LAW REFORM COMMISSION

OF

PAPUA NEW GUINEA

FAIRNESS OF TRANSACTIONS

WORKING PAPER NO. 5

OCTOBER 1976

PREFACE

In our country many people enter transactions with harsh conditions because they are unable to bargain for better conditions. The bill attached to this working paper would allow transactions containing harsh conditions to be re-opened so that those conditions could be varied and made fairer.. If circumstances change after a transaction has been entered so that it becomes unfair on one party, the bill would allow the transaction to be adjusted to overcome the unfairness.

The proposals in the working paper would make simple but important changes to the law. English law guarantees freedom of contract, but in reality this means the strong and sophisticated have power over the weak and unschooled. The bill attached to this working paper would change the emphasis in the law from guaranteeing the "freedom of contract" to requiring that contracts be fair to all parties to them.

View and comments on the working paper should be directed to -

The Secretary
Law Reform Commission
P. O. Wards Strip
Papua New Guinea

Phone: 258755 or 258941

and they should be submitted before Friday 3rd December, 1976.

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CHAPTER I. INTRODUCTION.

English contract law is based on the theory that people enter into contracts freely, that they bargain out the terms and conditions of their contracts and only seal their bargains when they are satisfied with the terms they have negotiated. The theory also requires, for the sake of certainty, that a contract once entered is binding no matter what happens in the future when the contract is being carried out.

But the theory and reality are rather different. Most contracts we enter are standard term contracts. A trade store owner offers goods at set prices and we either take them at those prices or leave them. Big business organizations offer goods according to their terms. If you want to buy a car or a truck, you buy on the terms and conditions of the dealer or you don't buy at all.

When people enter contracts which will run for sometime, things often happen which change the basis of the contract. One party may have entered to contract on the basis of certain facts e.g. that he could supply the goods sought at a certain price, which turn out not to be true. However English law says that the contract must be carried out to the letter even though subsequent events change the circumstances in which the contract was entered.

The English common law of contract is often harsh and we are not convinced that it suits the needs of our country. It assumes that people enter contracts on equal terms. This is usually not the case in our country. Most Papua New Guineans, like most people in most countries, do not understand much about contract law and very little about the fact that contracts for important things like a car, or for the building of a house or for the supply of certain items over a period, have detailed terms and conditions. They enter contracts with many terms and conditions without knowing the details of what they have undertaken because they believe that in their dealings with businessmen they have no other choice.

We think that the courts should have the power to re-write the conditions of a contracts where one person enters the contract on unequal terms and accepts conditions which place the greater part of the burden of the contract on him. The contract should be rewritten so that its terms and conditions are fair to both parties.

We also think that in the case of a contract which is to run for a period, if circumstances change so that the contract becomes unfair on one party, then if the parties and others affected by the contract cannot settle the matter themselves, the courts should be able to rewrite the contract so that it is fair to all persons affected by it.

Whilst the main principle of English contract law has been that people are bound by the contracts they enter, the courts have for a long time been prepared to let people off contracts they have been induced to enter as a result of sharp practices, or unequal bargaining power. The fact that the party pervailed upon was illiterate, poor and in great need, mentally weak or physically ill are matters which the courts take into account in deciding whether the parties to the bargain were equal.[1]

A recent case serves as an example. In *Lloyds Bank v Bundy*,[2] the defendant, a farmer, had for many years banked at a particular branch of the plaintiff bank. His son ran a company which banked at the same branch. Unfortunately the son's company got into financial difficulties and the father allowed the bank to mortgage his farm to help his son's company. This happened on three occasions. On the last occasion Mr Bundy signed the papers mortgaging his farm most reluctantly. He did so on the advice of the local bank manager who had the papers ready for him to sign. When the son's company finally collapsed, the bank went to court to have Mr Bundy ordered off his farm so that they could sell it to recover the loan they had made to Mr Bundy's son. The Court of Appeal refused to do this and Lord Denning

after reviewing the earlier cases said[3] -

> *They rest on 'inequality of bargaining power'. By virtue of it the English law gives relief to one who, without independent advice, enters into a contract upon terms which are very unfair or transfers property for a consideration which is grossly inadequate, when his bargaining power is grievously impaired by reason of his own needs or desires, or by his own ignorance or infirmity, coupled with undue influences or pressures brought to bear on him by or for the benefit of another.*

The case has been followed in Canada[4].

