffice: (see Lord Hobhouse at para 100). The promulgation of this scheme marks a definite and surprisingly, politically unfashionable trend away from accommodation of the commercial lenders and toward protection of the vulnerable. As Lord Hobhouse said (para 115):

“ The law has, in order to accommodate the commercial lenders, adopted a fiction [the reasonable assumption that a solicitor had given advice even where this was not true] which nullifies the equitable principle and deprives vulnerable members of the public of the protection which equity gives them. ”

The Solicitor’s duty of care to the surety

A Solicitor’s duty to the client has ostensibly been reduced in extent, but then compounded in its fine detail. The net effect may be thought to be a more onerous role for solicitors. A solicitor need only ensure that the surety understands the nature and effect of the transaction. He need not go further and satisfy himself that the client is free from undue influence, as held by the Court of Appeal in *Etridge*. There is no duty to advise the client against entering into the transaction. The decision to do so is ultimately hers (paras 58-61). Only in an extreme case, where it is obvious that the wife is being “grievously wronged,” must the solicitor decline to act any further.

However, the advice that a solicitor can be expected to give should cover the following matters as a “core minimum.”

(a) He will need to explain the nature of the documents and the practical consequences these will have for the wife if she signs them. She could lose her home if her husband's business does not prosper. Her home may be her only substantial asset, as well as the family's home. She could be made bankrupt;

(b) He will need to point out the seriousness of the risks involved. The wife should be told the purpose of the proposed new facility, the amount and principal terms of the new facility and its duration and that the Bank might

increase the amount of the facility, or change its terms, or grant a new facility, without reference to her;

(c) The surety should be told the amount of her liability under her guarantee. The solicitor should discuss the wife's financial means, including her understanding of the value of the property being charged. The solicitor should discuss whether the wife or her husband has any other assets out of which repayment could be made if the husband's business should fail. The effect of an "all monies" clause should be explained. These matters are relevant to the seriousness of the risks involved;

(d) The solicitor will need to state clearly that the wife has a choice. The decision is hers and hers alone. Explanation of the choice facing the wife will call for some discussion of the present financial position, including the amount of the husband's present indebtedness and the amount of his current overdraft facility;

(e) The solicitor should check whether the wife wishes to proceed. She should be asked whether she is content that the solicitor should write to the Bank confirming he has explained to her the nature of the documents and the practical implications they may have for her, or whether, for instance, she would prefer him to negotiate with the Bank on the terms of the transaction. Matters for negotiation could include the sequence in which the various securities will be called upon, or a specific or lower limit to her liabilities;

(f) The solicitor should not give any confirmation to the Bank without the wife's authority;

(g) The wife should be "tested" by the solicitor for misunderstandings which

should be corrected: (per Lord Scott at para 170).

The solicitor's discussion with the wife should take place at a face-to-face meeting, in the absence of the husband. The solicitor's explanations should be couched in suitably non-technical language. The solicitor should obtain from the Bank any information he needs. If the Bank fails for any reason to provide the information requested by the solicitor, the solicitor should decline to provide the confirmation sought by the Bank.

This re-defined duty of care is to be welcomed in principle, but no doubt, solicitor's insurers will not share that sentiment.

“Independent” legal advice

It is not necessary that the solicitor dispensing advice should be “independent” of the husband or the Bank. He may act for all parties. (paras 69-74, 173). However, the solicitor must be alive to the risk of any conflict of interest. In a case where the Bank does suspect undue influence, it should insist that the husband's solicitor does not advise the wife (per Lord Scott at para 174). The clarification of something of a jurisprudential old chestnut is to be welcomed.

Section 199 of the LPA 1925

Lord Nicholls followed cases such as *Halifax M.S v Stepsky* [1996] Ch 207, (where the knowledge sought to be imputed was the purpose of the loan), *Barclays Bank v Thomson* [1997] 4 All ER 816 and *National Westminster*

Bank v Beaton (1997) 30 HLR 99 and held that If the Solicitor gives the wife deficient advice and gives the Bank a certificate that advice was duly given to her, the solicitor's knowledge of his own deficient advice is not to be imputed to the Bank under section 199 of the Law of Property Act 1925. This being so, the Bank is not obliged to look behind such a certificate and can rely on it and assume that the solicitor has given proper advice (paras 75-78, 122). But as Lord Scott held (paras 178, 179), in a case where the solicitor states falsely that he has advised the wife, he never in fact becomes her agent and remains the agent of the Bank, such that his knowledge of the omission to advise will be imputed to the Bank. That exception is technically correct and its overdue clarification is to be welcomed.

The new landscape

Whilst the decision of the House of Lords skews the law of constructive notice very much in favour of wives and sureties, there are still balancing factors. It should not be forgotten that in any case in which the wife has received a benefit from the transaction she will be obliged to make restitution of it as a condition of relief: see *Dunbar Bank v Nadeem* [1998] 3 All ER 875. Moreover, in a presumed undue influence case it will still be necessary to ask whether the transaction constituted *an advantage* taken of the person subjected to the influence, which, failing proof to the contrary, was explicable *only* on the basis that undue influence had been exercised to procure it. Further, cross-examination exploring the absence of factors such as threats, emotional blackmail, bullying or prolonged persuasion will invariably serve to rebut the

presumption. Moreover, imprecision in recollection will undermine many averments of misrepresentation. It is also open to the lender to contend that, as a matter of causation, even if the wife had received full and detailed advice, she would still have supported the transaction: see *BCCI v Aboody* [1992] 4 All ER 955 and per Lord Hobhouse in *Etridge* at para 129. In the short-term, sureties will, however, no doubt seek to profit from a failure by lenders to comply with the new guidance. Anxiety as to the question of compliance will regularly promote ready offers of compromise by lenders. Litigation in all but the clearest cases will become the lender's last resort.

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