

## CASE COMMENTARY

### RECENT PROBLEMS IN UNDUE INFLUENCE

*Annulment Funding Co Ltd v Cowey and another* [2010] EWCA 711  
*First Plus Financial Group v Hewett* [2010] EWCA Civ 312

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After the flood of litigation at the end of the 20<sup>th</sup> Century, it was hoped that the House of Lords decisions in *O'Brien*<sup>1</sup> and *Etridge*<sup>2</sup> would put an end to the uncertainties facing those wishing to take security over a family home. But as seen in the recent Court of Appeal decisions in *Annulment Funding Co Ltd v Cowey and another* [2010] EWCA 711 (“*Cowey*”) and *First Plus Financial Group v Hewett* [2010] EWCA Civ 312 (“*Hewett*”), there still remain some interesting questions and potential problems for the unwary lender.

#### ANNULMENT FUNDING CO LTD V COWEY

##### *Facts*

In *Cowey*, Mr Cowley and Ms Cowlam were partners in a long established relationship and had a teenage son. They were joint owners<sup>3</sup> of a house in Dulwich where they lived. The house at the time in question was worth £800,000 and was subject to a first charge of £370,000, leaving an equity of £430,000.

Mr Cowley did not manage his financial affairs well and was made subject to a bankruptcy order.<sup>4</sup> Given that Mr Cowley owed about £120,000 to creditors and that his share in the equity was worth £215,000, he was advised to seek an annulment of the bankruptcy. He therefore approached the

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<sup>1</sup> *Barclays' Bank v O'Brien* [1994] 1 AC 180, 195, [1993] 4 All ER 417, 428.

<sup>2</sup> *Royal Bank of Scotland plc v Etridge (No 2)* [2001] UKHL 44, [2002] 2 AC 773, [2001] 4 All ER 449.

<sup>3</sup> It was assumed for the purposes of the case that they were equal beneficial owners.

<sup>4</sup> The petitioning creditor was Inland Revenue who were owed about £100,000.

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claimant who was in the business of providing bridging financing on a short term basis until a more permanent mortgage could be arranged.

On 3 July 2007, there was a meeting between a representative of the claimant, Mr Cowley, Ms Cowlam, a solicitor and an accountant instructed by Mr Cowley. At the meeting, the claimant advanced the scheme that the couple would enter into a short term mortgage to annul the bankruptcy and also instruct an associated company of the claimant to act as a mortgage broker to obtain permanent mortgage financing. Mr Cowley and Ms Cowlam executed the documents appointing the mortgage broker at the meeting. Subsequently, both Ms Cowley and Ms Cowlam signed documents which resulted in £138,000 being advanced, secured by a second charge on the house. This loan was interest free for the first three months and at a rate of 1.5% per month thereafter. This money was eventually used to pay Mr Cowley's creditors and resulted in the bankruptcy being annulled.

In spite of the best efforts of the mortgage broker, new financing was not available. This was due to the poor credit rating of Mr Cowley and because financial institutions were taking a more conservative approach to mortgages. So, the temporary mortgage was not paid off. The claimant called in the loan which could not be repaid and then started proceedings against both Mr Cowley and Ms Cowlam to enforce its charge on the house.

### *Decision*

The trial judge found that the charge had been entered into by Ms Cowlam as a result of the undue influence of Mr Cowley and that the claimant was bound by this fact so the charge had to be set aside as against Ms Cowlam.<sup>5</sup> There were various factors that acted on the trial judge's findings of undue influence. He found that while the claimant had not misrepresented the transaction to the couple, Mr Cowley did not understand the transaction and he passed this misunderstanding on to Ms Cowlam. He found that Mr Cowley was under great pressure, and again he passed this pressure on to Ms Cowlam. He found that Mr Cowley had acted with gross irresponsibility in looking after his own interests and then unduly influenced Ms Cowlam to act against her own interests.

As an alternative to actual undue influence, the trial judge found that if actual undue influence had not been proven, it could be presumed on the facts.

The claimant appealed on several grounds. The first ground was that where the defence had relied on the presumption of undue influence it was not open for the judge to find actual undue influence. The second ground was that there was insufficient evidence of actual undue influence.

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<sup>5</sup> The trial judge also refused to find that Ms Cowlam was liable as an unsecured creditor of the claimant.