The unequal bargaining power of companies over individuals has also worried the English courts. In 1954 in *Karsales (Harrow) Ltd v Wallis* a hire-purchase company sold a car to the defendant. But by the time the car was delivered to him it had been damaged and parts in it changed. It would not go and was delivered to him by being towed to his place at night. The defendant refused to accept the car and did not make any payments under the hire purchase agreement he had entered to pay for the car. The hire-purchase agreement contained a clause to the effect that the company gave no undertaking that it was road worthy or that it was fit for the purpose for which it was sold. The Court of Appeal, led by Lord Denning, said that the company could not rely on the clause because they had not carried out their part of the contract. They had fundamentally breached the contract by not supplying a car that worked.

The House of Lords criticised this decision in the *Swisse Atlantique* case in 1966 but Lord Reid acknowledged the problem as follows[5]

> *Exemption clauses differ greatly in many respects. Probably the most objectionable are found in the complex standard conditions which are now so common. In the ordinary way the customer has no time to read them, and if he did read them he would probably not understand them. And if he did understand and object to any of them, he would generally be told he could take it or leave it. And if he then went to another supplier the result would be the same. Freedom to contract must surely imply some choice or room for bargaining.*

But in 1974, the House of Lords struck down a restraint of trade agreement because it was an unequal bargain. In *Schroeder Music Publishing Co. Ltd. v Macaulay*,[6] the defendant composer entered a standard form agreement with the plaintiff publisher to give the publisher all the fruits of his song writing talents for 5 years. The publisher was to have the world copyright of the songs. If they were published or recorded, the composer got royalties, but if the publisher did not use the songs, the composer could not exploit his work himself or give it to another publisher.

Lord Diplock said[7] -

> *Terms of this kind of standard form contract have not been the subject of negotiation between the parties to it, or approved by any organization representing the interests of the weaker party. They have been dictated by that party whose bargaining power, either exercised alone or in conjunction with others providing similar goods or services, enables him to say: "If you want these goods or services at all, these are the only terms on which they are obtainable. Take it or leave it".*

and stuck the agreement down.

Lord Reid's judgement is more conservative, but the inequality of bargaining power of the parties is the crux of his decision[8].

The bill set out in this working paper goes further than the position presently reached by the English law, but we believe we must go in this direction otherwise we could be faced with the absurd situation in which Mr Justice Menzies of the High Court of Australia found himself in 1973. In *South Australian Railways Commissioner v Egan*, His Honour said[9] -

> *This appeal is concerned with perhaps the most wordy, obscure and oppressive contract that I have come across. It is the standard form of contract which the South Australian Railways Commissioner requires those executing railways works for him to sign. It was probably compiled a long time ago mainly by putting together, with some incongruity, provisions from other contracts. In the compilation, I am sure that not one oppressive provision which could be found was omitted. The contract is so outrageous that it is surprising that any contractor would undertake work for the Railways Commissioner upon its terms. It is, of course, a contract to which the doctrine of contra preferentem applies. The employment of such a contract tempts judges to go outside their function and attempt to relieve against the harshness of, rather than give effect to, what has been agreed by the parties. Courts search for justice but it is justice according to law; it is still true that hard cases tend to make bad law.*

and then went on to uphold the contract.

Not all standard form contracts are necessarily bad. Those which have been developed over the years and widely adopted in a field of commercial activity can facilitate the conduct of business. Other standard form contracts can be hammered out in lengthy negotiations and may contain clauses harsh on one party but which may have been agreed to in return for concessions from the other party. The bill we propose does not allow genuinely mutual contracts to be re-opened unless they have led to unforseen and unfair results.

