Chapter 8

VITIATING ELEMENTS

8.1 GENERAL

Evidence of a vitiating element may render a contract void, voidable or unenforceable.

- A **void contract** is a contract where the whole transaction is considered as a nullity. It means that at no time has there been a contract between the parties. Therefore the parties to the agreement must be returned, as far as possible, to their former positions.
- A **voidable contract** is one that operates as a valid contract until one of the parties takes steps to avoid it. This allows the injured party to set the contract aside through the remedy of rescission. The purpose of rescission is to restore the parties to the position that existed before they entered into the contract. Damages are also available to the same effect.
- An **unenforceable contract** is otherwise valid but contains a material defect. Generally such a contract is formatively or operatively illegal, such as being contrary to public policy (the common law) or the will of Parliament (statute). The courts will not enforce such a contract if a party refuses to perform its obligations or they may declare the contract void.

Vitiating elements apply to the following:

- where one party entered into the contract relying upon some statement of the other party, which later proves to have been untrue (misrepresentation);
- where one party was *coerced* by threats to enter into the contract (duress), or by some subtler influence exerted by the other party, which compromised his or her ability to exercise independent judgement (undue influence);
- certain forms of mistake, e.g. a mistake of law; and
- where a contract is invalid for want of a lawful or proper purpose (illegality).

8.2 MISREPRESENTATION

8.2.1 INTRODUCTION

A misrepresentation is an untrue factual statement, made by one party to the other either before or at the time of the making of the contract that does not become a term of the contract, which induces the other to enter the contract. The effect of an actionable misrepresentation is to render the contract *voidable*, giving the innocent party the right to rescind the contract, or to claim damages.

8.2.2 ELEMENTS OF A MISREPRESENTATION

The following core elements must be present for a misrepresentation to arise:

(i) There must be a false statement.
(ii) The statement must be of a material fact.
(iii) The statement must induce the other party to enter into the contract.

8.2.2.1 False Statement

The claimant must show on the facts in each case that the representation was untruthful. If the representation is direct, this is a straightforward matter of presenting the evidence. Proving an indirect representation, however, often requires the court to involve itself in further analysis. Indirect representations may take the following forms:

(i) **Misrepresentation by Silence**

Silence generally does not amount to representation. There is no positive duty of voluntary disclosure, which extends to correcting misapprehensions. A general duty of disclosure might also be too vague, since it would be impossible to specify, precisely, what should be disclosed. However, a person will be liable for misrepresentation where he makes a representation by conduct and fails to correct the impression given by his conduct, e.g. by the concealment of patches of dry rot before selling a flat which was intended to deceive purchasers (*Gordon v Selico* (1986) 18 HLR 219).

(ii) **Half-Truths**

Half-truths, such as describing property as "fully let", without disclosing to the buyer that the tenants had given notice to quit, has been held to be a misrepresentation (*Dimmock v Hallett* (1866) LR 2 Ch 21).

(iii) **Change of Circumstances**

A statement may be true when first made. However, if the circumstances change and it is no longer true, and a party acts or relies on the original statement, a duty to disclose the truth arises; e.g. where a business is now worth less than was originally stated (*With v O'Flanagan* [1936] Ch 575). Similarly, where a representation by conduct induces a contract, it may amount to an actionable misrepresentation. Accordingly, where a pop group participated in promotional activities for the defendant before signing an advertising contract, the fact that the group chose not to disclose that one member was about to the leave the group amounted to misrepresentation by conduct. The misrepresentation was that any member did not intend to leave the group during the term of the advertising contract (*Spice Girls Ltd. v Aprilla World Service BV* [2000] EWHC Ch 140).

(iv) **Contracts of the Utmost Good Faith**

Contracts that involve a duty of utmost good faith (*uberrimae fidei*) impose a duty of disclosure of all material facts. A material fact is said to be one which would influence a prudent and reasonable person to decide whether or not to enter into a contract. For example, under contracts of insurance, all material facts must be disclosed to the insurer. It would clearly be material to the contract if an insured party did not reveal to the insurer previous refusals by another insurance company (*Locker and Woolf Ltd. v Western Australian Insurance Co. Ltd* [1936] KB 408).

Non-disclosure of a material fact by one party may give rise to a right of rescission by the other party. Thus, in *Lambert v Co-operative Insurance Society* [1975] 2 Lloyd's Rep 485, Mrs Lambert made a claim under a household policy that she and her husband had held for nine years. At the commencement of the policy and at each subsequent renewal, the insurer failed to ask whether Mr or Mrs Lambert had any criminal convictions. Nevertheless, when the claim was made, the insurer set the policy aside, on the grounds that there had been a non-disclosure of convictions imposed on Mr Lambert. The principle of *uberrimae fidei* also operates in the following classes of contract:

(i) **Contracts for the sale of land.** The vendor of an estate or interest in land is under a duty to the purchaser to show good title to the estate or interest he has contracted to sell. All defects in title must, therefore, be disclosed. This duty does not extend to physical defects in the property itself;

(ii) **Family settlements.** These are agreements between members of a family for the protection or distribution of family property. If any member of the family has withheld material information, the agreement or arrangement may be set aside (*Gordon v Gordon* (1821) 3 Swan 400; see also *Greenwood v Greenwood* (1863) 46 ER 1339); and

(iii) **Fiduciary relationships.** A fiduciary relationship arises where the parties share a confidential relationship. Some examples include: trustee and beneficiary, solicitor and client, or principal and agent. Such relationships give rise to a duty that the fiduciary will reveal any material fact to the beneficiary. However, this is not a closed list and the duty of disclosure may be extended beyond these usual boundaries, as in *Tate v Williamson* (1866) 2 Ch App 55, where B advised A to sell certain land to raise money to repay his debts, and then offered to buy the land for half its real value. It was held that the contract could be set aside for constructive fraud, as B was aware of certain facts, which were material to the value of the land and which he failed to disclose to A.

