

## The Basis for Setting Aside a Three-Party Bank-Lending Transaction Entered into by 'Undue Influence' Under Section 16 of The Malaysian Contracts Act 1950: A Grey Area of Laws

NOOR INAYAH YAAKUB

### ABSTRACT

*One of the grey areas of law with regards to the law of undue influence in a three-party situation in Malaysia is its basis for setting aside a transaction. Since the word 'unconscionable' is not defined in the Contracts Act 1950, it is unclear from this subsection whether Malaysian courts would grant relief to a claimant not on the sole ground of undue influence but also on the proof of unconscionability. The main aim of this paper is to explain what is the actual basis in Malaysia for setting aside a bank-lending transaction entered into by undue influence.*

### ABSTRAK

*Salah satu daripada kekaburan undang-undang berkaitan pengaruh tidak wajar dalam transaksi tiga pihak ialah asas untuk melupuskan transaksi tersebut. Memandangkan perkataan ketidakwajaran tidak didefinisikan dalam Akta Kontrak 1950, adalah tidak jelas sama sekali sama ada Mahkamah Malaysia melupuskan sesuatu transaksi itu hanya berasaskan ketidakwajaran. Objektif utama artikel ini adalah menganalisa apakah yang menjadi asas sebenar untuk melupuskan sesuatu kontrak tiga pihak yang dimasuki secara pengaruh tidak wajar.*

### INTRODUCTION

Subsection (3) of section 16 states that where a person who is in a position to dominate the will of another enters into a contract with him, and the transaction appears to be unconscionable, the burden of proving that the contract was not induced by undue influence shall lie upon the person in a position to dominate the will of another. The elements contained in this section are complex. It is therefore difficult to ascertain what is the exact basis for setting aside a three-party bank-lending transaction entered into by 'Undue Influence' in Malaysia. This paper examines the difficulties of this section to show that the basis for setting aside such transaction remains unclear. All the elements contained in this section will be discussed under two headings as follows.

## UNCONSCIONABILITY AND DISADVANTAGE

In the case of *Polygram Records Sdn Bhd v. The Search & Anor*<sup>1</sup> Visu Sinnadurai J. stated that:

It has long been generally accepted both by judges and textbook writers, that in every case where undue influence was being alleged, the party seeking to set aside the transaction must also establish some manifest disadvantage to the contracting party: see for example the decision of the Court of Appeal in *Bank of Credit and Commerce International SA v. Abody* [1990] 1 QB 923; [1992] 4 ALL ER 955; [1989] 2 WLR 759.

The judge also considered the views expressed in *CIBC Mortgages v. Pitt & Anor*<sup>2</sup> where he stated:

However...the House of Lords in *CIBC Mortgages Plc v. Pitt & Anor* [1993] 4 ALL ER 433 explained that the requirement of establishing manifest disadvantage was not applicable to cases of actual undue influence but applied (if at all), only to cases of presumed undue influence.

What is more interesting from this case is that the judge in *Polygram* also pointed out the decision of the Privy Council in *Poosathurai v. Kannappa Chettiar*<sup>3</sup> wherein a party claiming to set aside a contract on the grounds of undue influence, under section 16 of the Indian Contract Act, which is in *pari material* to section 16 of the Malaysian Contracts Act 1950, cannot succeed in setting aside the contracts unless the party, besides establishing evidence of undue influence, also proves that the contract was 'unconscionable'.

Before embarking on the implications of the cases of *CIBC Mortgages Plc v. Pitt & Anor*<sup>4</sup> and *Poosathurai v. Kannappa Chettiar*<sup>5</sup> for the present case of *Polygram*, it is significant to look at the facts in *Polygram*. *Polygram* concerns the second contract that was entered into between the plaintiffs and the group, for the reason that there were some changes in the composition of the group. Although the second contract contained many provisions which were identical to those contained in the first contract, there was a major modification, which the group claimed was not brought to their attention. The modification was that the period of option which the members of the group granted to the plaintiffs was extended to two additional periods of 24 months each, instead of the two additional periods of 12 months each under the first contract. When *Polygram*

<sup>1</sup> [1994] MLJ Lexis 396.

<sup>2</sup> [1993] 4 All ER 433.