The proposed bill would apply to most contracts and transactions of an economic nature. It is a short bill expressed in simple language. In other countries law reformers have taken a different approach when trying to overcome problems caused when people are forced into harsh contracts by sharp practices or undue pressure. They have recommended very detailed legislation dealing with narrow topics. The Victorian *Consumer Protection Act*, for instance, deals in great detail, amongst other things, with door to door

salesman and unordered goods and services. Consumer Protection legislation in the other Australian states and elsewhere in the world takes a similar narrow and detailed approach. This approach would not suit the needs of our country. Furthermore were are concerned not only with consumer protection, but with seeing that all transactions are fair to all parties to them. And what we need to achieve this purpose is a simple piece of legislation that can easily be understood by all.

CHAPTER 2. THE TRANSACTIONS WITH THE NATIVES ACT.

The *Transactions with the Natives Act*, has been in force since 1958 and it replaced legislation that went back as far as 1893 in Papua and 1921 in New Guinea[1]. That Act covers much of the ground covered by the proposed bill but it has a number of defects.

It has a discrimanatory element in that it applies only to contracts to which a native (an automatic citizen) is a party. We think everyone in Papua New Guinea should be entitled test transactions for fairness regardless of the nationality of the parties.

The Act requires that for contracts to be enforceable they must be in writing and contain the full names and residences of every party and what is to be done under the contract by each of the parties[2]. Whilst this requirement allows people to escape from the consequences of harsh oral contracts, it also means that people can escape from the consequences of oral contracts that might be completely fair[3].

Section 8 is probably the most important provision of the Act. It states -

> *If an action is brought upon a contract by a party to the contract against another party to the contract, the Court which hears the action may, whether the contract has been completely executed by all the parties thereto or not, ignore the terms of the contract and give such verdict as the Court considers equitable.*

The section was intended to empower the courts to restructure unfair contracts but it is rarely used. There are two main reasons for this. First the section is very vague. It does not give the courts any guidance as to the criteria to be used for ignoring the terms of the contract and it leaves it open to the courts to interpret the section narrowly according

to the English common law concepts of contract.

Secondly it seems probable that the section applies only to those contracts which are enforceable under section 6 because they are in writing[4]. Thus a party to a contract which did not comply with section 6, for instance by not having the residence of a party in writing, could not use section 8 to have unfair provisions of the contract set aside and replaced by more equitable ones.

The Act does not apply to job contracts to be carried out by automatic citizens within a month. With the growth of the number of Papua New Guinean tradesmen, this provision could operate to exclude from the Act people who should be entitled to its protection.

As can be seen from this short discussion, the Act has a number of defects. We consider that it should be replaced by legislation that goes further down the path it pioneered and that the new legislation should give more guidance on the matters to be taken into account when restructuring contracts.

CHAPTER 3. THE PROPOSED BILL.

The main thrust of the bill is allow transactions which are unfair to be restructured to that they become fair. In some cases transactions will be so unfair that they will be declared void and of no effect, but in most cases unfair transactions will have their terms changed to make them fair.

The bill encourages the use of mediation to restructure unfair transactions. Arbitration would be used only if mediation has failed.

The bill would ensure the overall fairness of transactions in relation to the way they were entered into, their individual terms and conditions and their results. In the bill, fairness means the equitable distribution of the benefits and disadvantages of the transaction.

The bill would apply to most economic transactions, but it would not apply to transactions like those relating to marriage or the custody of children. Transactions between governmental bodies and either non-citizens or foreign enterprises would be exempted from the operation of the bill.

A transaction could be re-opened if it was not genuinely mutual or if the results of the transaction were unfair to a party. A transaction could, under the bill, be re-opened at any time during its operation or within 3 years of its completion. It could be re-opened more than once, but each time it is re-opened there must be new circumstances not anticipated in the earlier proceedings.