8.2.2.2 Material Fact

The statement must be one of past or existing fact; not one of opinion, intention or law.

(i) **Statements of Opinion**

An honest expression of opinion or a statement of belief, rather than a statement of fact, does not give grounds for actionable misrepresentation. In *Bissett v Wilkinson* [1927] AC 177, a statement as to whether a farmer's land could support 2,000 sheep, when both parties were aware that the farmer had not carried out sheep farming upon the land in question, did not justify a claim for rescission of the contract. The farmer's statement as to the carrying capacity of the land was nothing more than an expression of his opinion on the subject.

On the other hand, a statement of opinion by one who knows the true facts, where the other party does not know the true facts, may amount to a statement of fact. This is because, by implication, the person making the statement states that he knows facts which justify his opinion. Accordingly, where the claimant put his hotel on the market, stating that it was let to a "most desirable tenant" when in fact the tenant was actually bankrupt, it was held that the claimant's statement was not mere opinion, but fact based on the claimant's knowledge (*Smith v Land and House Property Corp.* (1884) 28 Ch D 7).

(ii) **Statements as to Future Intent**

A statement as to future conduct or intention is not generally actionable if false and does not bind the person making the statement. However, a false statement of future intention made by a person with no intention of so acting may be interpreted as a statement of fact. In *Edgington v Fitzmaurice* (1885) 29 Ch D 459, the claimant was induced to invest in a company based on prospective investment guarantees regarding future trade. In actual fact, the directors merely intended to use the claimant's investment to discharge existing liabilities. It was held that the statement of intention contained a statement of fact as to the existing state of the directors' mind.

(iii) **Statements of Law**

Contracting parties are presumed to know the law and are expected to seek legal advice rather than relying on the statement. In *Eaglesfield v Marquis of Londonderry* (1876) 4 Ch D 693, Jessel MR said that a statement of fact containing a conclusion of law "is still a statement of fact and not a statement of law". In other words, until a matter has been decided by the courts, a person's statement about the law is essentially just an opinion.

8.2.2.3 Inducement

For the false statement to be actionable there must have been material reliance on the false statement by the induced party:

(i) **Materiality**

If the false statement would have induced a reasonable person to enter into the contract, a presumption arises that it did so. The burden of proof is then shifted to the representor to show that the representee did not *in fact* rely on the false statement. Accordingly, in *Museprime Properties v Adhill Properties* [1990] 36 EG 114, the claimants bought property at an auction after the auctioneer repeated a false statement from the particulars of sale. The court rejected the defendant's assertion that no reasonable bidder would have been influenced by such a misrepresentation and found in favour of the claimants' plea for rescission on grounds of misrepresentation.

(ii) **Reliance**

The claimant must have relied on the misrepresentation. Further, the misrepresentation need not be the *sole* reason for the representee contracting, provided it was a relevant factor. It follows that there will be no inducement in the following circumstances:

(i) **The claimant was unaware of the misrepresentation**

If the statement was not actually communicated to the other party, his action will fail (e.g. where false reports of a company's financial affairs were published, but the claimant had not read them).

In *Horsfall v Thomas* [1862] 1 H&C 90 the sale of a gun was induced by a fraudulent misrepresentation by a seller who had concealed a defect in the gun. There was no actionable misrepresentation, however, because the buyer had not inspected the gun before purchasing it, so the concealment did not induce him to enter into the contract.

(ii) **The claimant did not allow the misrepresentation to affect his judgement**

If the defendant can show that there was no reliance, no grounds of action will arise for misrepresentation. In *Attwood v Small* (1838) 6 Cl&F 232, the claimant negotiated with the defendant for the sale of certain mines, in the course of which the defendant made widely exaggerated claims about their earning capacity. However, the claimant commissioned an independent engineer's report into the viability of the mines, which verified the defendant's statements. The court held that the claimant could not subsequently rescind the contract when the mines in question turned out to be virtually worthless, because he had not relied on the defendant's statement but on the independent report.

(iii) **The representor knew the statement to be untrue**

A misrepresentation is considered to be an inducement even if the representee chose not to discover the truth when given the opportunity. For that reason rescission was permitted where a solicitor purchased a legal practice based on statements that overestimated its value. The fact that the solicitor chose not to take up an offer to examine certain documents, which would have revealed the true facts about the practice, did not deprive him of a remedy (*Redgrave v Hurd* (1881) 20 Ch D 1). It follows that it is not sufficient to mitigate a falsehood, by giving the victim a chance to verify the statement from plans and documents containing the true position. Relief would not be barred where the representee unsuccessfully tried to discover the truth in a case of fraudulent misrepresentation.

8.2.3 CATEGORIES OF MISREPRESENTATION

8.2.3.1 Fraudulent Misrepresentation

Fraudulent misrepresentation is actionable in the tort of deceit. The crux of fraudulent deceit is dishonesty; the maker of the statement does not believe in the truth of the statement. A claimant must prove a fraudulent misrepresentation by showing that:

"...a false representation has been made (1) knowingly, or (2) without belief in its truth, or (3) recklessly, careless whether it be true or false... To prevent a false statement being fraudulent, there must, I think, always be an honest belief in its truth...Thirdly, if fraud be proved, the motive of the person guilty of it is immaterial..." (*Derry v Peek* [1889] LR 14 App Cas 337).

8.2.3.2 Negligent Misrepresentation

A negligent misrepresentation is an honest statement made by a person who has no reasonable grounds for believing it is true. Negligent misrepresentation can be divided into common law misrepresentation and statutory misrepresentation:

(i) **At Common Law**

A negligent misrepresentation is made when a representor, who owes a duty of care to a representee, acts carelessly in making the statement. *Hedley Byrne v Heller & Partners Ltd* [1963] 2 All ER 575 established that damages may be recoverable in tort, in some circumstances, where financial loss is caused by the negligent misstatement. The claimants had relied on a 'without responsibility' reference to extend credit to a third party, given by the third party's bank. The House of Lords held that no duty of care had arisen because the bank's disclaimer was effective. In *obiter dicta*, however, the court held that in the absence of any appropriately worded disclaimer, the bank may have been liable in negligence. This is because where a "special relationship" exists, a duty of care may be owed even if no fiduciary or contractual relationship exists between the parties.