<sup>3</sup> (1919) LR 47 Ind App 1 at pg. 3-4.

<sup>4</sup> [1993] 4 All ER 433.

<sup>5</sup> (1919) LR 47 Ind App 1 at pg. 3-4.

<sup>6</sup> (1919) LR 47 Ind App 1 at pg. 3-4.

commenced proceedings against the group for breach of contract and against the sixth defendant for inducing the group to breach their contract with Polygram, the group counterclaimed, *inter alia*, with a declaration that both the contracts were voidable on the grounds of undue influence.

As the present case was one dealing with presumed undue influence and not one of actual undue influence, it is interesting to note that the judge felt compelled to consider the Privy Council decision in *Poosathurai v. Kamappa Chettiar*,<sup>6</sup> and also to be aware of the reservations expressed by Lord Browne-Wilkinson in the *CIBC Mortgages plc v. Pitt & Anor* case. This was crucial in establishing whether the defendants had succeeded in establishing that the contract entered into was unconscionable or one of manifest disadvantage.

Visu Sinnadurai J. pointed out that the second contract contains similar terms to those contained in the first contract except for the duration of the contract. He further held that these terms in the second contract were not new terms, but merely those which were already known to the defendants, by virtue of the first contract. Thus, the defendants cannot now be heard to say that they were not aware of the terms of the second contract or that it was an unconscionable bargain.<sup>7</sup>

From the aforesaid paragraphs, it seems that even though the judge acknowledged that some of the terms appeared to be onerous, or may even, perhaps, be labelled as unconscionable,<sup>8</sup> the fact that there was no radical change to the nature of the contract, and therefore no new terms, had barred the defendants from claiming that the terms in the second contract constituted an unconscionable bargain.

More important was the requirement that disadvantage be confirmed necessary in cases of presumed undue influence. The judge strictly reminded that this element, for the purposes of the doctrine of undue influence, has to be a disadvantage which was obvious to any independent and reasonable person who considered the transaction as a whole at the time it was entered into, with full knowledge of all relevant facts; and the mere overbearing of a person's will is not in itself a disadvantage in the relevant sense.<sup>9</sup>

Another important point deriving from the statements of the judge is:

I therefore hold that as the defendants had failed to establish that the second contract as a whole, and not some of the terms contained therein, was "manifestly disadvantageous" to them or that it was unconscionable, the defendants' attempt to set aside the contract on the ground of undue influence fails.<sup>10</sup>

<sup>7</sup> [1994] MLJ Lexis 396.

<sup>8</sup> *Ibid.*

<sup>9</sup> *Ibid.*

<sup>10</sup> *Ibid.*

The judge made it clear that in *Polygram* in interpreting section 16 of Malaysian Contracts Act 1950, the requirement of manifest disadvantage must be present in cases of presumed undue influence.

At this point, it is also interesting to note that even if the element of manifest disadvantage need no longer be established as a separate requirement in cases of presumed undue influence, the judge raised doubts as to whether the defendants in the present case are in a position to set aside the second contract on the grounds of undue influence since they appear to have affirmed the contract.<sup>11</sup>

Hence, several remarks can be made about the decision in *Polygram* above. First, the court concurred with the view that besides the position to dominate, the element of disadvantage must also present. This was clear when the judge referred to *Aboody*<sup>12</sup> in cases of presumed undue influence. Secondly, the court also considered the effects of the decision in *CIBC Mortgages v. Pitt*<sup>13</sup> to the claimant who proves actual undue influence is not under the further burden of proving that the transaction induced by undue influence was manifestly disadvantageous. Since section 16 requires both elements of dominion and disadvantage, *Pitt*'s<sup>14</sup> case stressed that the point about the claimant who proves actual undue influence not being under the further burden of proving manifest disadvantage did not really capture the court's attention in the case of *Polygram*.<sup>15</sup>

Thirdly, the judge confused equitable jurisdiction to set aside contracts entered into as a result of undue influence, and the effects of an established principle of law that affirmation of a voidable contract is a bar to the setting aside of the voidable contract. In this regard, the court ruled that defendants in the present case appear to have affirmed the contract<sup>16</sup> and consequently, it doubts very much whether the defendants in the present case are in a position to set aside the second contract on the grounds of undue influence.