*Appeal*

**(i) relationship between actual and presumed undue influence**

Morgan, J referred to passages from the judgements of Lord Nichols and Lord Scott in the leading case of *Etridge*. He stated:

“What that passage establishes is that an issue as to whether there was undue influence involves an issue of fact. The party asserting that there has been undue influence can call direct evidence which supports such a finding. Alternatively, that party can call evidence of other matters which justify the inference that undue influence was used. Either way, the party is attempting to prove the fact of undue influence.”<sup>6</sup>

Thus, the defence can start by attempting to prove the presumption of undue influence and in the course of this produce evidence of actual undue influence. The presumption is only a tool to answer the question of whether there had been undue influence so there was nothing wrong with the trial judge finding that undue influence had been proven, with or without the presumption.<sup>7</sup>

**(ii) no evidence of undue influence**

The second ground for appeal were that there was no evidence to support the finding of undue influence.<sup>8</sup> In reviewing the transcripts, most of the blame from Mr Cowley and Ms Cowlam was directed at the claimant’s behaviour, rather than at each other. As a couple still living together, Ms Cowlam was reluctant to make the case that it was Mr Cowley’s fault. While there was little evidence of undue influence, Morgan, J found that there was enough to uphold Ms Cowlam’s defence. Mr Cowley was under pressure and there was evidence that he had put pressure on Ms Cowlam to enter into the transaction. In addition, Mr Cowley had misunderstood the nature of the

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<sup>6</sup> *Cowley*, at para 50.

<sup>7</sup> In E Peel *Treital, The Law of Contract* (London: Sweet & Maxwell, 12<sup>th</sup> ed, 2007) p 456, it is noted that while it is acceptable for a party to plead actual undue influence and the presumption of undue influence, it would not be acceptable for a judge to find no actual undue influence, but then use the presumption to find undue influence.

<sup>8</sup> There was some confusion which came from counsel for the claimant asserting she was not challenging the judge’s findings of primary fact. Morgan, J decided to review the transcripts of the trial in any event.

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transaction and had misrepresented it to Ms Cowlam. The trial judge had conflated these two findings to support his finding of undue influence.

Morgan, J found that the several speeches in *Etridge* took different approaches. Lord Nicholls<sup>9</sup> appeared to use misrepresentation as a form of undue influence, whereas Lord Scott<sup>10</sup> was careful to treat undue influence and misrepresentation as two separate wrongs. But all agreed that the misrepresentation would allow a transaction to be set aside. Morgan, J appeared to favour Lord Scott's approach in finding that Mr Cowley's misrepresentation to Ms Cowlam justified having the transaction set aside.

### FIRST PLUS FINANCIAL GROUP V HEWETT

#### *Facts*

Mr and Mrs Hewett lived in a house they jointly owned, together with their children and Mrs Hewett's mother. The main problems facing the family were financial, in particular Mr Hewett's not uncommon ability to run up a huge credit card balance. This balance became so large that the combined income of the Hewett's was unable to cover the payments required. The solution was a refinancing and this required a charge over the house.

Mrs Hewett was understandably troubled to be asked to risk her interest in the house to pay off her husband's profligate spending but disaster was looming for him and this was the only way out. Her husband swore on the lives of his children that he would amend his ways and limit his spending. So Mrs Hewett was persuaded to sign the charge to First Plus.

Unfortunately, things in the Hewett household deteriorated. Mr Hewett continued his spending. Worse than that, it emerged that at the time of the execution of the charge, he had been having an affair with another woman. It also turned out that Mr Hewett had forged his mother-in-law's signature as an occupant of the property on the charge. Not exactly an ideal husband!

Mr Hewett lost his job and stopped making payments to First City. He moved out of the matrimonial home to live with the other woman. He was convicted for the forgery and went bankrupt. His trustee in bankruptcy sold his equity in the house to Mrs Hewett for a pound. Thus, his role in the proceedings had come to an end.

Mrs Hewett was unable to repay the charge and so First Plus brought an action for possession of the house. Mrs Hewett defended the action. She claimed that she had entered into the charge because of the undue influence of her husband and that since First City had not taken adequate steps to advise her, the transaction with Mrs Hewett could be set aside.

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<sup>9</sup> *Etridge* para 36.

<sup>10</sup> For example, *Etridge*, para 132.

### *Decision*

At trial, it was found that there was no undue influence. The wife was in a difficult position and had hard decisions to make, but she had made up her mind freely and knew exactly what she was doing. It therefore did not matter that First City had failed to take the steps to avoid constructive notice.

This was overturned on appeal. Briggs, LJ, found that it would be wrong to limit undue influence to situations where one partner meekly submitted to the other. The decision to be made by Mrs Hewett required the assumption that her husband was committed to the preservation of their home life and his affair carried with it a serious risk of this home life being disrupted. Because of this, Mr Hewett's affair "cried out for disclosure."<sup>11</sup>

Once it was found that Mr Hewett had unduly influenced his wife, First City's failure to take steps to advise Mrs Hewett meant that it could be in "no better position"<sup>12</sup> than the husband. Therefore Mrs Hewett could have the mortgage set aside as against her own interest in the property at the time of the charge.