The duty can arise in commercial relationships in which the person making the statement has some special skill or knowledge and the person knows, or can reasonably assume, that the person to whom the statement is made will rely on that statement. The burden of proof rests on the person to whom the statement was made to prove that the statement was a negligent misstatement. Thus, a petrol company which offered an inaccurate forecast of the probable sales of a filling station was held liable in damages to a tenant who contracted with the company on the basis of the forecast; the court also took into consideration the fact that the petrol company had substantial skill and expertise in estimating the potential sales of petrol stations (*Esso Petroleum v Mardon* [1976] 2 All ER 5).

The remedies for negligent misrepresentation are rescission (subject to exceptions, discussed later) and damages in the tort of negligence (*infra*).

(ii) **Under Statute**

The Misrepresentation Act 1967 was introduced with the purpose of addressing the difficulties involved in proving common law negligent misrepresentation.

Section 2(1) of the Act provides:

> "Where a person has entered into a *contract*[8] after a misrepresentation has been made to him by another party thereto and as a result thereof he has suffered loss, then, if the person making the misrepresentation would be liable to damages in respect thereof had the misrepresentation been made fraudulently, that person shall be so liable notwithstanding that the misrepresentation was *not* made fraudulently unless he proves that he had reasonable ground to believe and did believe up to the time the contract was made that the facts represented were true".

One advantage to a claimant who issues statutory proceedings for negligent misrepresentation, rather than for common law fraudulent misrepresentation, is that there is no requirement of a "special relationship". Another advantage is that while statutory damages are the same as common law damages, the burden of proof is reversed, so that the maker of the statement must disprove the misrepresentation. This means that the maker of the statement must prove he reasonably believed the statement to be true and to disprove negligence (*Howard Marine & Dredging Co Ltd v Ogden & Sons (Excavations) Ltd* [1978] 2 All ER 1134).

8.2.3.3 Wholly Innocent Misrepresentation

An innocent misrepresentation occurs where the person making the statement honestly believes it to be true, and it is a statement that is not made fraudulently or negligently. The person making the statement must prove that he or she reasonably believed the statement to be true both at the time the statement was made *and* when the parties entered into the contract.

The remedy is either: (i) rescission with an indemnity; or (ii) damages in lieu of rescission, under the court's discretion, in s. 2(2) Misrepresentation Act 1967.

8.2.4 REMEDIES FOR MISREPRESENTATION

Once an actionable misrepresentation has been established, it is then necessary to consider the remedies available to the injured party. The main remedies available for misrepresentation are rescission and damages. Whilst not mutually exclusive, where rescission by itself provides for a satisfactory remedy, the courts tend to refuse to award damages in order to avoid "double recovery".

8.2.4.1 Rescission

Rescission is the principal remedy for misrepresentation, since all misrepresentations give the innocent party the right to set aside the contract and be restored to the pre-contractual position.

[8] To rely on the Misrepresentation Act 1967, the misrepresentation must have induced the representee to enter into a contract. Where the representor is not a party to a contract, then s. 2(1) will not be available and the representee will only be able to sue under the common law principle of *Hedley Byrne*.

The injured party may rescind the contract, by giving notice to the representor (in the absence of which the representor is entitled to treat the contract as subsisting). There is no need to resort to legal action for a formal order of rescission[9].

However, notice is not always necessary, as any act indicating repudiation, including notifying the authorities or publicising his decision in some other appropriate way, may suffice, if the communication of his decision to rescind is not practicable (such as where the other party has disappeared). To illustrate this, in *Car & Universal Finance v Caldwell* [1965] 1 QB 525, the owner of a car was induced by fraud to sell his car to a rogue, who disappeared and could not be traced. On discovering the fraud, the owner notified the police – an act which was held sufficient to enable him to treat the contract as rescinded, so that an innocent third party, who had bought the car from the rogue, acquired no title to it[10].

One final point to note is that, for innocent misrepresentation, two previous bars to rescission were removed by s. 1 of the Misrepresentation Act 1967:

- the claimant can rescind, even if the misrepresentation has become a term of the contract, even if the false statement was first made as a mere representation (s. 1(a)); and
- the claimant can rescind, even if the contract has already been executed (s. 1(b)); generally, this will be relevant to contracts for the sale of land and to tenancies.

BARS TO RESCISSION:

(i) **Affirmation of the contract**

A representee who affirms the contract, with full knowledge of the facts, cannot subsequently avoid the contract. Accordingly, a claimant who continued to drive a vehicle after realising that its condition had been misrepresented to him had no right of rescission (*Long v Lloyd* [1958] 1 WLR 753). Where the claimant, however, is not aware of his right to choose between acceptance and affirmation, his right to rescind may remain (*Peyman v Lanjani* [1985] 1 Ch 457).

(ii) **Lapse of time**

Rescission is an equitable remedy which applies to both innocent and negligent misrepresentation. The maxim 'delay defeats equity' applies. If the injured party does not act within a reasonable time frame, the right to rescind is lost. In non-fraudulent misrepresentation cases time runs from the date of the contract. Thus, in *Leaf v International Galleries* [1950] 2 KB 86, the claimant's application for rescission of a five-year old agreement to buy a painting, innocently misrepresented by the seller as an original John Constable, failed for lapse of time.

For fraudulent misrepresentation, however, the clock starts when the fraud is, or should have been, discovered (s. 32 Limitation Act 1980).

(iii) **Restitution is impossible**

Where substantial rescission is impossible, the parties cannot be restored to their original

[9] Albeit that this may be desirable, such as where the effect of the rescission is to require one party to pay back a sum of money.

