

# 20A

## INCAPACITY

### CENTRAL ISSUES

1. The law relating to incapacity seeks to strike a balance between two competing policies. The first is the desire to protect those who have limited contractual capacity and the second is the wish to protect people who deal in all good faith with those who are in some way incapacitated. The trend in the modern law is to give greater emphasis to the latter policy over the former.
2. Those who have limited contractual capacity include children, people who suffer from some mental incapacity, companies, and local authorities. The various forms of incapacity are regulated in different ways but the differences in treatment are not always easy to justify. They seem to be attributable to historical accident rather than rational development. For example, in cases of mental incapacity the contract will only be set aside where the defendant has knowledge that the claimant is suffering from an incapacity, whereas there is no such knowledge requirement in the cases where an adult concludes a contract with a child. In such cases the law does not examine the state of the adult's knowledge and, indeed, cases can be found in which the contract was held not to be binding on the child notwithstanding the fact that the child fraudulently misrepresented that he was an adult.
3. Incapacity cases are also related to some of the cases discussed in Chapter 20 (dealing with unconscionability and inequality of bargaining power). The link between the two groups of cases is particularly apparent in cases of alleged mental incapacity.

### 1. INTRODUCTION

Contract textbooks written in the nineteenth century and in the early part of the twentieth century gave considerable prominence to the issue of contractual capacity. The reason for this was that, during this period, over half the population had limited contractual capacity. At common law a married woman did not, as a general rule, have contractual capacity; that is to say, she could not enter into a contract on her own account. These restrictions on the contractual capacity of women have since been repealed but the process of repeal was not completed until the enactment of the Law Reform (Married Women and Tortfeasors) Act

1935 and the Married Women (Restraint upon Anticipation) Act 1949. Today the topic of contractual capacity excites far less interest. Women now have full contractual capacity. While children still have limited contractual capacity, one consequence of the reduction of the age of majority from twenty-one to eighteen has been to reduce the practical significance of the issue because many of the old cases concerned with the contractual capacity of children involved children aged between eighteen and twenty-one. Such 'children' now have full contractual capacity.

But it does not follow from the reduced practical significance of incapacity that it has lost all relevance and interest. Difficult issues can still arise in relation to the capacity of companies and public bodies. An area which also gives rise to difficulty is the contractual capacity of the elderly and the infirm. Many people in society are concerned for the welfare of their elderly parents, some of whom exhibit signs of memory loss which may or may not be associated with a form of dementia. What is the contractual capacity of people whose intellectual powers are diminishing in this way? There is an acute conflict of policy here. On the one hand, we do not wish to infantilize the elderly by depriving them of their capacity to enter into contracts. On the other hand, we do not want to leave them vulnerable to exploitation by those who are tempted to prey on their reduced capacity for their own gain. It is not uncommon now for elderly parents to confer a power of attorney on their children so that the children can contract on their behalf and relieve them of the responsibility of having to look after their own financial affairs. The difficulties associated with the contractual capacity of the elderly are likely to assume greater significance in the future, not less.

The law in this area attempts to strike a balance between two competing policies. First, there is the desire to protect those who have limited capacity. For example, in the case of children, the law wishes to protect children from their lack of understanding and experience of life. Secondly, there is the desire to protect people who deal in all good faith with those who suffer from some form of incapacity. For example, a person may enter into a contract with a seventeen-year-old, unaware of the fact that he is a child or enter into a contract with another adult unaware of the fact that that person is suffering from dementia. The balance between these two policies has proved to be a difficult one and it has resulted in the creation of a complex body of case-law.

## 2. CHILDREN

A child is a person who is under the age of eighteen. The word that is used in law to describe a child is a 'minor'. Children have limited contractual capacity. Unfortunately, the law has developed in a piecemeal fashion, with the result that the rules of law are unnecessarily complex. When seeking to ascertain the contractual capacity of children it is necessary to distinguish between different contracts and the different bases on which children may incur liability towards adults or be able to assert rights against adults as a result of the 'contracts' which they conclude.

