Unconscionable transactions – the roles of knowledge and "predatory state of mind"

A wealthy, ageing parent makes a series of substantial gifts of money to a child. There is disputed evidence as to whether the gifts are spontaneous or at the child's request. After the parent dies, the executor sues to recover the gifts. Suppose it is established that the parent lacked sufficient memory to recall the previous gifts to the child, and lacked a sufficient degree of independence to decide whether to accede to any requests. Should the gifts be set aside through the operation of the doctrine of unconscionable conduct? That in turn presents at least two issues of law. What level of knowledge of the ageing parent's declining mental state is required of the child if the gifts are to be set aside? If there is merely the passive retention of gifts, can that be unconscionable?

That was the background to *Nitopi v Nitopi*.[1] Those facts also demonstrate the limited role for undue influence in cases of this kind, by reason of the presumption of advancement.[2] Of course, cases of this nature call for a "precise examination of the particular facts, a scrutiny of the exact relations established between the parties and a consideration of the mental capacities, processes and idiosyncrasies of the [weaker party]".[3] In particular, mental decline is often gradual, and the awareness of it by others may also be gradual. Here the deceased lived in Queensland. He was diagnosed with a variety of intellectual incapacities in later 2008 and 2009. He was admitted to an aged care facility in June 2009 in Sydney, where his youngest daughter Cristina visited him, but he was unhappy there and was discharged and returned to Queensland, where he lived independently and alone for around four months. In November 2009 he was admitted to hospital, diagnosed with chronic myeloid leukaemia, underwent an MMSE in which he scored 0/5 for concentration and 0/3 for short term memory. The trial judge recorded: "He was unable to recall the date and the name of the city, town or hospital he was in. He could not complete the subtracting seven exercise ... and was unable to recall the names of three objects he had been asked to remember. He was also unable to write a complete sentence. His overall MMSE score was 12/30."[4] On any view by late 2009 the deceased suffered from a special disadvantage apt to enliven equity's jurisdiction to set aside transactions as unconscionable.

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1 [2022] NSWCA 162.

2 Decisions on the presumption applicable in cases of unconscionable transactions are collected in *Nitopi v Nitopi* [2022] NSWCA 162 at [36]–[39], [139]–[147]. See also *Bosanac v Commissioner of Taxation* [2022] HCA 34 at [21]-[22], [67], [97]–[98], [103].

3 *Jenyns v Public Curator (Qld)* (1953) 90 CLR 113 at 119.

4 *Estate of Nitopi (No 2)* [2021] NSWSC 748 at [87].

The deceased made 12 payments in all between February 2008 and June 2010 to Cristina, with the first five in 2008, the 6th on 30 April 2009, the 7th to 11th between 28 July 2009 and 28 October 2009, and the last on 4 June 2010. The deceased also executed instruments in September 2009 revoking a power of attorney in favour of another daughter, and in December 2009 appointing his son as his attorney, but QCAT found they were ineffective because he lacked capacity when they were executed. QCAT's decision was delivered in March 2010.

The trial judge dismissed the executor's claim in relation to the first six gifts, and there was no cross-appeal. Cristina accepted that after March 2010 she was aware of QCAT's decision and accepted that she bore the onus to show that the last gift, which was of $202,000, was fair, just and reasonable. Despite that gift being relatively small compared to an estate of $21 million, the Court of Appeal rejected her submission **[14]** that these were not improvident gifts as a product of a loving relationship, and declined to interfere with the judge's conclusion that Cristina had not discharged the onus.

The principal focus of the appeal was on the five gifts made between 28 July and 28 October 2009, in amounts of $50,000, $332,000, $65,000, $360,000 and $252,000, which the trial judge had set aside for reasons which will be developed below. Throughout this period, the father was in Queensland and the daughter in New South Wales. Two points were at the forefront of the argument. The first was what was what level of knowledge of her father's incapacity was required in order for her seeking and retention of the gifts to be unconscionable. The second was whether equitable principle setting aside an unconscionable dealing extended to the "passive acceptance" of a benefit.

Knowledge of a special disadvantage

Cristina had maintained that her father's cognitive functioning had been unproblematic over the entire period, despite the medical evidence to the contrary, and that each of the payments had been made "on a wholly spontaneous, and unrequested, basis".[5] The primary judge rejected her evidence as to the circumstances of the payments as "unimpressively vague". His Honour found that "before each of the payments Cristina had at least implicitly made it known to her father that she needed money for one purpose or another, and thereby imposed a degree of moral pressure on him to give

[5]At [243].

her what she wanted", and posed the issue as being "whether, at the relevant times, the deceased was in a position to conserve his own interests in the face of this pressure".[6]

On the child's knowledge, the trial judge said "Cristina was clearly on notice that there were concerns about his mental state. Even if in June 2009 Cristina lacked actual knowledge of the full extent of the deceased's disabilities, in my view she could not have failed to see the signs of his vulnerability. I am satisfied that Cristina was on notice of his special disadvantage from that point."[7] His Honour concluded that the child "ought to have known" of her father's disadvantage from November 2008 onwards, and thus set aside the 7th to 12th payments.