[10] Clearly, the application of this rule can create a dilemma for the court, such as where both parties are innocent: first the representee and then the third party who has innocently acquired the goods in question.

position. This means that the right to rescind is lost. An example is where consumer goods have already been consumed, or where natural resources had been totally exhausted by the time the claimant elected to plead rescission (*Vigers v Pike* (1842) 2 ER 220).

However, as rescission is essentially an equitable remedy, precise restoration is not required and the remedy is still available if substantial restoration is possible. Thus, deterioration in the value or condition of property is not a bar to rescission.

(iv) **Third parties have acquired rights in the subject matter of the contract**

If a third party acquires rights in property, in good faith and for value, the misrepresentee will lose his right to rescind (*Phillips v Brooks Ltd* [1919] 2 KB 243).

A person who relies on a misrepresentation when purchasing goods, and subsequently sells those goods to a good-faith third party purchaser, loses the right to rescind. This is because the third party is considered to have purchased the goods without notice of the representation (s. 2(2) Misrepresentation Act 1967).

(v) **Award of damages in lieu of rescission**

Section 2(2) of the 1967 Act contains a bar to rescission whereby the court may grant an award of damages *in lieu* of rescission if:

- the claimant would have a right to rescind, and
- the misrepresentation was non-fraudulent, and
- it would be equitable to award such damages with reference to the type of representation involved *and* the loss that the claimant would suffer if the contract were to be maintained.

There is uncertainty as to whether the right to award damages *in lieu* exists where the right to rescind has already been lost.

8.2.4.2 Indemnity

Damages are not generally available for a wholly innocent misrepresentation. However, where there has been a wholly innocent, non-negligent, misrepresentation, the courts may order an indemnity along with an order for rescission. The indemnity mandates that the person making the statement must cover the expenses of the person relying on the statement. Such expenses must have directly arisen from the obligations of the contract.

The case of *Whittington v Seale-Hayne* (1900) 82 LT 49 illustrated the distinction between an indemnity and the common law right to damages. The claimants were poultry breeders who were induced to enter into a lease of property belonging to the defendants, by an oral representation that the premises were in sanitary condition. The lease that was later executed did not contain this representation, and the representation was not, therefore, a term of the contract. The premises were, in fact, unsanitary. The claimants (the lessees) claimed an indemnity from the landlords, under the following heads: (i) value of stock lost; (ii) loss of profits; (iii) loss of breeding season; (iv) rent and removal of stores; (v) medical expenses; (vi) rates; and (vii) the cost of repairs ordered by the local authority. It was held that the claimants could recover only those payments which they were contractually bound (under the lease) to make, viz. heads (vi) and (vii). They could not recover removal expenses and consequential loss, etc., as these did not arise from the obligations created, directly, by the contract.

While the Misrepresentation Act 1967 does allow for damages in lieu of rescission[11], this modification of the law is subject to certain limitations:

- it is an equitable remedy within the court's discretion; and
- the award of damages is *in lieu of* rescission: a claimant cannot, therefore, both rescind and be awarded damages for innocent misrepresentation (cf. fraudulent or negligent misrepresentation, for which both remedies can be awarded).

8.2.4.3 Damages

(i) Fraudulent Misrepresentation

A person induced by fraud to enter into a contract may affirm (or rescind) the contract and claim damages for the tort of deceit. The purpose of damages is to restore the victim to the position he occupied before the representation had been made, i.e. the more generous contractual measure of damages versus the tortious measure. The test of remoteness in deceit is that the injured party may recover for all the direct loss incurred, as a result of the fraudulent misrepresentation, *regardless of foreseeability* (*Doyle v Olby (Ironmongers) Ltd* [1969] 2 QB 158).

Not all consequential loss will be recoverable, however. Thus, while in *East v Maurer* [1991] 1 WLR 461, the Court of Appeal agreed with the *Doyle* proposition, it held that the assessment of loss of profits was to be made on a tortious basis, that is, by putting the claimant in the same position he would have been in, had the wrong not been committed (viz. based on the potential profit that could have been made, had the representation been true, rather than on the basis of a contractual warranty that a particular state of affairs should continue). More recently, the Court of Appeal held, in *Downs v Chappell* [1996] 3 All ER 344, that the claimants' damages were to be assessed by reference to what they lost as a result of entering into the transaction. The claimants were not entitled to recover damages after the date he discovered the misrepresentation and had had an opportunity to avoid further loss.

It is not yet clear what measure of damages will be awarded by the courts for fraudulent misrepresentation. In *Smith New Court Securities Ltd v Scrimgeour Vickers (Asset Management) Ltd* [1996] 4 All ER 769, as a result of fraudulent misrepresentation, the claimants were induced to make a bid to buy shares in company F, at a price of 82.5p per share, rather than 78p per share, which is what they would have bid, in the absence of the misrepresentation.

The House of Lords held that, where a fraudulent misrepresentation had occurred, the claimant was entitled to compensation for all damage (consequential losses included), that resulted from the claimant having entered into the contract, regardless of whether such damage was foreseeable or not. Therefore, in the case in question, they were held entitled to receive the difference between what they had paid for the shares (82.5p) *and what they had received from their* ***subsequent*** *sale* (44p), rather than the less generous difference between the contract price (82.5p) and *what the shares would have fetched on the open market at the time of sale* (78p).

[11] Under the common law, damages were only available for fraudulent misrepresentation, based on a tortious action for deceit; whereas for a negligent or innocent misrepresentation, the common law afforded only the remedy of rescission, with no right to damages at common law.

(ii) **Negligent Misrepresentation**

Damages at common law

The injured party may elect to claim damages for negligent misrepresentation at common law. The test of remoteness in the tort of negligence is that the injured party may recover for only reasonably foreseeable loss (*Esso Petroleum Co Ltd. v Mardon* [1976] 2 All ER 5).