It should be noted that there is already provision for the re-opening of hire purchase contracts in Papua New Guinea. Section 39 of the *Hire-Purchase Act* provides that the National Court may re-open harsh or unconscionable contracts or give relief to a party on an equitable ground.

All those affected by the transaction, including those who would, under English law, be treated as third parties, may join in the proceedings to restructure the transaction.

Lawyers would be able to appear in the proceedings only if all the parties were represented by lawyers. However if under custom a person was obliged or expected to represent a party in proceedings, he would be allowed to do so.

The courts would be required to attempt to mediate disputes brought under the bill and to restructure the mediated transactions. Only when mediation has failed would the courts mediate upon the transaction.

No one would be able to enter a contract to avoid the provisions of the bill and transactions which were defective in certain ways would remain subject to the bill.

If some one started an action under another part of contract law, the courts could use the powers in the bill to restructure a transaction if they thought that doing so would do justice between the parties.

Finally, the bill would repeal and replace the *Transactions with the Natives Act*, 1958 - 1963.

FOOTNOTES.

CHAPTER I.

1. K.L. Fletcher, *Review of Unconscionable Transactions*, (1973) 8. University of Queensland Law Journal 45. See generally.

2. [1975] 1 QB 326.

3. [1975] 1 QB 326 at 339.

4. *McKenzie v Bank of Montreal* (1975) 55DLR (3d) 641. See also a similar approach taken in *Towers v Affleck* [1974] 1 W.W.R. 714 and *Pridmore v Calvert* (1975) 54 DLR (3d) 133.

5. [1967] 1 AC 361 at 406.

6. [1974] 1 W.L.R. 1308

7. [1974] 1 W.L.R. 1308 at 1316.

8. [1974] 1 W.L.R. 1308 at 1314 - 15.

9. (1973) 47 ALJR 140 at 141.

CHAPTER 2.

1. (a) *Transactions with the Natives Ordinance*, 1893-1952 (Papua)
   (b) *Natives' Contracts Protection Ordinance*, 1921-1952 (New Guinea)

2. See Section 6.

3. An attempt to use the Act to have a hire purchase contract declared unenforceable was made in *Edric Eupu v AGC (Pacific) Co. Ltd.* [1971-72] P&NGLR 470 but it failed only because it was held that the rather vague address of "Edric Eupu of Popondetta" was sufficient for the purposes of the Act.

4. Kelly J, obiter dictum in *Edric Eupu v AGC (Pacific)* [1971-72] P&NGLR 470 at 473.

(Law Reform Commission Draft)

Draft of 15/8/1976

THE INDEPENDENT STATE OF PAPUA NEW GUINEA

Fairness of Transactions Bill 1976

ARRANGEMENT OF CLAUSES

PART IV - MISCELLANEOUS

Division 1 - Legal Matters

Division 2 - General

(Law Reform Commission Draft)

THE INDEPENDENT STATE OF PAPUA NEW GUINEA

A BILL

for

AN ACT

entitled

Fairness of Transactions Act 1976

Being an Act relating to the effect of certain transactions, so as to ensure that they operate fairly without causing undue harm to, or imposing too great a burden on, anyone, and in such a way that no one suffers unduly because he is economically weaker than, or is otherwise disadvantaged in relation to, another person.

MADE by the National Parliament to come into operation on a date to be fixed by the Head of State, acting with, and in accordance with, the advice of the Minister, by notice in the National Gazette.

PART I - PRELIMINARY

1. INTERPRETATION.

In this Act, unless the contrary intention appears -

"agreement" includes an agreement that is void, voidable or unenforceable by virtue of any law (otherwise than on a ground of public policy);
"governmental body" has the same meaning as in Section Sch. 1.2(1) of the Constitution;
"lawyer" means a lawyer who is resident in the country;
"this Act" includes the regulations;
"transaction" means any promise, agreement, arrangement or dealing that is intended to have, or that has, a legal effect, and includes an incomplete transaction.

