

Society of Lloyds v Khan
QUEEN'S BENCH DIVISION (COMMERCIAL COURT)
[1998] 3 FCR 93, [1999] 1 FLR 246, [1999] Fam Law 92
HEARING-DATES: 4 March 1998
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CATCHWORDS:

Husband and wife - Wife becoming member of Lloyds - All applications and arrangements made by husband - Wife incurring underwriting losses - Lloyds seeking summary judgment - Whether wife had arguable defence of undue influence of husband.

HEADNOTE:

The wife was introduced as a member of Lloyds of London by her husband who was some 30 years older than her with considerably more experience in life and business matters. He made all applications in her name, which she signed when and where he directed. She attended Lloyds for the customary meeting but he attended as well and did all the talking. She received no advice on joining Lloyds other than that from her husband and no one suggested that she should. He provided the bank guarantee which represented her stake money but later replaced it with a guarantee over her jewellery. Lloyds sought summary judgment for her underwriting losses. The wife sought to defend on the basis that she was induced to become a Name by the undue influence of the husband.

Held - To show presumed undue influence arising from a special relationship, in the present case that of husband and wife, the wife had to show not only that she was influenced by the husband but also that the transaction was to her manifest disadvantage. Such a transaction was one which was so improvident that it could not be explained by ordinary motives by which ordinary men and women acted. It must also be shown that the creditor had actual or constructive knowledge of the fact of undue influence. Constructive notice arose where the transaction was not on its face beneficial to the person seeking to allege undue influence and where there was a substantial risk that a transaction of the kind in question would have been procured by undue influence. On the facts, the transaction enabled the wife to take a risk for reward and as such was not manifestly to her disadvantage. The remedy for undue influence was rescission to set aside the agreement. The circumstances in which that would be done depended not on an inflexible application of the doctrine of *rescissio in integrum* but on what the justice of the case required taking into account the protection of third parties and bona fides purchasers for value without notice. In the circumstances of the present case the remedy of rescission was not possible as the ability to write insurance was personal and not returnable as it would not only adversely affect other Names and Lloyds but also the insured third parties. The wife had shown no arguable defence and the application for summary judgment would be allowed.

CASES-REF-TO:

O'Sullivan v Management Agency and Music Ltd [1985] QB 428, [1985] 3 All ER 351, [1984] 3 WLR 448, CA.
Lloyds of London v Leighs [1997] CA Transcript 1416.

INTRODUCTION:

Application

The plaintiff, Society of Lloyds (Lloyds), sought summary judgment under RSC Ord 14 for underwriting losses against the defendant, Mrs Khan, who, in seeking to defend the application on the ground that she had been induced to become a Name by the undue influence of her husband, applied for, and was refused, an adjournment to seek funds for representation. The facts are set out in the judgment.

COUNSEL:

David Foxton for Lloyds; The wife as a litigant in person; Mark Watson-Gandy and as *amicus curiae*.

PANEL: TUCKEY J

JUDGMENTBY-1: TUCKEY J

JUDGMENT-1:

TUCKEY J. Mrs Khan says she has an arguable defence to Lloyd's claim against her for the Equitas premium because she was induced to become a name by the undue influence of her husband.

The facts which I assume for the purposes of this RSC Ord 14 application are to be found in her affidavit. I should say that the affidavit was prepared by solicitors acting on her instructions. I have had the benefit of a skeleton argument prepared by Mr Mark Watson-Gandy for the purpose of this hearing on her behalf. At the beginning of the hearing he appeared to say that his solicitors, Messrs Tennakoons, felt unable to proceed because they were not in funds. I rejected an application for an adjournment, but Mr Watson-Gandy stepped from counsels' benches to sit alongside Mrs Khan and has developed the arguments which he summarised in his skeleton argument, for which I am extremely grateful.

The facts on which those arguments are based are to be found in the affidavit. They are these: Mrs Khan married her husband, Captain Taj, when she was 21. He was in his 50s when they married. He had served in the Pakistan Navy as a commander and then had obtained his commercial captain's licence and become a director of a shipping company. He therefore had considerably more experience of life and business matters than his wife. Quite apart from the difference in age and the difference in their experience, culturally she would expect to leave all financial matters to her husband. That indeed was the case when she became a member of Lloyds. He made all applications in her name, which she signed when and where he directed her to. This included the general undertaking under which she became a member of Lloyds, which she signed, I am told, some time towards the end of 1986.

She attended at Lloyds for the customary meeting but her husband attended as well and did all the talking. In short she left the whole thing to him, including arrangement of the bank guarantee which he originally put up himself but later substituted with a guarantee secured over Mrs Khan's jewellery. She never received any advice about becoming a Name at Lloyds from anyone other than her husband, and no one suggested that she should. When money was paid, as it apparently was as a result of some profitable underwriting, he took the money. Unfortunately in 1991 they separated and he went to Pakistan. She has not seen him since, although it is obvious that she is in contact with him. It was only at that time that she realised that there were losses for which she was being held liable to Lloyds.

For the purpose of considering whether there is an arguable defence, it is necessary to look at what a party in the position of Mrs Khan has to show in order to establish undue influence. Undue influence negatives contractual consent but does not make any contract induced by it void, only voidable, at the instance of the party affected. In this case, Mrs Khan first sought to avoid the contract under which she became a member of Lloyds in October 1997.

There are two kinds of undue influence which the courts have considered and refined in the cases in the last 10 or 15 years. First, there are cases of actual undue influence where undue influence has been used as an instrument of fraud. That is not the type of undue influence alleged here. The type alleged here is presumed undue influence arising from a special relationship, in this case the relationship of husband and wife. In such a case the authorities show that not only must the transaction be influenced by (in this case) the husband (that is accepted for the purpose of Ord 14), but also that the transaction was to the manifest disadvantage of (in this case) Mrs Khan. Such a transaction is one which is so improvident that it could not be explained by the ordinary motives by which ordinary (in this case) women act.