Damages under s. 2(1) Misrepresentation Act 1967

Alternatively, the injured party may claim damages for negligent misrepresentation, under s. 2(1) Misrepresentation Act 1967. This will be the normal course to pursue, as s. 2(1) reverses the burden of proof. Damages will be assessed on the same more generous basis as fraudulent misrepresentation, rather than the tort of negligence, i.e. "direct consequence", rather than "reasonable foreseeability" – *Royscott Trust Ltd v Rogerson* [1991] 3 WLR 57. In that case, a car dealer induced a finance company to enter into a hire purchase agreement, by innocently misrepresenting the amount of the deposit paid by the customer. The customer later defaulted and dishonestly sold the car to a third party. The dealer was held liable to the finance company for innocent misrepresentation, under s. 2(1), for the balance due under the agreement. The Court of Appeal held that the measure of damages recoverable, under s. 2(1), was a tortious, rather than contractual one. All the losses occurring as a natural consequence, including unforeseeable losses could, therefore, be recovered, provided they were not otherwise too remote.

(iii) **Wholly Innocent Misrepresentation**

In cases of *non*-fraudulent misrepresentation, there is no automatic right to damages. Instead, under s. 2(2) Misrepresentation Act 1967, the court is given a *discretion*, where the injured party would be entitled to rescind, to award damages in lieu of rescission. Damages under s. 2(2) cannot be claimed as such; they can only be awarded by the court. Section 2(2) states:

> "Where a person has entered into a contract after a misrepresentation has been made to him *otherwise than fraudulently*, and he would be entitled, by reason of the misrepresentation, to rescind the contract, then, if it is claimed, in any proceedings arising out of the contract, that the contract ought to be or has been rescinded the court or arbitrator may declare the contract subsisting and award *damages in lieu of rescission*, if of opinion that it would be *equitable* to do so, having regard to the nature of the misrepresentation and the loss that would be caused by it if the contract were upheld, as well as to the loss that rescission would cause to the other party".

It is not clear, from the above words, if the right to damages will be lost if the representee has lost the right to rescind. According to *Thomas Witter Ltd. v TBP Industries Ltd.* [1996] 2 All ER 573, this will *not* be a bar provided the claimant had such a right in the past.

It is not yet clear what the measure of damages is under s. 2(2). Some authorities suggest that damages, under s. 2(2), may be lower than the damages awarded under s. 2(1). Chitty suggests the possibility of a special measure to compensate the injured party for the loss of the right to rescind. According to contract law experts, Cheshire & Fifoot, compensation should be limited to an indemnity. This was, in substance, the view taken by the High Court in *Thomas Witter Ltd. v TBP Industries Ltd.*

In exercising its discretion as to whether to grant damages in lieu of rescission, the court must have regard to the nature and seriousness of the misrepresentation, the loss that would

be caused if the contract were upheld, and the loss that rescission would cause to the other party. So, where the misrepresentation is trivial and where rescission itself would have serious consequences for the representor, the court is unlikely to grant rescission. *Williams Sindall plc v Cambridgeshire CC* [1994] 3 All ER 932 is a case in point. Land was purchased, in early 1989, for development. Preliminary enquiries failed to discover a private foul sewer running just under the surface of the land. The courts accepted that there had been a mistake, but refused to grant rescission, on the grounds that to do so would be inequitable. The land was now worth only half its value when purchased, due to the rescission, and to order the defendants to return the purchase price and interest would be unfair in the circumstances.

8.2.5 Excluding Liability for Misrepresentation

Any term of a contract which excludes liability for misrepresentation or restricts the remedy available is subject to the test of reasonableness. Section 3 Misrepresentation Act 1967, as amended by s. 8 UCTA 1977, provides that:

> "If a contract contains a term which would exclude or restrict -
>
> a) any liability to which a party to a contract may be subject by reason of any misrepresentation made by him before the contract was made; or
>
> b) any remedy available to another party to the contract by reason of such a misrepresentation;
>
> that term shall be of no effect except insofar as it satisfies the requirement of reasonableness as stated in s. 11(1) of the Unfair Contract Terms Act 1977[12]; and it is for those claiming that the term satisfies that requirement to show that it does".

Cremdean Properties Ltd v Nash (1977) 244 EG 547 was a case in which the claimants purchased two properties for use as office space, by way of sale by tender, on the basis that the total area of available space, as represented in the invitation to tender, was accurate. In fact, it was inaccurate, and the claimants sought to rescind the contracts of sale. For their part, the defendants sought to rely on a clause in the conditions of tender, which disclaimed liability for accuracy of the particulars contained in the invitation to tender, and which explicitly imposed the onus of inspecting the correctness of each of the statements contained in the particulars on the intending purchaser. The Court of Appeal held that the statement was a representation which was false, enabling the provisions of the Misrepresentation Act to be applied.

Notwithstanding the above, it may be difficult to draw a distinction between a clause excluding liability and one defining the authority of, for example, an agent. So, in *Overbrooke Estates Ltd v Glencombe Properties Ltd* [1974] 3 All ER 511, the contract of sale expressly stated that the sellers did not make any representation or warranty in relation to certain premises, and nor did the auctioneers have any authority to make such representation or warranty. Here, the court held that the clause prevented the seller from being responsible for any misrepresentation made; s. 3 could not qualify the right of a principal to publicly limit the otherwise ostensible authority of his agent.

[12] i.e. that the term is a fair and reasonable one to be included having regard to the circumstances which were, or ought reasonably to have been, known to or in the contemplation of the parties when the contract was made.

8.3 DURESS

8.3.1 INTRODUCTION

In order for a contract to be valid, the parties must act freely when entering into their legal obligations. If one of the parties is forced to make the contract by some form of improper pressure, this amounts to (the common law doctrine of) *duress*, and renders the contract voidable. This is because, notwithstanding the overarching principle of freedom of contract, the victim of such pressure cannot be said to have acted freely and voluntarily.