Two textual complexities were at the forefront of the argument in and decision of the Court of Appeal. The first was that the trial judge had not made a finding of actual knowledge, and had used the language of "ought to have known" and "on notice" throughout the judgment. The second was that joint judgments of the High Court had been expressed in different language in three recent decisions.

On appeal, Cristina accepted that there was no basis to challenge the demeanour-based findings rejecting her account that there was nothing to indicate her father's cognitive decline, but submitted that the findings at trial were to be regarded as findings of constructive knowledge or constructive notice, which could not stand with what had been said in *Kakavas v Crown Melbourne Ltd.*[8] The daughter submitted that absent any findings of actual knowledge (including within that term wilful blindness) of her father's special disadvantage, it could not be unconscionable to retain the gifts. This submission was rejected.

Bell CJ contrasted constructive notice (ie knowledge of facts which would put a person on inquiry) with constructive knowledge (ie knowledge of facts from which a person *ought* to have known that another person was suffering under the relevant special disadvantage). It is settled that constructive notice is not sufficient in such cases. The High Court had said in *Garcia v National Australia Bank Ltd* that constructive notice "may well distract attention from the underlying principle: that the enforcement of the legal rights of the creditor would, in all the circumstances, be unconscionable".[9]

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6 At [247].
7 At [278]-[279].
8 (2013) 250 CLR 392.
9 (1998) 194 CLR 395 at [39].

But constructive notice is different from constructive knowledge. Aspects of *Kakavas* appeared to reject any role for constructive knowledge, and Bell CJ noted that *Kakavas* had been interpreted in that way by the Western Australian Court of Appeal.[10] But subsequently, in *Thorne v Kennedy*,[11] Kiefel CJ, Bell, **[15]** Gageler, Keane and Edelman JJ said that "it is also generally necessary that the other party knew *or ought to have known* of the existence and effect of the special disadvantage".[12] The emphasised words were hard to reconcile with actual knowledge being necessary. Most recently and most explicitly, in *Stubbings v Jams 2 Pty Ltd*,[13] Kiefel CJ, Keane and Gleeson JJ said that a finding of actual knowledge was "not essential to the appellant's case for relief".[14]

Seeking to rationalise those decisions, Bell CJ concluded:[15]

> the only way to reconcile *Kakavas* and *Thorne* in relation to questions of knowledge is that *Kakavas* must be understood as standing as authority only for the negative proposition that constructive notice is insufficient but not as standing for the additional proposition that constructive knowledge of a special disadvantage in the sense I have explained is also insufficient. This reading has recently been proffered by Y K Liew and D Yu in their article, "The Unconscionable Bargains Doctrine in England and Australia: Cousins or Siblings?" (2021) 45(1) *Melbourne University Law Review* 206 at 223. On this basis, the trilogy of decisions of the Western Australian Court of Appeal referred to at [6] above may be in error but, if error there be, the unqualified language of *Kakavas* may have contributed to that position.

Ward P reasoned to substantially the same effect. That conclusion is fortified by a review of the oral submissions made in *Kakavas* which suggest that constructive knowledge was explicitly conflated with constructive notice. Hence it was put by the successful respondent that:[16]

> Turning to constructive notice, because we are concerned with a branch of equitable fraud we are concerned with conduct that affects conscience. It does not extend to constructive notice – and I use "notice" advisedly. I am talking about that species of constructive

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10 *Mavaddat v HSBC Bank Australia Ltd [No 2]* [2016] WASCA 94 at [79]; *Serventy v Commonwealth Bank of Australia [No 2]* [2016] WASCA 223 at [18]; *Dewar v Ollie* [2020] WASCA 25 at [178].

11 (2017) 263 CLR 85; [2017] HCA 49.

12 At [38].

13 (2022) 399 ALR 409; [2022] HCA 6.

14 At [44].

15 At [9].

16 *Kakavas v Crown Melbourne Ltd* [2013] HCATrans 70. Counsel for the appellant invariably referred to constructive knowledge, not constructive notice.

> knowledge where a person is put on inquiry.