### (a) VALID CONTRACTS

A limited category of contracts entered into by children are valid and binding; that is to say the child can both sue and be sued on the contract. The clearest example of a contract that is valid and binding upon a child is a contract for necessities. The definition of 'necessaries' is not a straightforward matter because regard must be had to the status in life of the particular

child. What is 'necessary' for a child from a very wealthy background may well not be necessary for a child from a poorer background (contrast in this respect *Peters v. Fleming* (1840) 6 M & W 42 and *Nash v. Inman* [1908] 2 KB 1). In the case of a contract for the sale of goods 'necessaries' are defined as 'goods suitable to the condition in life of the minor or other person concerned and to his actual requirements at the time of sale and delivery' (Sale of Goods Act 1979, section 3(2)). Secondly, a contract of employment concluded by a child is binding on the child provided that the contract is a beneficial one (*Clements v. London and North Western Railway Company* [1894] 2 QB 482). The position is otherwise where the contract of employment is not for his benefit and is, in some way, oppressive (*De Francesco v. Barnum* (1890) 45 Ch D 490).

## (b) VOIDABLE CONTRACTS

A second group of contracts are voidable at the instance of the child; that is to say, the child is entitled to set the contract aside provided that he does so before he reaches the age of eighteen or within a reasonable time thereafter. However, it cannot be set aside by the adult. Here we see the protective role of the law at work in that the protection is confined to the child. The child can enforce the contract as against the adult but the adult cannot, in general, enforce the contract against the child, at least where the contract has been set aside by the child. This category of voidable contracts can be sub-divided into two groups. The first, and largest category, consists of contracts that are not binding upon the child unless he ratifies them within a reasonable time of reaching majority. This category of contract consists of contracts other than those that are valid (as in category (a) above) or fall within the second sub- category. That second category consists of contracts that are binding upon the minor unless he disclaims the contract either during his childhood or within a reasonable time after reaching the age of majority. Contracts that are binding upon a child unless set aside by him in this way include contracts for the acquisition of an interest in land and contracts for the acquisition of shares in a company.

## (c) A CHILD'S RESTITUTIONARY RIGHTS

Suppose that a child confers a benefit upon an adult in performance of a contract that is not binding upon him. Can the child recover the value of the benefit so conferred upon the adult? The answer is that the incapacity does not, of itself, entitle a child to recover the value of a benefit conferred upon an adult. In order to recover the value of a benefit conferred the child must show that he is entitled to recover its value on one of the standard grounds on which restitution is ordered, such as mistake or total failure of consideration. A case which illustrates the operation of this rule is:

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### ***Steinberg v. Scala (Leeds) Ltd*** [1923] 2 Ch 452, Court of Appeal

The infant plaintiff, the respondent, bought shares in a company. She subsequently repudiated the contract and her allotment of shares was set aside. She sought the return of the money which she had paid for the shares. Her claim failed because she was unable to show that the consideration for her payment had wholly failed.

### Lord Sterndale MR

I think the argument for the respondent has rather proceeded upon the assumption that the question whether she can rescind and the question whether she can recover her money back are the same. They are two quite different questions, as is pointed out by Turner LJ in his judgment in *Ex parte Taylor* 8 D M & G 254, 257, 258. He there says: 'It is clear that an infant cannot be absolutely bound by a contract entered into during his minority. He must have a right upon his attaining his majority to elect whether he will adopt the contract or not'. Then he proceeds: 'It is, however, a different question whether, if an infant pays money on the footing of a contract, he can afterwards recover it back. If an infant buys an article which is not a necessary, he cannot be compelled to pay for it, but if he does pay for it during his minority he cannot on attaining his majority recover the money back'. That seems to me to be only stating in other words the principle which is laid down in a number of other cases that, although the contract may be rescinded the money paid cannot be recovered back unless there has been an entire failure of the consideration for which the money has been paid. Therefore it seems to me that the question to which we have to address ourselves is: Has there here been a total failure of the consideration for which the money was paid?

Now the plaintiff has had the shares; I do not mean to say she had the certificates; she could have had them at any time if she had applied for them; she has had the shares allotted to her and there is evidence that they were of some value, that they had been dealt in at from 9s. to 10s. a share. Of course her shares were only half paid up and, therefore, if she had attempted to sell them she would only have obtained half of that amount, but that is quite a tangible and substantial sum.