PART II - BASIC PRINCIPLES

2. OBJECTS.

(1) The object of this Act is to ensure the overall fairness of transactions to which it applies, not only as to the manner of entering into

them, or as to their legality, propriety or fairness in individual aspects, but also as to their results.

(2) For that purpose, and subject to the procedural requirements laid down in it, this Act allows for -

(*a*) the re-opening of a transaction (including a completed transaction), irrespective of fault and irrespective of any rule of law concerning the validity, enforceability or effect of any promise or agreement; and

(*b*) the fair distribution of benefits and disadvantages arising out of a transaction.

3. FAIRNESS.

(1) For the purposes of this Act, the concept of fairness relates to the principle of the equitable distribution or redistribution of the ultimate benefits and disadvantages of a transaction.

(2) Accordingly, in the application of this Act, except where the contrary intention appears both circumstances at and before the time of any transaction and circumstances after that time are to be taken into account, as appropriate.

PART III - RE-OPENING OF TRANSACTIONS

4. TRANSACTIONS TO WHICH THIS ACT APPLIES.

This Act applies to and in relation to transactions (other than transactions referred to in Sections 5 and 6) of an economic nature, other than -

(*a*) gifts, whether of a reciprocal nature or otherwise; or

(*b*) transactions that are primarily of a non-economic kind (including transactions relating to marriage, divorce, engagement to marry and custody of children), except to the extent that their economic aspects or consequences can properly be treated separately from their non-economic aspects and consequences.

5. EXCLUDED TRANSACTIONS.

Nothing in this Act applies to or in relation to any transaction as between a governmental body and a non-citizen or a foreign enterprise within the meaning of the *National Investment and Development Act*, 1974.

6. ILLEGAL TRANSACTIONS.

(1) This Act does not allow the enforcement of a promise, agreement or arrangement to break the law or to do something in a manner that involves breaking the law.

(2) Nothing in this Act prevents a court from exercising its powers under this Act in such a way as to prevent a party from gaining advantage or benefit from or arising out of a promise, agreement or arrangement referred to in Subsection (1).

7. GROUNDS ON WHICH TRANSACTIONS MAY BE RE-OPENED.

(1) A transaction to which this Act applies may be re-opened by a court if -

(*a*) the transaction or any agreement or arrangement that was part of, or was associated with, the transaction was not genuinely mutual; or

(*b*) the transaction, or any agreement or arrangement that was part of, or was associated with, the transaction, or the result of the transaction, was otherwise unfair to a party.

(2) A transaction that has been dealt with under this Act may be re-opened if the court is satisfies that there exist new circumstances or circumstances or consequences not anticipated in the earlier proceedings.

(3) For the purposes of Subsection (1) a transaction shall, without limiting the generality of the expression "not genuinely mutual", be deemed not to be genuinely mutual if -

(*a*) a party to the transaction did not understand its nature or terms, or its likely consequences; or

(*b*) a party to the transaction was, in relation to the complainant, in a predominant position (whether economically, socially, personally or otherwise), so that an ordinary person with the background of the complainant was not likely to exercise a true freedom of choice in relation to the transaction; or

(*c*) a party to the transaction had information concerning anything to do with the transaction or its likely consequences that another party did not have; or

(*d*) a party to the transaction was under a mistake or miscalculation as to the transaction or its likely consequences,

unless the court is satisfied that the transaction was in fact entered into on an equal footing in all material respects.

8. LIMITATION OF ACTIONS

Proceedings under this Act must be commenced within three years after the date of the transaction to which they relate.

PART IV.- PARTIES TO AND EXTENSION OF PROCEEDINGS

9. ORIGINAL PARTIES TO PROCEEDINGS.

A person who -

(*a*) derives or derived, or is entitled or was intended to derive, any benefit from the transaction; or

(b) suffers or has suffered, or may suffer, any disadvantage from the transaction,

is entitled to take, or to join in taking, any proceedings under the Act in respect of a transaction to which this Act applies under Part III.