## DISCUSSION

### (a) Misrepresentation and Non-disclosure

Using misrepresentation as some kind of wrong akin to undue influence has been long recognised. In *O'Brien* itself, the husband misrepresented that he has only liable for half the partnership loan. This was sufficient to be treated as the same as undue influence.

Both cases represent extensions to this idea. *Cowley* is closer to *O'Brien*, but instead of a particular, material fact about the transaction as in *O'Brien*, in *Cowley* there is only a muddled Mr Cowley hoping that the transaction will lead to a permanent solution and Ms Cowlam being carried along in his belief. There is no finding of fraud and usually an innocent statement of intent, here the intention to find a permanent solution, would not be actionable as a misrepresentation.<sup>13</sup>

In *Hewitt*, the husband failed to disclose a fact which was totally unrelated to the financial aspects of the mortgage. The test put forward was "whether a solicitor, consulted by Mrs Hewett for advice about the wisdom of the transaction, would have thought it relevant to know that her husband was, while asking for her unqualified trust, at the same time conducting a

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<sup>11</sup> *Hewett*, para 33.

<sup>12</sup> *Hewett*, para 37.

<sup>13</sup> *Edgington v Fitzmaurice* (1885) LR 29 Ch D 459.

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clandestine affair.”<sup>14</sup> One thing that makes *Hewett* difficult is the lack of clarity with regard to what requires disclosure. While an affair clearly destroys the relationship of trust, there is a large range of possibilities between absolute fidelity and an outright affair and many husbands will fall into this grey area. What impure thoughts and actions need be disclosed?

### **(b) Relationship of the Parties at the Time of the Trial**

*Cowley* and *Hewett* are opposite ends of the spectrum when it comes to the issue of the relationship of the parties at the time of trial. *Hewett* is straightforward as the husband is gone and can be blamed for the transaction. *Cowley* is a much more difficult case as the couple are still living together and come to the courtroom arguing the same case. In *Cowley*, the couple had the same legal representation at trial.<sup>15</sup> On appeal, Morgan J only allowed the representative to act for Ms Cowlam but even he commented on the reluctance to give evidence of undue influence. On the other hand, since the partners will have the same interest, there is equally the concern that they will collude in their evidence.

### **(c) Likely Effect of Independent Legal Advice**

In both cases, the lender was put on enquiry because of its failure to insist that independent legal advice had been given to the partner. It is therefore of interest to see what might have happened had the lender followed the recommended path.

In *Cowley*, it is somewhat speculative as to what would have happened. As the case involves Ms Cowlam not understanding what she was doing, it may be that an independent lawyer might have stopped the transaction from happening and structured it in another way. If this is the case, it is hard to know what Mr Cowley’s lawyer and accountant were doing as their advice did not stop him from proceeding without really understanding the transaction. In fairness to them, there was little discussion of the role of the lawyer and the accountant so it is not known what advice they gave to Mr Cowley.

In *Hewett*, it would seem that independent legal advice would not have made any difference. While it is correct that he would have viewed it as relevant if told of the affair, a commercial solicitor acting for Mrs Hewett might have asked her if she felt her relationship with her husband would last, but short of insisting on hiring detectives to follow Mr Hewett, it is hard to see

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<sup>14</sup> *Hewett*, para 35.

<sup>15</sup> The legal representative was, in fact, a McKenzie friend.

how the affair would have been discovered. So had the lender followed the correct procedure, it would not have made any difference to Mrs Hewett.

**(d) Why the Lender is affected?**

The logic of *O'Brien* was the legal fiction that the lender had “constructive notice” of the wrong. In *Etridge*, it was said that the lender is “put on enquiry” of the wrong committed, but this still involves a legal fiction. How exactly this works is still a matter of some confusion.<sup>16</sup> This continuing confusion is shown in *Hewett* where Briggs, J says:

“For those reasons I consider that Mrs Hewett's decision to participate in the charge of the Property to First Plus was, as between herself and her husband, vitiated by his abuse of her trust. Since as the Judge found, First Plus is affected by such undue influence as may be proved to have occurred between husband and wife, it can be in no better position.”<sup>17</sup>

He does not explain what the transaction was between the husband and the wife. The transaction in question is the charge from the wife to the lender.