In those circumstances is it possible to say that there was a total failure of consideration? If the plaintiff were a person of full age suing to recover the money back on the ground, and the sole ground, that there had been a failure of consideration it seems to me it would have been impossible for her to succeed, because she would have got the very thing for which the money was paid and would have got a thing of tangible value.

The argument for the respondent is I think to this effect: That it is necessary, in order to show that the consideration has not entirely failed, to prove that the plaintiff has not only had something which was worth value in the market and for which she could have obtained value, but that she has in fact received that value. It was admitted that if she had in this case sold the shares and received the 125*l.* which would have been receivable according to one of the prices mentioned in evidence she could not have recovered the money back, but it is said that as she did not in fact do that and had only an opportunity of receiving that benefit, there has been a total failure of consideration. I cannot see that. If she has obtained something which has money's worth then she has received some consideration, that is, she has received the very thing for which she paid her money, and the fact that, although it has money's worth, she has not turned that money's worth into money, does not seem to me to prevent it being some valuable consideration for the money which she has paid. I cannot see any difference when you come to consider whether there has been consideration or not between the position of a person of full age and an infant. The question whether there has been consideration or not must, I think, be the same in the two cases . . .

**Warrington and Younger LJJ** delivered concurring judgments.

### Commentary

The law therefore accords protection to a child in the sense that it allows the child to escape from the transaction but it does not then allow automatic restitution once the contract has

been set aside. The child must still prove one of the standard grounds of restitution and, if he cannot do that, then he cannot recover the value of the benefit conferred. An alternative, and possibly preferable approach, would be to conclude that the child should always be entitled to recover the value of the benefit conferred provided that he restores to the adult the value of any benefit which he has received as a result of performance by the adult of his obligations under the contract before it was set aside (see *Valentini v. Canali* (1889) 24 QBD 166 which was, however, regarded as a case of total failure of consideration in *Pearce v. Brain* [1929] 1 KB 310).

#### (d) THE LIABILITY OF A CHILD IN RESTITUTION

Section 3 of the Minors' Contracts Act 1987 provides:

- (1) Where—
- (a) a person ('the plaintiff') has after the commencement of this Act entered into a contract with another ('the defendant'), and
  - (b) the contract is unenforceable against the defendant (or he repudiates it) because he was a minor when the contract was made, the court may, if it is just and equitable to do so, require the defendant to transfer to the plaintiff any property acquired by the defendant under the contract, or any property representing it.
- 2) Nothing in this section shall be taken to prejudice any other remedy available to the plaintiff.

This is a curiously worded provision. The liability of the child is to restore to the adult 'any property acquired . . . under the contract, or any property representing it'. The return of identifiable property will be relatively straightforward in most cases but the same cannot be said for 'property representing' the original property. What does this mean? Does it mean that the child who sells an asset and pays the proceeds into his bank account is liable to pay the proceeds out of this account at least while the account is in credit? A further difficulty which arises out of this example is whether or not the word 'property' includes 'money'. There is no authority on this point but the generally accepted view is that money ought to be included in the definition of property. Finally, it should be noted that the adult does not have a right to have the property transferred to him. Rather, the court is given a discretion to order the transfer.

Section 3(2) preserves the common law rights of the adult. The rights of adults at common law (here including equity) are, however, restricted. In *Cowern v. Nield* [1912] 2 KB 419 the plaintiff paid the defendant minor £35 19s for clover and hay. The defendant failed to deliver the hay and the clover which he delivered was found to be rotten. The plaintiff rejected the clover and sought to recover his pre-payment. His claim failed. Phillimore J stated that the position would have been otherwise had the money been obtained by the defendant by fraud. An example of the difference that fraud can make is provided by the case of *Stocks v. Wilson* [1913] 2 KB 235. The defendant child, by fraudulently misrepresenting his age, induced the plaintiff to sell and deliver to him some furniture and other goods from her house. The sale price was £300. The defendant promised to repay the value of the goods at a later date and gave the plaintiff a licence to repossess the goods in the event of his failure to pay. The defendant sold some of the goods for £30 and, with the consent of the plaintiff, granted a bill of sale of the remainder as security for an advance of £100. The defendant failed to