8.3.2 DEFINITION

While the original common law doctrine of duress confined the doctrine to very narrow limits (only duress to the person, in the form of actual or threatened violence to the victim, was recognised during the 19th Century), other forms of duress have gradually been recognised by the law, including damage to goods or business and even a threat to break a contract.

8.3.3 DURESS BY PHYSICAL THREATS OR COERCION

8.3.3.1 Threats of Violence

There must be physical threats or economic pressure amounting to coercion of will exerted on the victim. Whether the victim protested at the time or took steps to avoid the contract once he entered into it will be relevant considerations when determining coercion. Threats of violence would in all likelihood see the contract being set aside. This was the case in *Barton v Armstrong* [1976] AC 104, where the defendant threatened to kill the managing director of a company if he did not arrange for the company to make a payment to, and buy shares from, the defendant. The threat must be illegal to the extent that it would constitute a crime or a tort.

8.3.3.2 Threats to Property

Threats to property were once considered insufficient to amount to duress to enable the threatened party to avoid the contract (*Skeate v Beale* (1840) 11 A&E 983). The courts have been moving away from this stance, however, and in *Occidental Worldwide Investment Corp v Skibs A/S Avanti (The Siboen and The Sibotre)* [1976] 1 Lloyd's Rep 293, it was stated *obiter* that duress would be a defence if a person was forced to enter into a contract because of the threat of having a valuable painting slashed or his house burnt down.

8.3.4 ECONOMIC DURESS

Following the recognition of economic duress as a basis for allowing a party to avoid a contract by the *obiter* statements of Kerr J in *The Siboen and The Sibotre,* the matter was addressed head on in *North Ocean Shipping v Hyundai Construction (The Atlantic Baron)* [1979] QB 705. In *The Atlantic Baron* a building company demanded a 10% increase in the purchase price of a ship that they had already committed to sell, largely due to a devaluation of the US dollar. The purchaser protested that there was no legal basis on which the demand could be made. The company threatened to break the construction contract, in which case, amicable business relations would not continue between the parties, and the purchaser then agreed to pay the increased price. The court held that the illegitimate pressure exerted by the building company amounted to economic duress.

Where the unlawful action threatened is simply a breach of contract, rather than a tort (which may well be the case outside the industrial context), the courts have found it more difficult to police the borders of what constitutes legitimate pressure. In the Privy Council case of *Pao on v Lau Yiu Long* [1980] AC 614; [1979] 3 All ER 65, however, Lord Scarman identified several factors that indicate whether a person acted voluntarily or under duress:

> "... it is material to inquire whether the person alleged to have been coerced did or did not protest; whether, at the time he was allegedly coerced into making the contract, he did or did not have an alternative course open to him such as an adequate legal remedy; whether he was independently advised; and whether after entering into the contract he took steps to avoid it...".

This test was referred to in *Universe Tankships Inc of Monrovia v International Transport Workers Federation, The Universe Sentinel* [1983] 1 AC 366, where Lord Scarman referred to the victim having "no practical choice but to submit to the duress". *The Universe Sentinel* also confirms that, in respect of industrial action, a union's unlawful actions under English employment law will allow claimants to avoid any obligations made as a result of the unlawful behaviour.

More recently, in *Kolmar Group AG v Traxpo Enterprises Pty Ltd* [2010] EWHC 113 (Comm); [2010] 2 Lloyd's Rep 653, Christopher Clarke J, sitting in the High Court, gave a practical summary of how the doctrine of economic duress operates:

(i) economic pressure can amount to duress, provided it may be characterised as illegitimate and has constituted a "but for" cause inducing the claimant to enter into the relevant contract or to make a payment (see Mance J in *S.L. Huyton S.A. v Peter Cremer GmbH & Co* [1999] 1 Lloyd's Rep 620);

(ii) a threat to break a contract will generally be regarded as illegitimate, particularly where the defendant must know that it would be in breach of contract if the threat were implemented;

(iii) it is relevant to consider whether the claimant had a "real choice" or "realistic alternative" and could, if it had wished, equally well have resisted the pressure and, for example, pursued practical and effective legal redress. If there was no reasonable alternative, that may be very strong evidence in support of a conclusion that the victim of the duress was in fact influenced by the threat;

(iv) the presence, or absence, of protest may be of some relevance when considering whether the threat had coercive effect. However, even the total absence of protest does not mean that the payment was voluntary.

8.3.5 REMEDIES

The effect of duress is clearly to make the contract voidable, not void. The injured party will, therefore, be entitled to have the contract set aside for operative duress, unless he has expressly or impliedly affirmed it, allowed time to lapse or if there is an intervention by a third party. He may even be able to recover damages in tort.

Damages are not recoverable for duress, even if the contract is not rescinded. This is because the doctrine of duress was founded upon the basis that no binding agreement existed in the first place due to a lack of true consent, although damages incurred from duress may be recoverable, on a 'reliance' basis, as they are for most categories of misrepresentation.

8.4 UNDUE INFLUENCE

8.4.1 INTRODUCTION

In contrast to the common law concept of duress, undue influence is an equitable doctrine. It applies when one party is able to exert influence over another, to the extent of preventing them from exercising independent judgement, and uses this influence to force them into making a gift or entering into a contract.

There are two classes of undue influence: actual (express) influence; and influence which is presumed from the special relationship between the parties.

8.4.2 ACTUAL (EXPRESS) UNDUE INFLUENCE

Actual undue influence occurs where the claimant can prove that he or she entered into the transaction as a result of undue influence from the other party and would not have done so otherwise. Here, the party seeking to avoid the transaction must prove that the gift or contract was the result of improper pressure, e.g. where a promise to pay money was obtained by a threat to prosecute the promisor's son (*Williams v Bayley* (1866) LR 1 HL 200). The claimant must show, on the balance of probabilities, that the defendant used undue influence in respect of a particular transaction. The claimant need not show that there has been a previous history of such influence, nor show that the transaction was manifestly disadvantageous to the claimant. The doctrine can apply even if it's the first time that the undue influence for the particular disputed transaction has occurred.