Both Bell CJ and Ward P drew attention, respectfully, to a minor error in *Stubbings* on this point. It was said in *Stubbings*[17] that in *Kakavas* "this Court approved over the emphasis laid by Mason J in *Amadio* that "the other party knows or ought to know of the existence" the special disadvantage. The passage appears in *Kakavas* but the joint judgment is merely recording the unsuccessful appellant's submission.[18] But the evident sense is clear and welcome. The reference to *Kakavas* in *Stubbings* entails that the unequivocally clear statement in *Stubbings* that actual knowledge was not necessary represents the law, notwithstanding that some might take a different view of the effect of *Kakavas*. That is to say, contrary to the submissions advanced by Cristina, *Kakavas* did not represent a narrowing of the test for knowledge.

Having identified error by the trial judge, the Court of Appeal concluded that neither actual nor constructive knowledge could be found on the evidence. The President referred to evidence of a conversation at the Sydney aged care facility, accepted by the primary judge, that the deceased had told his daughter that he was not suffering from dementia, the absence of any medical records at this time of concerns of mental ability, and the fact that "some cognitive ability must have been required for the transfer of moneys from Hong Kong to put in the local account funds from which to withdraw the impugned payments".[19]

[16] *Victimisation and predatory state of mind*

Cristina had also contended that an actual or implied request for money by an adult child was without more insufficient to engage the equitable jurisdiction to set aside the gift. She submitted that "there must be some positive exploitative act or conduct directed towards the weaker party amounting to an unconscientious taking advantage of or victimisation of that weaker party", relying on the opening words of the judgment of Brennan J in *Louth v Diprose*:[20]

> "The jurisdiction of equity to set aside gifts procured by unconscionable conduct ordinarily arises from the concatenation of three factors: a relationship between the parties which, to the knowledge of the donee, places the donor at a special disadvantage vis-a-vis the donee; the donee's unconscientious exploitation of the donor's disadvantage; and the consequent

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17 *Stubbings v Jams 2 Pty Ltd* (2022) 96 ALJR 271 at [45]; [2022] HCA 6.
18 *Nitopi* at [7] and [118].
19 At [122].
20 (1992) 175 CLR 621 at 626.

> overbearing of the will of the donor whereby the donor is unable to make a worthwhile judgment as to what is in his or her best interest."

This was linked to the unequivocal statement in *Kakavas* that:[21]

> Equitable intervention to deprive a party of the benefit of its bargain on the basis that it was procured by unfair exploitation of the weakness of the other party requires proof of a predatory state of mind. Heedlessness of, or indifference to, the best interests of the other party is not sufficient for this purpose. The principle is not engaged by mere inadvertence, or even indifference, to the circumstances of the other party to an arm's length commercial transaction. Inadvertence, or indifference, falls short of the victimisation or exploitation with which the principle is concerned

But the Court of Appeal held, notwithstanding what might be thought to follow from a requirement of a "predatory state of mind", and by reference to long-standing principle, that "victimisation" in this context was not to be understood narrowly, and further that the retention of a benefit voluntarily given might be unconscionable.[22] There is a valuable discussion of the authorities illustrating the width of notions of "victimisation" and "predatory state of mind" in the Chief Justice's judgment.[23] The President noted, by reference to what had been said in the joint judgment in *Thorne v Kennedy*,[24] that the term "predatory state of mind" was to be understood as "simply another way of saying that there needs to be unconscientious exploitation with the requisite knowledge".[25]

Conclusions

Thus while Cristina's submissions which had sought to circumscribe the scope of the equitable doctrine were rejected, her appeal was substantially successful, based on the absence of actual or constructive knowledge. Six observations made by made from the reasoning in *Nitopi v Nitopi.*

First, in a case such as this, whether or not the recipient's conscience is affected will turn on what the recipient knew or ought to have known of the special disadvantage. Notions of constructive

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21 At [161].
22 By reference to *Wilton v Farnsworth* (1948) 76 CLR 646 at 655; *Louth v Diprose* at 637; *Johnson v Smith* [2010] NSWCA 306 at [5]; *Wu v Ling* [2016] NSWCA 322 at [7]-[14].
23 At [25]-[33].
24 (2017) 263 CLR 85 at [38].
25 At [181].

notice have no role to play, and thus the pleading, cross-examination and findings in cases of this kind ought to be informed by the distinction. n. That is to say, those pleading the case and those involved in preparing the evidence need to be familiar with the way knowledge is to be advanced or rebutted.

Secondly, the fact that a parent makes an unsolicited gift to a child does not immunise the gift from scrutiny. There may be circumstances where the child's retention of the gift, if the child knew or ought to have known of the parent's special disadvantage, makes it unconscionable to retain it.