pay the plaintiff on the appointed day and so an action was brought in equity to recover the reasonable value of the goods supplied. It was held that the defendant was liable to account to the plaintiff for the £30 and the £100 advance that he obtained as a result of the transactions into which he had entered. A different result was, however, reached in *R Leslie Ltd v. Sheill* [1914] 3 KB 607 where a child induced the plaintiff moneylenders to lend him £400 by fraudulently misrepresenting that he was an adult. When they discovered the true position the plaintiffs sought to recover the money they had advanced to him. It was held that they were not entitled to recover the £400. The reason for not recognising a restitutionary claim on the facts of *Leslie* is that, to do so, would risk undermining the legal rule which rendered the contract with the minor unenforceable; that is to say, it would be rather pointless to conclude that the contract could not be enforced as a loan if the same sum, or a very similar one, were to be recoverable from the minor by way of a restitutionary claim. The decision in *Stocks*, by contrast, demonstrates that there are limits to the protection afforded to the wrongdoing minor, albeit that the relationship between *Stocks* and *Leslie* is an uneasy one, *Stocks* demonstrates that, while the courts will not employ a restitutionary claim in order to enforce by the back-door a contract with a minor, they may, via an equitable claim, require a wrongdoing minor to account for a benefit which remains in his or her hands and which is attributable to his or her wrongdoing.

### (e) THE LIABILITY OF A CHILD IN TORT

The protection afforded to a child by the law of contract is not generally to be found in the law of tort. Childhood itself does not confer a defence to an action in tort. But, where the effect of allowing a claim to succeed in tort would be to undermine the protection afforded to the child by the law of contract, then the child will, to that extent, enjoy a defence to the action in tort (*R Leslie Ltd v. Sheill* [1914] 3 KB 607).

## 3. MENTAL INCAPACITY

The law relating to mental incapacity has undergone significant change as a result of the enactment of the Mental Incapacity Act 2005. Section 1(2) of the Act provides that a person must be assumed to have capacity unless it is established that he does not. Lack of capacity is the subject-matter of section 2 of the Act. A person is stated to lack capacity ‘in relation to a matter if at the material time he is unable to make a decision for himself in relation to the matter because of an impairment of, or a disturbance in the functioning of, the mind or brain’ (s.2(1), as further defined in s.3). The impairment or disturbance can be temporary or permanent (s2(2)). A person is not to be treated as unable to make a decision unless all practicable steps to help him to do so have been taken without success (s.1(3)); nor is he to be treated as unable to make a decision merely because he makes an ‘unwise decision’ (s.1(4)) Further, a lack of capacity cannot be established merely by reference to a person’s age or appearance or by a condition of his, or an aspect of his behaviour, which might lead others to make unjustified assumptions about his capacity (s2(3)). If necessary goods or services are supplied to a person who lacks capacity to contract for the supply, he must pay a reasonable price for them (and necessities, for this purpose, are defined to mean ‘suitable to a person’s condition in life and to his actual requirements at the time when the goods or services are supplied’)(s.7). The Act also makes provision, in Part 2, for a Court of Protection which

has wide powers to make decisions in relation to the conduct of life of a person who lacks capacity.

Where the property of the incapacitated person is not subject to control by the court, then the contract is binding upon that party unless the disability was known to the other party. This rule is illustrated by the following case:

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***Hart v. O'Connor***  
[1985] AC 1000, Privy Council

The defendant, Mr Hart, agreed to purchase farm land from Mr Jack O'Connor, who was then sole trustee of his father's estate and who farmed the land in partnership with his brothers. Mr O'Connor was then aged eighty-three but, unknown to the defendant, was of unsound mind. He agreed to sell land to the defendant under an agreement which was drawn up by the defendant's solicitor. The agreement stated that the price to be paid was the market value of the land as determined by a named independent valuer. The plaintiffs, who were one of Mr O'Connor's brothers and his two sons, sought a declaration that the agreement should be set aside on the ground of the vendor's lack of capacity and also on the ground that it was an unconscionable bargain. The trial judge held that the agreement was unenforceable but that the transaction could not be set aside because the defendant was entitled to invoke the defence of laches. The Court of Appeal allowed the plaintiffs' appeal and held that laches was inapplicable. On the defendant's appeal to the Privy Council it was held that the plaintiffs were not entitled to set aside the transaction: there had been no unconscionable dealing by the defendant and the transaction could not be set aside on the ground of the vendor's lack of capacity because the defendant was unaware of the lack of capacity on the part of the vendor.