That is what needs to be established to show undue influence. It must also be shown that (in this case) Lloyds had actual or constructive notice of the fact of undue influence. Actual notice needs no further explanation. Constructive notice arises where the transaction is not on its face beneficial to the person seeking to allege undue influence (in this case Mrs Khan) and where there is a substantial risk that a transaction of the kind in question would have been procured by undue influence. These two questions obviously overlap with the question of manifest disadvantage.

Finally, the remedy for undue influence is rescission to set aside the agreement. The circumstances in which that can be done where *restitutio in integrum* is no longer possible have been the subject of recent authorities. The most favourable dictum from the point of view of Mrs Khan is, I think, to be found in *O'Sullivan v Management Agency and Music Ltd* [1985] QB 428 at 466-467, [1985] 3 All ER 351 at 372. There, after deciding that equity did not require a rigid application of the doctrine that rescission should be refused where *restitutio in integrum* was not possible, Fox LJ said:

‘... it seems to me that the principle that the court will do what is practically just as between the parties is applicable to a case of undue influence even though the parties cannot be restored to their original position. That is, in my view, applicable to the present case. The question is not whether the parties can be restored to their original position; it is what does the justice of the case require? That approach is quite wide enough, if it be necessary in the individual case, to accommodate the protection of third parties. The rights of a bona fide purchaser for value without notice would not in any event be affected.’

So no inflexible application of the doctrine *restitutio in integrum* is required; the question is, what does the justice of the case require? But in considering that, the protection of third parties and bona fide purchasers for value without notice has to be taken into account.

Mr Watson-Gandy submits that the transaction was to Mrs Khan’s manifest disadvantage; that there was actual or constructive notice to be derived arguably at least from Lloyds’ course of dealings with the husband on behalf of the wife - documents sent to him rather than her, documents signed ‘PP’ on her behalf by him and so on; and, on the question of remedy, recognising the difficulties which arise at this point in the case, he argued that this was not a situation in which the contracts which were made on behalf of Mrs Khan as an underwriting Name at Lloyds would fall away as a result of the plea of undue influence being successful. I will come back to examine that in a moment.

On behalf of Lloyds, Mr David Foxton submitted that the transaction was not manifestly to Mrs Khan’s disadvantage. It had merely enabled her to undertake risk in return for reward and the risk that she might be exposed to loss. For the same reason one could not say that this was a transaction which met the requirements necessary for constructive notice. No question of actual notice could arise. The remedy of rescission in the circumstances of this case was no longer possible. That follows, Mr Foxton submitted, from the decision of the Court of Appeal in the Leighs’ case, where Names were arguing that as a result of fraudulent misrepresentation on the part of Lloyds the Equitas contract was voidable and therefore liable to rescission (see *Lloyds of London v Leighs* [1997] CA Transcript 1416). Both Colman J at first instance and the Court of Appeal considered those arguments and rejected them on the basis that it was not possible for a Name to rescind his membership of Lloyds because the benefit obtained from the general undertaking, namely the ability legally to write insurance business through the institutions of the Lloyds’ market was not in its nature returnable; because of the adverse effect on third party policy holders, other names and Lloyds, which would result from the fact that the defendants were not reinsured by Equitas and their insurance business would be fragmented from other names on the same syndicates; because the defendants would be placed in the position of running off their insurance business illegally in breach of the Insurance Companies Act 1982; and because in the test cases before the court at that time, Equitas had already been paying the defendants’ claims for three months before they sought to rescind.

Here Mr Foxton said the same reasons apply a fortiori. Rescission would have exactly the same consequences and in this case Mrs Khan did not seek to rescind for more than 12 months after Equitas had started paying claims on her behalf.

Mr Watson-Gandy’s answer to the rescission point, as I have said, is that the contract contained in the general undertaking would not be avoided. What would happen would be that Mrs Kahn would not be liable under it. What it comes to, he contends, is *non est factum*, that is to say Mrs Khan never made a contract at all with Lloyds.

I do not think that this analysis can be justified on any recognised legal principles. Mr Watson-Gandy then said that in some way one could drop Mrs Khan out of the picture and say that the contract subsisted between Captain Taj and Lloyds. In other words, the undue influence in some way novated the contract to the husband. But I am afraid I cannot accept this analysis either. Valiantly though he struggled to escape from the manacles of Lloyds’ point about rescission, I am wholly unpersuaded that Mr Watson-Gandy had been able to do so. This was a contract with Mrs Khan. It is she who has to avoid it. That she cannot do for the reasons which persuaded Colman J and the Court of Appeal that rescission could not be granted in the Leighs’ case.

If undue influence gives rise to a right to equitable compensation (and this is doubtful on the authorities) that is a claim which may be made against Lloyds but by virtue of cl 5.5 of the contract this does not give Mrs Khan a defence to this claim.

So on the rescission point I am sure that Mrs Khan's claim would founder if allowed to proceed to trial and therefore there is no arguable defence. But I also think it would because Mrs Khan fails to show, even arguably, that this was a transaction which was manifestly to her disadvantage. As Mr Foxton submitted, it enabled her to undertake risk in return for reward, and as such was not manifestly to her disadvantage. On the question of notice the same difficulty arises. It cannot be said that the transaction was obviously not beneficial to Mrs Khan.

For these reasons, ably and helpfully though the arguments were presented by Mr Watson-Gandy on her behalf, I do not think Mrs Khan has shown an arguable defence.

DISPOSITION:

Order accordingly.

SOLICITORS:

Dibb Lupton Alsop; Tennakoons