8.4.3 PRESUMPTION OF UNDUE INFLUENCE – ON BASIS OF SPECIAL RELATIONSHIP

A transaction can be set aside, in equity, where undue influence is presumed from the relationship between the parties. Here, the onus is on the party receiving the benefit to show that the benefit was *not* obtained by undue influence.

Such a confidential relationship can be established in two ways:

CLASS A: Undue influence will be presumed in cases where a fiduciary relationship exists between the parties (solicitor-client, parent-child, doctor-patient, trustee-beneficiary, religious adviser and disciple, etc.), although not as between husband and wife, in the absence of any particular circumstances of dependency, coupled with mutual trust.

CLASS B: However, even if no fiduciary relationship exists, a confidential relationship may still exist – and a presumption of undue influence raised – if the complainant can prove the existence of a relationship, under which the complainant, generally, reposed trust and confidence in the wrongdoer. The following points should be noted, in respect of Class B cases:

8.4.3.1 No Need to Prove Abuse

Where no fiduciary relationship exists, and in the absence of evidence disproving undue influence, the presumption of undue influence still applies where the complainant can prove that a relationship existed and that trust and confidence was placed in the wrongdoer under that relationship. Thus, there is no need to prove any abuse of that relationship through undue influence by the wrongdoer. By way of example, in *Hewett v First Plus Financial Group* [2010] EWCA Civ 312, the Court of Appeal held that a wife who had reposed a sufficient degree of trust and confidence in her cheating husband gave rise to an obligation of candour

and fairness owed to her. This trust and confidence was sufficient to affect the mortgage company by such undue influence as occurred between her and her husband. This is because her decision to accede to her husband's request to re-mortgage the matrimonial home was based upon an assumption that he was as committed as she was to the marriage, their family and to the preservation of their future home life. The decision in *Hewett* demonstrates that, despite the guidelines set forth by the House of Lords, in *Royal Bank of Scotland plc v Etridge* (No 2) [2001] UKHL 44, lenders still fail to meet their obligations, and are then the subject of such undue influence claims.

A bank/customer relationship will not give rise to the presumption of undue influence unless the customer placed him or herself entirely in the hands of the bank and was provided no opportunity to seek independent advice.

8.4.3.2 Need to Prove "Manifest Disadvantage"

In these cases, therefore, the complainant only has to show, in the first instance, that there was a relationship of trust and confidence between the complainant and the wrongdoer, of such a nature that it is fair to presume that the wrongdoer abused that relationship in procuring the complainant to enter into the impugned transaction. There is no need to produce evidence that actual undue influence was exerted in relation to the particular transaction impugned: once a confidential relationship has been proved, and provided it has been shown that the transaction was "*manifestly disadvantageous*" to the party alleged to be influenced (*National Westminster Bank v Morgan* [1985] 1 AC 686), the burden then shifts to the wrongdoer to prove that the complainant entered into the impugned transaction freely, for example, by showing that the complainant had independent advice.

It should be noted that in cases of "actual" undue influence, whilst the person seeking to avoid the contract must prove improper pressure, it is *not* necessary to prove a manifest disadvantage to the influenced party (*CIBC Mortgages PLC v Pitt* [1993] 4 All ER 433).

8.4.3.3 Case Law on the Presumption of Undue Influence

There have been a number of important cases in this expanding category. The cases emphasise the *nature* of the transaction. Thus, in *Allcard v Skinner* (1887) 36 Ch D 145, Lindley LJ commented:

> "Where a gift is made to a person standing in a confidential relation to the donor, the Court will not set aside the gift of a small amount simply on the ground that the donor has no independent advice. In such a case, some proof of the exercise of the influence of the donee must be given. The mere existence of such influence is not enough in such a case; *...But if the gift is so large as not to be reasonably accounted for on the ground of friendship, relationship, charity or other ordinary motives on which ordinary men act, the burden is upon the donee to support the gift*".

However, the doctrine applies not only to transactions of gift. A commercial relationship can become one in which one party assumes a role of dominating influence over the other. In *Lloyd's Bank v Bundy* [1974] EWCA Civ 8, a guarantee was given to the bank by an elderly farmer, a customer of the bank, for his son's indebtedness. The guarantee was secured by a mortgage of Mr Bundy's house, in favour of the bank. It was held by the Court of Appeal that, as Mr Bundy was liable to be influenced by the bank, which was obtaining a benefit, there was a duty on the bank to ensure that he formed an independent judgement on the transaction. The bank had failed to arrange for the customer to have independent advice. Quite the contrary; it had persuaded Mr Bundy to mortgage his house to the hilt and it did not appear that his son's financial circumstances were likely to improve.

This case can be contrasted with *National Westminster Bank v Morgan* [1985] 1 AC 686. A house was owned, jointly, by Mr and Mrs Morgan. The husband became unable to meet his mortgage commitments, whereupon he made re-financing arrangements with the bank, secured by a mortgage in the bank's favour over the matrimonial home. The bank manager called at the home to get the wife to execute the charge, which turned out (contrary to the advice given to her by the bank manager) to be unlimited in extent, and could, thus, even extend to all of the husband's business liabilities. The wife had not received independent legal advice before executing the mortgage. The husband and wife fell into arrears with their payments, whereupon the bank obtained an order for possession of the home. The wife contended that she had executed the mortgage because of undue influence from the bank and that it should, therefore, be set aside.

Here, the House of Lords held that the manager had not crossed the line between explaining an ordinary business transaction and entering into a relationship in which he had a dominant influence. Moreover, the transaction was not unfair to the wife. If she had suffered loss as a result of the manager's incorrect statement, her remedy would be to sue in respect of misrepresentation or negligent misstatement. A transaction would not be set aside on the grounds of undue influence, unless it could be shown that it was manifestly disadvantageous to the party alleged to be influenced.