**Lord Brightman**

It is important to appreciate that no imputations whatever are made by the plaintiffs against the integrity of the defendant, and rightly so. The defendant's conduct leading up to the sale was above reproach . . .

Apart from questions arising out of the defendant's claim for compensation, the issues raised by the parties on this appeal are as follows: (A) Whether *Archer v. Cutler* [1980] 1 NZLR 386 was rightly decided; that is to say, whether a contract by a person of unsound mind, whose incapacity is unknown to the other contracting party, can be avoided (at law) on the ground that it is 'unfair' to the party lacking capacity (or those whom he represents), there being no imputations against the conduct of the other contracting party. (B) If *Archer v. Cutler* was rightly decided, whether the High Court and the Court of Appeal were correct in finding that the sale agreement was 'unfair' to the vendor. (C) If *Archer v. Cutler* was wrongly decided, whether the plaintiffs were entitled to have the contract set aside (in equity) as an 'unconscionable bargain' notwithstanding the complete innocence of the defendant. (D) If *Archer v. Cutler* was rightly decided, and the courts below correctly found that the sale agreement was 'unfair', whether the sale agreement would escape rescission because it was impossible to achieve restitutio in integrum.

In order to avoid unnecessary prolongation of the hearing and with a view to saving the parties expense, their Lordships invited counsel to confine their submissions to issues (A) and (C), leaving issues (B) and (D) for subsequent argument if necessary.

Their Lordships turn first to a consideration of *Archer v. Cutler* [1980] 1 NZLR 386. Their Lordships attach importance to three factors. First, this decision was accepted by both sides as correct when the case was argued at first instance. Secondly, the Court of Appeal in a strong judgment affirmed without hesitation that the law there set out was the law of New Zealand. Thirdly the Court of Appeal, when they gave judgment on the compensation appeal, underlined their previous statement of the law in the following important passage [1984] 1 NZLR 754, 755:

'In that case [*Archer v. Cutler*] it was held that there were no considerations of policy or principle precluding the court from holding that a contract entered into by a person of unsound mind is voidable at his option if it is proved either that the other party knew of his unsoundness of mind or, whether or not he had that knowledge, the bargain was unfair. On the basis that this principle should be adopted for New Zealand this court expressly approved *Archer v. Cutler*. In the result it made a declaration that the agreement for sale and purchase was rescinded.'

If *Archer v. Cutler* is properly to be regarded as a decision based on considerations peculiar to New Zealand, it is highly improbable that their Lordships would think it right to impose their own interpretation of the law, thereby contradicting the unanimous conclusions of the High Court and the Court of Appeal of New Zealand on a matter of local significance. If however the principle of *Archer v. Cutler*, if it be correct, must be regarded as having general application throughout all jurisdictions based on the common law, because it does not depend on local considerations, their Lordships could not properly treat the unanimous view of the courts of New Zealand as being necessarily decisive. In their Lordships' opinion the latter is the correct view of the decision.

*Archer v. Cutler* was a purchaser's action for specific performance of a contract for the sale of land. By way of defence the vendor pleaded first that she was of unsound mind to the knowledge of the purchaser, secondly that she was induced to enter into the agreement by the undue influence of the purchaser, and thirdly, at 388, 'that the contract should be set aside as a catching and unconscientious bargain'. The facts were briefly as follows. The vendor and the purchaser were adjoining land owners. The purchaser had a problem over access to his land, which would be solved if he acquired the vendor's land. He knew the vendor had already given a purchase option to a friend, but he made known to the vendor his interest in acquiring her land should the opportunity occur. At some later time the vendor got in touch with the purchaser, and inquired if he was still interested in buying, as her friend had decided not to exercise her option. He called on her next day to discuss the matter. The vendor suggested a price of \$15,000. The purchaser thought that \$17,000 would be a fairer figure and he offered to pay it subject to his being able to arrange finance. He put his offer in writing, and she wrote out her acceptance. A week later he told her that he had arranged finance and that the sale was therefore unconditional. McMullin J held that an informed vendor would have expected to receive at least \$24,000; that there was however no evidence that the purchaser knew the true value of the land, and that it was understandable that two persons with no professional expertise should fix a value of \$17,000 as being a fair price. He also found that the vendor was suffering from advanced senile dementia at the time of the agreement which rendered her incapable of understanding the bargain, but that the purchaser was unaware of this. The agreement represented a sale at a substantial undervalue. It was held that contractual incapacity was established; that a contract entered into by a person of unsound mind was voidable at that person's option if the other party knew of the incapacity or, whether or not he knew, if the contract was 'unfair' to the person of unsound mind; and that the contract was unfair, the indicia of unfairness being (i) a price significantly below the true value, (ii) the absence of independent legal advice for the vendor, and (iii) the difference in bargaining positions resulting from the disparity in their respective mental capacities.