Finally, since the word 'unconscionable' is not defined in Contracts Act 1950 it is interesting to see the judge applying the requirement of 'unconscionable' as insisted in *Poosathurai*.<sup>17</sup> Visu Sinnadurai J. said:

...the defendants had a difficult task in establishing that the second contract was in fact unconscionable, or that it was manifestly disadvantageous to them.<sup>18</sup>

---

<sup>11</sup> Ibid.

<sup>12</sup> [1992] 4 All ER 955.

<sup>13</sup> [1994] 1 AC 200.

<sup>14</sup> [1993] 4 All ER 433.

<sup>15</sup> [1994] MLJ Lexis 396.

<sup>16</sup> Ibid.

<sup>17</sup> (1919) LR 47 Ind App 1 at pg. 3-4.

<sup>18</sup> [1994] MLJ Lexis 396.

He later stated:

I therefore hold, that as the defendants had failed to establish that the second contract as a whole, and not some of the terms contained therein, was ‘manifestly disadvantageous’ to them or that it was unconscionable, the defendants’ attempt to set aside the second contract on the ground of undue influence fails.<sup>19</sup>

The above statement correctly applied the language of section 16(3)(a). However, such a statement did not clearly explain the meaning of the word unconscionable in that section. More importantly, there was no indication firmly made in *Polygram* to show that section 16 also required both elements of unconscionability and undue influence to set aside a transaction. As a result, there was no certainty as to whether a relief to a claimant was given based not on the sole ground of undue influence but also on the proof of unconscionability. It may be argued that the judge in *Polygram* has somehow indicated that the claimant had to prove that the transaction was unconscionable but it should be emphasised that the judge in *Polygram* did not explain the word unconscionable as contained in section 16. Surprisingly, he was more inclined to refer to the Indian case of *Poosathurai* rather than a local case. There was actually one local case that seemed to have been ignored in *Polygram* on the meaning of unconscionability. Chong Siew Fai J. (as he then was) expressed the meaning of ‘unconscionable’ in section 16 in *Fui Lian Credit & Leasing Sdn Bhd v. Kim Leong Timber Sdn Bhd*<sup>20</sup> He states:<sup>21</sup>

In order that a party may free himself from complying with an agreement he had entered into, he must show that the bargain or some of its terms was unfair and unconscionable. It is not enough to show that, in the eyes of the Court, it was unreasonable. A bargain cannot be unfair and unconscionable unless it is shown that one of the parties to it has imposed an objectionable term in a morally reprehensible manner, that is to say, in a way which affects his conscience or has procured the bargain by some unfair means.

Regrettably, the statements of Chong Siew Fai J in the above case of *Fui Lan Credit & Leasing Sdn Bhd v. Kim Leong Timber Sdn Bhd* were not referred to in the case of *Polygram* and the subsequent cases on undue influence described below.

In the case of *Rosli bin Darus v. Mansor @ Harun bin Hj Saad & Anor*,<sup>22</sup> for example, even though it is concerned with the transfer of land, the element of undue influence is discussed extensively. This was the plaintiff’s application

---

<sup>19</sup> *Ibid.*

<sup>20</sup> [1991] 1 CLJ 522.

<sup>21</sup> *Ibid.*, pg. 619 at para g.

<sup>22</sup> [2001] MLJ Lexis 651.

for a declaration that the transfer of a piece of land was null and void as the transfer was without consideration and was induced by the undue influence of the defendants. In this case, the first defendant had informed the plaintiff that the plaintiff, being an adopted child, could not inherit the land, as the same was the property of the defendants' father. The defendants averred that as soon as the plaintiff found out that his adoptive mother had transferred her share in the land to him, the plaintiff voluntarily transferred his share to the defendants as he felt morally obligated to the first defendant who had helped raise him after the death of his adoptive father. According to the first defendant, he provided the plaintiff with food, clothing and expenses and carried out his role as the plaintiff's guardian; during that time, the plaintiff always obeyed the first defendant.