10. JOINDER OF OTHER TRANSACTIONS, PERSONS, ETC.

(1) Where in any proceedings under this Act it appears to the court that in the interests of justice and for the purpose of attaining the object of this Act it is desirable that -

(*a*) some other transactions to which this Act applies should be dealt with in the same proceedings or in association with, or at the same time as, those proceedings; or

(*b*) a person who is not a party to the proceedings should be made a party,

the court may order that the other transaction be so dealt with, or that the person be so joined.

(2) The court may adjourn any proceedings in order to allow for the implementation of an order under Subsection (1).

11. REPRESENTATION IN PROCEEDINGS.

(1) With the approval of the court, a person who, in relation to a transaction -

(*a*) is by law entitled or obliged; or

(*b*) would, in accordance with custom, be permitted or expected,

to stand in the place of a person who is, or is entitled to be or to become, a party to any proceedings under this Act may take such proceedings in relation to the transaction, or may represent a party for the purposes of such proceedings.

(2) A party shall not be represented by a lawyer in proceedings under this Act unless all other parties to the proceedings are represented by lawyers.

PART V - SETTLEMENT OF PROCEEDINGS

12. PRIMARY FUNCTION OF COURTS.

In dealing with proceedings under this Act, the primary function of a court is to adjust the balance of benefits and disadvantages arising out of the transaction in question so as to achieve the object of this Act.

13. MEDIATION.

(1) In all proceedings under this Act, a court shall attempt to arrive at an amicable settlement that conforms with its primary function as set out in Section 12, in the first instance by mediation before exercising its jurisdiction under Section 14.

(2) The court may adjourn any proceedings if it thinks that by so doing such a settlement may be arrived at.

(3) If the court consists of more members than one, one of the members may exercise the mediatory jurisdiction of the tribunal under Subsection (1).

(4) If a mediated settlement in accordance with Subsection (1) is arrived at, the court shall include it in a settlement order, and it is enforceable accordingly.

14. ARBITRATED ORDERS.

If in the opinion of the court the attempt at a mediated settlement, in accordance with Section 13, of any proceedings under this Act has failed and there is no real likelihood of such a settlement being arrived at within a reasonable time, the court shall proceed to hear and determine the matter and make such order between the parties as seems to it just and in conformity with its primary function, in order to settle the matter of the proceedings (including, so far as the court thinks it proper to do so, any transaction dealt with in them or in association with them).

PART VI - MISCELLANEOUS

Division 1 - Legal Matters.

15. CONTRACTING OUT.

A promise, agreement or arrangement the purpose, intention or effect of which is to exclude or restrict the operation of this Act in relation to a transaction is, to the extent that it attempts to do so, ineffective.

16. EXCLUSION OF CERTAIN RULES OF CONTRACT, ETC.

Notwithstanding anything in any law other than this Act, it is immaterial, for the purposes of this Act, whether or not -

(*a*) a transaction, promise, agreement or arrangement is, or is evidenced, in writing or under seal; or

(*b*) there was consideration for any promise; or

(*c*) a promise or agreement was made in any form or with any formalities required by law; or

(*d*) a transaction, promise, agreement or arrangement was otherwise void, voidable or unenforceable.

17. EFFECT OF OTHER LAWS.

In any proceedings commenced in any court under any other law but relating to a transaction to which this Act applies, the court may apply the provisions of this Act if it considers that doing so would do justice between the parties to the proceedings.

Division 2 - General.

18. REGULATIONS.

The Head of State, acting on advice, may make regulations, not inconsistent with this Act, prescribing all matters that by this Act are required or permitted to be prescribed, or that are necessary or convenient to be prescribed for carrying out or giving effect to this Act.

19. REPEAL.

The *Transactions with Natives Act*, 1958 and the *Transactions with Natives Act*, 1963 are repealed.