If a contract is stigmatised as 'unfair', it may be unfair in one of two ways. It may be unfair by reason of the unfair manner in which it was brought into existence; a contract induced by undue influence is unfair in this sense. It will be convenient to call this 'procedural unfairness'. It may also, in some contexts, be described (accurately or inaccurately) as 'unfair' by reason of the fact that the terms of the contract are more favourable to one party than to the other. In order to distinguish this 'unfairness' from procedural unfairness, it will be convenient to call it 'contractual imbalance'. The two concepts may overlap. Contractual imbalance may be so extreme as to raise a presumption of procedural unfairness, such as undue influence or some other form of victimisation. Equity will relieve a party from a contract which he has been induced to make as a result of victimisation. Equity will not relieve a party from a contract on the ground only that there is contractual imbalance not amounting to unconscionable dealing. Of the three indicia of unfairness relied upon by the judge in *Archer v. Cutler* (assuming unfairness to have existed) the first was contractual imbalance and the second and third were procedural unfairness.

The judgment in *Archer v. Cutler* [1980] 1 NZLR 386 contains, if their Lordships may be permitted to say so, a most scholarly and erudite review by the judge of the textbook authorities and reported cases on the avoidance of a contract made by a person of unsound mind. For present purposes the key passages in the judgment are, at 400:

'From these authorities, it would seem that the English law on the subject is ill-defined. The case of *Imperial Loan Co Ltd v. Stone* [1892] 1 QB 599 widely accepted as being a statement of the law on avoidance of contracts made with persons of unsound mind would, save in the judgment of Lopes LJ, seem to regard unfairness of the contract as being of no moment. Proof of unsoundness of mind and the other party's knowledge of that unsoundness alone will avoid the contract. But the passage cited from the judgment of Lopes LJ and the dicta of Pollock CB in *Molton v. Camroux* (1848) 2 Exch 487, of Patteson J on appeal in the same case, of Sir Ernest Pollock MR in *York Glass Co Ltd v. Jubb* (1924) 131 LT 559 and of Sargant LJ in the same case would suggest that proof of unfairness of a bargain entered into by a person of unsound mind, even though that unsoundness be not known to the other party, will suffice to avoid it.'

And, at 401:

'I find nothing in policy or principle to prevent me from holding that a contract entered into by a person of unsound mind is voidable at his option if it is proved either that the other party knew of his unsoundness of mind or, whether or not he had that knowledge, the contract was unfair to the person of unsound mind.'

Their Lordships apprehend that in these passages the judge is dealing indifferently with procedural unfairness and contractual imbalance, either of which, or both of which in combination, may enable the contract to be avoided against a contracting party ignorant of the mental incapacity of the other.

The original rule at law, and still the rule in Scotland, was that a contract with a person of unsound mind was void, because there could be no consensus ad idem. This was later qualified by a rule that a person could not plead his own unsoundness of mind in order to avoid a contract he had made. This in turn gave way to a further rule that such a plea was permissible if it could be shown that the other contracting party knew of the insanity.