The judge following the Indian case of *Ballo v. Parasam*<sup>23</sup> ruled that if it has been established that the defendants were in a position to dominate the plaintiff's will and that the transaction was unconscionable, the burden of proof of absence of undue influence rested upon the defendants;<sup>24</sup> they had to show that the transfer was perfectly fair and reasonable and that they had not taken advantage of the first defendant's position, and to rebut the presumption that the transfer was procured by the exertion of undue influence.<sup>25</sup>

In *Chemsource (M) Sdn Bhd v. Udanis bin Mohammad Nor*,<sup>26</sup> the judge further stressed that the doctrine of undue influence is an equitable doctrine allowing a contract to be set aside where there has been a wrongful exercise of influence by one party over the other.<sup>27</sup> Moreover, the judge had asked what sort of influence the courts would view as being wrongful.<sup>28</sup> Despite the above, the judge did not make any attempt to comment on whether such transactions amount to unconscionable. What is apparent from the judgement is that he had placed emphasis on the dominant position and used that position to obtain an unfair advantage by referring to English authorities such as *Bank of Credit and Commerce International SA v. Aboody*<sup>29</sup> and *National Westminster Bank v. Morgan*.<sup>30</sup>

It is thus not an extreme statement to conclude that although the word unconscionable appears in section 16(3) of the Contracts Act 1950, courts in Malaysia are not inclined to define the meaning of unconscionable or to clearly determine what constitutes an unconscionable transaction. As a result, even

<sup>23</sup> (1972) AIR 33.

<sup>24</sup> [2001] MLJ Lexis 651.

<sup>25</sup> *Ibid.*, pg. 4.

<sup>26</sup> [2002] 6 MLJ 273 per Abdul Malik Ishak J.

<sup>27</sup> [2002] MLJ Lexis 389.

<sup>28</sup> *Ibid.*

<sup>29</sup> [1990] 1 QB 923.

<sup>30</sup> [1985] 1 All ER 821.

cases like *Rosli* and *Chemsource* above place emphasis on the importance of proving the transaction unconscionable in order to satisfy section 16; yet this remains a grey area in Malaysia since no exhaustive attempt has been made to consider to what extent unconscionable transactions or at least the statements of Chong Siew Fai J. in the case of *Fui Lan Credit* have been considered.

### INEQUALITY OF BARGAINING POWER

In one final argument, it is also important to note that *Polygram's* case also mentioned the doctrine of inequality of bargaining power as a ground to set aside a transaction. This is clear when the judge stressed that:<sup>31</sup>

In the absence of any established precedent on this aspect of the law in Malaysia, and in view of my earlier findings that the second contract, as a whole, is not one which may be labelled as being grossly unfair to the defendants, I therefore make no findings as to whether the second contract may be set aside on the grounds of inequality of bargaining power.

It is unclear from the above statement as to whether the doctrine of inequality of bargaining power is one of the grounds for setting aside the transaction. But from the judge's earlier statement it may be suggested that the doctrine of inequality of bargaining power was regarded as the basis of undue influence. He stated:<sup>32</sup>

In Malaysia, though there is some support for the view that, public policy may, in some exceptional cases, demand that certain contracts which are grossly unfair to one of the parties to a contract ought to be set aside on the grounds of inequality of bargaining power under s 24(e) of the Act, there has been to date, no leading case in which this doctrine has been invoked by the Malaysian courts.

In fact, the doctrine of inequality of bargaining power was explicitly regarded as the basis of undue influence in Malaysia when the judge in *Societe Des Etains De Bayas Tudjuh v. Who Heng Mining Kongsi*<sup>33</sup> stated:

On the issue of undue influence, I could see no reason why it was not open to the defendants to raise this issue, at least on the basis of the doctrine of inequality of bargaining power recently enunciated in several recent decisions in England, to be determined on the evidence to be adduced at the trial of this action.

<sup>31</sup> [1994] MLJ Lexis 396.

<sup>32</sup> *Polygram Records Sdn Bhd v. the Search & Anor* [1994] MLJ Lexis 396.

<sup>33</sup> [1978] 2 MLJ 267.