Thirdly, the nature of advocacy is such that from time to time passages in judgments will be taken out of context, and invoked in circumstances to which they were not intended to apply, leading to a subsequent correction or clarification.

This recurs in the law. In *Lee v Lee* at [55] the High Court confirmed that "appellate **[17]** restraint with respect to interference with a trial judge's findings unless they are 'glaringly improbable' or 'contrary to compelling inferences' is as to factual findings *which are likely to have been affected by impressions about the credibility and reliability of witnesses formed by the trial judge as a result of seeing and hearing them give their evidence.*"[26] That may be understood as a response to a decision cited by the High Court, namely, *Robinson Helicopter Co Inc v McDermott*,[27] where a more general proposition was laid down, namely, that "a court of appeal should not interfere with a judge's findings of fact unless they are demonstrated to be wrong by 'incontrovertible facts or uncontested testimony', or they are 'glaringly improbable' or 'contrary to compelling inferences'." *Robinson* was a case which turned, in part, on lay and expert evidence. But the passage was not expressed to be confined to such cases, and advocates seized upon it to defend decisions at trial which were not influenced by testimonial evidence. For example, *Robinson* was subsequently invoked in wholly documentary cases,[28] and in at least one appeal was used to uphold findings made in cases turning entirely on documents.[29] But the passage could not sensibly be understood as overturning what had been hammered out, at length, in *Warren v Coombes*.[30] The confirmation that that was so in *Lee v Lee* was welcome.

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26 *Lee v Lee* (2019) 266 CLR 129 at [55].
27 [2016] HCA 22; (2016) 90 ALJR 679 at [43].
28 For example *Minister for Families and Children v Certain Children by their Litigation Guardian Sister Marie Brigid Arthur* [2016] VSCA 343.
29 See for example the trade mark appeal in *Accor Australia & New Zealand Hospitality Pty Ltd v Liv Pty Ltd* [2017] FCAFC 56; 345 ALR 205 at [200].
30 (1979) 142 CLR 531.

Fourthly, the reasons display a welcome engagement with serious academic writing, on points that were central to the appeal. The influence of the article by Liew and Yu on distinguishing constructive knowledge and constructive notice is clear from the passage reproduced above. The requirement that "victimisation" be active was criticised by Professor Ridge, "Sir Anthony Mason's Contribution to the Doctrine of Unconscionable Dealing: Amadio's Case",[31] and was also acknowledged by the Chief Justice.[32]

Finally, it is as well to bear in mind the caution stated by White JA in his concurring judgment:[33]

> "[T]o my mind the most important point to arise from *Stubbings* is the plurality's reminder (at [39]) that the "elements" to be satisfied to establish grounds for equity's intervention where the defendant has unconscientiously exploited the plaintiff's "known" position of special disadvantage are not to be addressed separately as if they were elements of a cause of action in tort."

This reflects a central distinction between common law and equity. This is orthodox, basal and binding. The joint judgment in *Kakavas* said, quoting the passage from *Jenyns* mentioned at the commencement of this note:

> "[invoking equitable doctrines] calls for a precise examination of the particular facts, a scrutiny of the exact relations established between the parties and a consideration of the mental capacities, processes and idiosyncrasies of the [other party]. Such cases do not depend upon legal categories susceptible of clear definition and giving rise to definite issues of fact readily formulated which, when found, automatically determine the validity of the disposition. Indeed no better illustration could be found of Lord Stowell's generalisation concerning the administration of equity: 'A court of law works its way to short issues, and confines its views to them. A court of equity takes a more comprehensive view, and looks to every connected circumstance that ought to influence its determination upon the real justice of the case': *The Juliana*."

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31 In B McDonald, B Chen and J Gordon (eds), *Dynamic and Principled: the Influence of Sir Anthony Mason* (2022, Federation Press) 376 at 385, citing R Bigwood, "Still Curbing Unconscionability: Kakavas in the High Court of Australia" (2013) 37 *Melbourne University Law Review* 463 at 478.

32 At [27].

33 At [198].

[18] Until not so long ago, a jury would determine the binary issues of breach and causation in tort. Even when determined at a judge-alone trial, a plaintiff who establishes the elements of a tortious cause of action is entitled as of right to damages. Indeed, the context for the familiar statement in *Jenyns* reproduced at the beginning of this note was the High Court's observation that to attempt to determine such a case with a jury was "anomalous and inappropriate [and] best with difficulties and embarrassments".[34] Foreign to all this is any attempt to identify and apply the principles governing the equitable jurisdiction to set aside an unconscionable transaction as if they were elements of a common law cause of action.

MJL

[34] (1953) 90 CLR 113 at 119.