[Lord Brightman then turned to consider in some detail the three cases mentioned in the first citation from *Archer v. Cutler*, namely *Molton v. Camroux* (1848) 2 Exch 487; (1849) 4 Exch 17, *Imperial Loan Co Ltd v. Stone* [1892] 1 QB 599, and *York Glass Co Ltd v. Jubb* (1924) 131 LT 559; (1925) 134 LT 36 and continued]

In the opinion of their Lordships it is perfectly plain that historically a court of equity did not restrain a suit at law on the ground of 'unfairness' unless the conscience of the plaintiff was in

some way affected. This might be because of actual fraud (which the courts of common law would equally have remedied) or constructive fraud, i.e. conduct which falls below the standards demanded by equity, traditionally considered under its more common manifestations of undue influence, abuse of confidence, unconscionable bargains and frauds on a power. (Cf. *Snell's Principles of Equity*, 27th edn. (1973), 545ff.) An unconscionable bargain in this context would be a bargain of an improvident character made by a poor or ignorant person acting without independent advice which cannot be shown to be a fair and reasonable transaction. 'Fraud' in its equitable context does not mean, or is not confined to, deceit; 'it means an unconscientious use of the power arising out of these circumstances and conditions' of the contracting parties; *Earl of Aylesford v. Morris* (1873) LR 8 Ch App 484, 491. It is victimisation, which can consist either of the active extortion of a benefit or the passive acceptance of a benefit in unconscionable circumstances.

Their Lordships have not been referred to any authority that a court of equity would restrain a suit at law where there was no victimisation, no taking advantage of another's weakness, and the sole allegation was contractual imbalance with no undertones of constructive fraud. It seems to their Lordships quite illogical to suppose that the courts of common law would have held that a person of unsound mind, whose affliction was not apparent, was nevertheless free of his bargain if a contractual imbalance could be demonstrated which would have been of no avail to him in equity. Nor do their Lordships see a sufficient foundation in the authorities brought to their attention to support any such proposition . . .

In the opinion of their Lordships, to accept the proposition enunciated in *Archer v. Cutler* that a contract with a person ostensibly sane but actually of unsound mind can be set aside because it is 'unfair' to the person of unsound mind in the sense of contractual imbalance, is unsupported by authority, is illogical and would distinguish the law of New Zealand from the law of Australia . . . for no good reason, as well as from the law of England from which the law of Australia and New Zealand and other 'common law' countries has stemmed. In so saying their Lordships differ with profound respect from the contrary view so strongly expressed by the New Zealand courts.

To sum the matter up, in the opinion of their Lordships, the validity of a contract entered into by a lunatic who is ostensibly sane is to be judged by the same standards as a contract by a person of sound mind, and is not voidable by the lunatic or his representatives by reason of 'unfairness' unless such unfairness amounts to equitable fraud which would have enabled the complaining party to avoid the contract even if he had been sane.

Their Lordships turn finally to issue (C), whether the plaintiffs are entitled to have the contract set aside as an 'unconscionable bargain'. This issue must also be answered in the negative, because the defendant was guilty of no unconscionable conduct. Indeed, as is conceded, he acted with complete innocence throughout. He was unaware of the vendor's unsoundness of mind. The vendor was ostensibly advised by his own solicitor. The defendant had no means of knowing or cause to suspect that the vendor was not in receipt of and acting in accordance with the most full and careful advice. The terms of the bargain were the terms proposed by the vendor's solicitor, not terms imposed by the defendant or his solicitor. There was no equitable fraud, no victimisation, no taking advantage, no overreaching or other description of unconscionable doings which might have justified the intervention of equity to restrain an action by the defendant at law. The plaintiffs have in the opinion of their Lordships failed to make out any case for denying to the defendant the benefit of a bargain which was struck with complete propriety on his side.

For these reasons their Lordships have tendered to Her Majesty their humble advice that the appeal should be allowed.

## Commentary

*Hart* is a difficult and a controversial decision. It can be said to leave the infirm in a vulnerable position because their entitlement to set aside a transaction depends upon their ability to prove that the other party knew of the disability or ought to have known of it (*Dunhill v. Burgin (Nos 1 and 2)* [2014] UKSC 18, [2014] 1 WLR 933, [25]). A party who cannot demonstrate such knowledge can set aside the transaction only if he can establish a ground of relief that is also available to a person of sound mind (for example, under the rule laid down in *Fry v. Lane* (1888) 40 Ch D 312, p. 664 of the textbook). One consequence of the decision in *Hart* might be to tempt the courts to strain the evidence to find that the defendant did have knowledge of the claimant's incapacity. An example of the latter phenomenon is arguably provided by *Ayres v. Hazelgrove*, unreported, 9 February 1984 (discussed by P Birks, *Restitution—The Future* (Federation Press, 1992), pp. 50–1) in which Lady Ayres, who suffered from senile dementia, sold paintings to Hazelgrove for a fraction of their true value. He visited her at home when she was alone, but he denied that he had any knowledge of her condition. Russell J inferred that Hazelgrove must have known of her lack of capacity and he set aside the sales of the paintings. He also held that the transactions could be set aside under the rule in *Fry v. Lane*.