The same approach was taken in later cases including *Malayan Banking Bhd v. Kim Produce Pte Ltd & Ors And Another Action*,<sup>34</sup> *Polygram Records Sdn Bhd v. The Search and Anor*,<sup>35</sup> *Mohd Latiff Bin Shah Mohd & Ors v. Tengku Abdullah Ibnu Sultan Abu Bakar & Ors And Other Actions*,<sup>36</sup> *Tengku Abdullah Ibnu Sultan Abu Bakar & Ors v. Mohd Latiff Bin Shah Mohd & Ors And Other Appeals*<sup>37</sup> and *Oriental Bank Bhd v. Alphabumi (Malaysia) Sdn Bhd & Ors*<sup>38</sup> These cases show that the inequality of bargaining power between the parties was considered vital in determining whether the guarantor had given his consent as a result of undue influence.

However, it is interesting to see that before these cases were decided, the doctrine of inequality of bargaining power was in fact not considered as forming the basis of undue influence in Malaysia. In the case of *Saw Gaik Beow*,<sup>39</sup> Edgar Joseph was clearly imposing a different approach. The judge followed the observations made by Lord Scarman in *National Westminster Bank v. Morgan*,<sup>40</sup> that the foundation of the principle to grant equitable relief of this kind is not inequality of bargaining power but the prevention of victimisation by one party of another. The approach taken by *Saw Gaik Beow* has never been referred to by the post-dated *Morgan* cases in Malaysia and it was only in the recent case of *Khaw Cheng Bok v. John Khoo Boo Lai*<sup>41</sup> that the approach taken by the judge in *Saw Gaik Beow* was followed.

The acknowledgement by the court in *Societe Des Etains De Bayas Tudjuh v. Who Heng Mining Kongsu*<sup>42</sup> in 1978 that the doctrine of inequality of bargaining power forms the basis of undue influence is, perhaps, understood since at that time the prevailing English decision was *Lloyds Bank v. Bundy*.<sup>43</sup> In *Bundy's* case, Lord Denning believed that the doctrine of undue influence could be subsumed under the general principle that English courts would grant relief where there has been inequality of bargaining power. However, it is strange to see the subsequent Malaysian cases which were decided after the year 1985 still applying the same position as in *Bundy's* case. Cases like *Malayan Banking Bhd v. Kim Produce Pte Ltd & Ors And Another Action*,<sup>44</sup> *Polygram Records Sdn Bhd v. The Search and Anor*,<sup>45</sup> *Mohd Latiff Bin Shah Mohd & Ors v. Tengku*

<sup>34</sup> [1991] 2 MLJ 448.

<sup>35</sup> [1994] 3 MLJ 127.

<sup>36</sup> [1995] MLJ Lexis 1091.

<sup>37</sup> [1996] 2 MLJ 265.

<sup>38</sup> [1997] MLJ Lexis 501.

<sup>39</sup> [1989] 3 MLJ 301.

<sup>40</sup> [1985] 1 All ER 821.

<sup>41</sup> [2003] MLJ Lexis 166.

<sup>42</sup> [1978] 2 MLJ 267.

<sup>43</sup> [1974] 3 All ER 757.

<sup>44</sup> [1991] 2 MLJ 448.

<sup>45</sup> [1994] 3 MLJ 127.



*Abdullah Ibni Sultan Abu Bakar & Ors And Other Actions*,<sup>46</sup> *Tengku Abdullah Ibni Sultan Abu Bakar & Ors v. Mohd Latiff Bin Shah Mohd & Ors And Other Appeals*<sup>47</sup> and *Oriental Bank Bhd v. Alfabumi (Malaysia) Sdn Bhd & Ors*<sup>48</sup> are cases post-1985 where the position in England had already changed. Lord Denning's observations in that regard in *Lloyds Bank Ltd v. Bundy*<sup>49</sup> were disapproved by the House of Lords in *National Westminster Bank Plc v. Morgan*.<sup>50</sup>

In *Morgan's* case, Lord Scarman stated:

Accordingly, it is, I think, not an unfair summary of the legal position to say that it is only in exceptional circumstances that the equitable remedy of setting aside a transaction on grounds of undue influence will be granted. So, even if a bargain may appear to be harsh, courts are not inclined to intervene unless it can also be demonstrated that the transaction was to the manifest disadvantage of the person subjected to the dominating influence. The foundation of the principle to grant equitable relief of this kind is not inequality of bargaining power but the prevention of victimization by one party of another.