The matter does not trouble the Court of Appeal in *Cowley* and there is little on the subject. What Morgan, J says is:

“At paras 79 to 82 of his first judgment, the judge then made his findings as to whether the Claimant was fixed with notice of the undue influence and he held that it was. It is not necessary to give further detail of his reasoning in this respect as it is not challenged on appeal.”<sup>18</sup>

“Fixed with notice of the undue influence” seems to be returning to the *O'Brien* approach of “constructive notice” and so, if anything, leads to more confusion as to why the lender has its charge set aside.

## CONCLUSION

In *O'Brien*, Lord Browne-Wilkinson's stated that his aim was to "restate the law in a form which is principled, reflects the current requirements of

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<sup>16</sup> Why the explanations of the doctrine do not work is well described in M Chen-Wishart *Contract Law* (Oxford: Oxford University Press, 2005) ch 9.3.4.

<sup>17</sup> *Hewett* at para 37.

<sup>18</sup> *Cowley*, at para 37.

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society and provides as much certainty as possible."<sup>19</sup> The lack of certainty flowing from *O'Brien* is demonstrated by the numerous cases which followed and eventually led to the decision in *Etridge*.

*Cowley* and *Hewett* show that the uncertainty has not ended. The obvious conclusion from *Etridge* is that lenders who do not demand a certificate of independent legal advice are in grave danger. That much remains clear and what the lenders must do to be safe is also clear. But the role of undue influence in all of this remains uncertain. This perhaps gives us some insight into the source of the problem.

If the courts wish to require lenders to give advice to the guaranteeing partner to a non-commercial loan, the only weapon available to them is to use some kind of idea of notice. But by using the tool of "constructive notice" or "enquiry", the courts must also find a "wrong" committed by one partner at the expense of the other. In the search for the wrong, the courts have extended the range of what is wrong from undue pressure of one partner on the other to a variety of wrongs.<sup>20</sup> Now we find that to be a bit muddled about your own finances in *Cowley* or to fail to tell of your extra-marital activities in *Hewitt*, is equivalent to "undue influence."

Undue influence is not really required to justify interference into this type of transaction. When it becomes necessary for one partner to guarantee the debts of the other and to mortgage the family home (whether to finance one partner's business, pay off a credit card or otherwise), the family is at time of decision bordering on a crisis. There is a lot of scope for undue pressure from one partner on the other in such circumstances. But undue pressure is not necessary to make this a dangerous situation. It is the situation itself that will be putting pressure on the parties and there is scope for either or both not to really understand what is going on in the transaction.

Instead of focusing on the undue influence, perhaps the better approach would be just to focus on the advice to be given to the borrowers where they are raising non-purchase money<sup>21</sup> secured by a family home. It is important that people be allowed to raise finance based on such security,<sup>22</sup> but it is equally important that both partners understand what they are doing. This is consumer credit law rather than undue influence. It would require statutory intervention to require lenders to give the correct advice in such circumstances. But, rather than focusing on the wrongs committed by one partner against the other and making extensions of the law of undue influence

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<sup>19</sup> *Barclays' Bank v O'Brien* [1994] 1 AC 180, 195, [1993] 4 All ER 417, 428.

<sup>20</sup> Five possibilities are listed in N Andrews *Contract Law* (Cambridge :Cambridge University Press, 2011) p 332.

<sup>21</sup> The difficulties of applying these principles to an acquisition of the property is shown in *Dunbar v Nadeem* [1998] All ER (D) 282.

<sup>22</sup> Lord Bingham in *Etridge* para 2.

to prove such wrongs, the focus should be on what advice would be appropriate to give at the time of the mortgage. That is not advice to minimise the risk of undue influence but rather advice that would be useful when making such a major decision.<sup>23</sup>

One area would be basic business advice as was shown in *Cowley*. Is this the best way to finance the transaction? Do both partners have to give security? Will the money raised be used for a good purpose? How will the loan be repaid? As was shown in *Hewett*, the other area might be family advice. If I refuse my partner's financial plans, one consequence may be the end of the relationship. The partner may need emotional advice or may need family law advice as to their legal position on the termination of the relationship. The technical advice set out in *Etridge* would have been of little help to Mrs Hewett but some relationship support might have been invaluable.

It is very easy to say that an area of law is crying out for statutory reform and one can give credit to the various judges who have tried to create a workable scheme of useful advice in the absence of statutory intervention. But the solutions adopted require legal fictions which in turn create theoretical problems. *Cowley* and *Hewett* show that these problems continue, especially for those who receive the *Etridge* advice and find it is of little help. It is time for Parliament to look carefully at this area and sort it out.

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<sup>23</sup> S Gardner ('Wives' "Guarantees of their Husbands' Debts") [1999] 115 LQR 1, questioned whether the value of the advice given was more than symbolic.