Why is knowledge of the incapacity a vital ingredient in cases of mental incapacity but irrelevant in cases of childhood or minority? Professor Birks (*Restitution—The Future* (Federation Press, 1992), p. 52) has suggested the following:

There is a strong need to preserve the dignity and autonomy of all elderly people. If restitution were not restricted . . . old people would not be able to deal with their property in an adult, independent and unsupervised manner. The dispositions of an old person must in general stand up. Hence the strict liability has to be inhibited.

The restitutionary rights of the infirm adult must be restricted to preserve the credit and dignity of all adults, but especially the very elderly. Except in relation to necessities, minors do not need their credit preserving. That is the crucial difference. Hence it must ultimately be decided how much the restitutionary rights arising from infirmity of mind should be restricted to prevent the infantilisation of adults and, especially, the elderly. The common law restricts restitution by saying the other must know of the infirmity. Perhaps credit and dignity would be preserved if the restriction were phrased in the alternative. Restitution would then follow if either the other knew of the infirmity of mind or the assets passed at an undervalue. This is very close to the New Zealand position which *Hart v. O'Connor* rejected.

It should be noted that the policy reasons identified by Professor Birks do not necessarily, as he acknowledges, lead to the result reached by the Privy Council in *Hart*. It might be possible to recognize a wider right of recovery without infantilizing the elderly. But there is another aspect to the issue which Professor Birks does not consider and that relates to the role of the relatives of the elderly and the infirm. If the law does not take sufficient steps to protect them from exploitation, it may be left to close relatives to seek a power of attorney in order to provide the protection from exploitation which the law does not provide. In other words, too great a willingness to recognize the contractual capacity of the elderly may, paradoxically, result in their effective infantilization as their children seek powers of attorney in order to control or regulate their financial affairs. A preferable rule may be that mental incapacity should of itself (that is to say, irrespective of the knowledge of the other party) suffice to give

rise to a claim in restitution. This is the rule in Scots law: see *John Loudon & Co v. Elder's Curator Bonis*, 1923 SLT 226.

## 4. COMPANIES AND LOCAL AUTHORITIES

Companies and local authorities have limited contractual capacity in the sense that their powers are defined, in the case of companies, by the terms of their memorandum and articles of association, and, in the case of local authorities, by the terms of the statute which set them up. A company or a local authority which acts beyond its powers acts *ultra vires*. In *Ashbury Railway Carriage and Iron Co v. Riche* (1875) LR 7 HL 653 it was held that a contract which was *ultra vires* a company was void. This conclusion could have detrimental effects on third parties and statute has since intervened to protect third parties in the case of both companies and local authorities. *Ultra vires* is now of limited practical significance in the corporate context because of section 39(1) of the Companies Act 2006 which states that 'the validity of an act done by a company shall not be called into question on the ground of lack of capacity by reason of anything in the company's constitution'. The intention behind this provision is to abrogate the *ultra vires* rule as far as third parties who deal in all good faith with the company are concerned but to leave it intact for internal purposes relating to the relationship between the shareholders and the company. In the case of local authorities, section 2(1) of the Local Government (Contracts) Act 1997 provides:

Where a local authority has entered into a contract, the contract shall, if it is a certified contract, have effect (and be deemed always to have had effect) as if the local authority had had power to enter into it (and had exercised that power properly in entering into it).

A company or a local authority which confers a benefit upon another party in the course of performance of an *ultra vires* contract may be entitled from that third party to recover the value of the benefit so conferred in a restitutionary action (see *Brougham v. Dwyer* (1913) 108 LT 504 (companies) and *Commonwealth of Australia v. Burns* [1971] VR 825 (local authorities)).

### FURTHER READING

HUDSON, AH, 'Mental Incapacity Revisited' [1986] *Conveyancer and Property Lawyer* 178.

**Incorporated Council of Law Reporting:** extracts from the *Law Reports: Appeal Cases* (AC) and *Chancery* (Ch).