Lord Scarman in *Morgan*, referring to Lord Denning's view in *Bundy*, observed that:

He deliberately avoided reference to the will of one party being dominated or overcome by another. The majority of the court did not follow him; they based their decision on the orthodox view of the doctrine as expounded in *Allcard v. Skinner*, 36 Ch D 145. This opinion of the Master of the Rolls, therefore, was not the ground of the court's decision, which has to be found in the view of the majority, for whom Sir Eric Sachs delivered the leading judgment. Nor has counsel for the respondent sought to rely on Lord Denning's general principle; and in my view, he was right not to do so. The doctrine of undue influence has been sufficiently developed not to need the support of a principle which by its formulation in the language of the law of contract is not appropriate to cover transactions of gift where there is no bargain. The fact of an unequal bargain will, of course, be a relevant feature in some cases of undue influence. But it can never become an appropriate basis of principle of an equitable doctrine which is concerned with transactions 'not to be reasonably accounted for on the ground of friendship, relationships, charity, or other ordinary motives on which ordinary men act' (Lindley LJ in *Allcard v. Skinner*, at p 185). And even in the field of contract I question whether there is any need in the modern law to erect a general principle of relief against inequality of bargaining power.

In *National Westminster Bank plc v. Morgan* Lord Scarman ruled out any general doctrine of inequality of bargaining power on the ground that the task

<sup>46</sup> [1995] 2 MLJ 1.

<sup>47</sup> [1996] 2 MLJ 265.

<sup>48</sup> [1997] MLJ Lexis 501.

<sup>49</sup> [1975] QB 326, at pg. 339.

<sup>50</sup> [1985] AC 686, at pg. 707-8.

of limiting freedom of contract so as to relieve such inequality was essentially a legislative task for Parliament.

It is arguable that Lord Denning repeated the same principle of inequality of bargaining power in later cases such as *Arrale v. Costain Civil Engineering Ltd*<sup>51</sup> and *Levison v. Patent Steam Carpet & Cleaning Co. Ltd.*<sup>52</sup> However, it is evident that it has found little or no judicial support in subsequent case law. Privy Council *Pao On v. Lau Yiu Long*<sup>53</sup> rejected the proposition that a transaction was invalid if obtained by 'an unfair use of a dominating bargaining position.'<sup>54</sup>

Recently, the decision of the Court of Appeal in the case of *Saad bin Marwi v. Chan Hwan Hua & Anor*<sup>55</sup> confirms that the doctrine of inequality of bargaining power does not form a basis for undue influence in Malaysia. That decision confirms the acceptance of the importance of the inequality of bargaining power independent of undue influence as part of Malaysian jurisprudence.

## CONCLUSION

It is therefore not extreme to state that the basis of undue influence, which is fundamental in understanding the concept of undue influence, is in reality vague in Malaysia. Such a situation resulted in the apparent discrepancies in the Malaysian-decided case law and thus blurred the application of the equitable principles of undue influence in a three-party situation in Malaysia. It is hoped that in future Malaysian courts should clearly define the exact basis for setting aside such transaction.

Dr Noor Inayah Yaakub  
Faculty of Law  
Universiti Kebangsaan Malaysia  
43600 UKM Bangi,  
Selangor Darul Ehsan  
Malaysia.

<sup>51</sup> [1976] Lloyd's Rep. 98 at pg. 102 (CA).

<sup>52</sup> [1978] QB 69, at pg. 78-79.

<sup>53</sup> [1980] AC 614.

<sup>54</sup> *CTN Cash and Carry Ltd v. Gallaher Ltd* [1994] 4 All ER 714 at pg.717, per Steyn L.J.; *Horry v. Tate & Lyle Refineries Ltd* [1982] 2 Lloyd's Rep. 416 at pg. 422, per Peter Pain J; *Alec Lobb (Garages) Ltd v. Total Oil (Great Britain) Ltd* [1985] 1 WLR 173; *Burmah Oil Co. v. Bank of England* [1981] 125 S.J 528 per Walton J.

<sup>55</sup> [2001] 3 CLJ 78.