This conclusion was reinforced in *BCCI v Aboody* [1989] 2 WLR 759, in which the Court of Appeal disallowed an appeal by a wife, alleging undue influence by her husband, on the basis that there was no manifest disadvantage to the wife. This was because, at the time, she signed guarantee and mortgage documents over the family home in favour of the bank; her husband's business was comfortably supporting her and there was no indication (unlike in *Bundy*) that it would not continue to do so. She had benefited from the business which she secured, and there was a strong probability that the wife would have entered into the transaction, even if the husband had not deliberately concealed from her the nature of the documents she had signed.

8.4.3.4 Undue Influence & Third Parties – Guarantees to Secure Business Loans & Independent Advice

The effect on a transaction brought about by undue influence by a third party typically arises where a wife guarantees her husband's business debt with a bank, by using the jointly owned matrimonial home as security. The courts have held that, in such situations, the transaction with the creditor can be set aside, even though the husband was not a party to the transaction. The law was summarised in *Royal Bank of Scotland plc v Etridge* (No 2) [2001] UKHL 44, which states:

(a) a bank is always put on inquiry where a wife offers to stand surety for her husband's debts;

(b) a bank is also put on inquiry where the wife becomes surety for the debts of a company in which she and her husband both hold shares;

(c) a bank is not put on inquiry where the money is advanced to husband and wife jointly, unless "the bank is aware the loan is being made for the husband's purposes as distinct from their joint purposes".

In *Barclays Bank plc v O'Brien* [1994] 1 AC 180, Lord Browne Wilkinson gave explicit instructions to banks which were getting very nervous as to the correct actions to take when they were under constructive notice of undue influence. This would avoid them being "fixed" with constructive notice. The bank should: "Insist that the wife attend a private meeting (in the absence of the husband) with a representative of the creditor in which she is told the extent of her liability as surety (guarantor), warned of the risk she is running and urged to take independent legal advice". However, in later cases, the private meeting failed to materialise,

and the requirement changed to merely a need to ensure that the wife had independent advice. Lord Nicholls, in *Etridge*, accepted that the banks were not arranging private meetings for valid reasons. The emphasis, therefore, moved to the independent advice wives were receiving. This was not always of high quality, so Lord Nicholls gave detailed instructions to *solicitors* as to their obligations and also gave detailed instruction to banks.

Banks should:

(a) communicate directly with the wife, informing her that, for its own protection, it would require written confirmation from a solicitor acting for her that the solicitor had fully explained the nature of the documents and their practical implications for her;

(b) tell her that the reason for this is that she would not be able to dispute that she is legally bound once she had signed the documents;

(c) the wife should be told that she may use the same solicitor as her husband, but that she must be asked if she would prefer a different solicitor;

(d) the bank must provide the solicitor with all the financial information s/he needs;

(e) the bank should not proceed with the transaction until it has received an appropriate response directly from the wife.

It follows that significant burdens are now placed on solicitors advising those entering into a security arrangement for the borrowing of another person. If the solicitor does not give the kind of independent advice required of him in *Etridge*, he is liable to find himself being sued in negligence and/or breach of contract. The business lender is now entitled to assume that the legal adviser has carried out his function and will have an enforceable security and transaction against the wife. Needless to say, the cost of legal advice in security transactions has risen.

8.4.4 REMEDIES

The remedy, in cases of undue influence, is rescission, in which case the whole transaction will be set aside.

However, in both duress and undue influence cases, the right to avoid the contract may be lost:

- if the party affirms the contract, by performing obligations without protest;
- if the party delays in taking action (laches) after the influence has ceased to have effect;
- if an innocent third party has acquired rights;
- if the parties cannot be substantially restored to their original positions.

Damages are not available for undue influence except in cases where a bank has broken a duty of care to a wife-surety, in which case damages may be available in negligence, under *Hedley Byrne v Heller & Partners Ltd* [1964] 2 All ER 575, as indicated in *National Westminster Bank v Morgan* [1985] 1 AC 686 (*supra*).

8.5 MISTAKE

Mistake occurs where either one or both of the purportedly contracting parties believe that one set of facts exists, and this belief is subsequently shown to be wrong. An operative mistake will render a contract void. The mistake must, however, occur during the formation of the contract

(see *Amalgamated Investment and Property Co Ltd v John Walker & Sons Ltd* [1976] 3 All ER 509).

The main species of mistakes are:

8.5.1 COMMON MISTAKE

Common mistake occurs when both parties are mistaken about the same fact, or set of facts.

Within the specie of common mistake, three further sub-species exist:

(a) Mistake as to the existence of the subject matter of the contract (res extincta)

In *Galloway v Galloway* (1914) 30 TLR 531, a couple, who honestly believed that they had entered into a valid marital separation agreement, saw this agreement rendered void for operative common mistake when they subsequently discovered that the husband's previous wife was still alive. In contrast, *McRae v Commonwealth Disposals Commission* (1951) 84 CLR 377 stands for the principle that, where one of the parties specifically promises that the subject matter exists, then mistake has no role to play, and the other party can sue for breach of the promise. In *McRae*, the Commonwealth advertised a wrecked tanker for sale, which was supposed to be off the coast of Papua New Guinea. *McRae* won the tender, and equipped an expedition to go and salvage it. Although the Commonwealth supplied precise co-ordinates, so that *McRae* should have been able to locate it, it turned out that there was no tanker.

(b) Mistake as to possibility of performing the contract

A contract may be declared void at common law as a result of common mistake where, for example, both parties mistakenly believe that arable land should produce a specific amount of a particular crop in a given season, but this turns out to be physically impossible (*Sheikh Bros Ltd v Ochsner* [1957] AC 136). Similarly, a contract to rent land may be void at common law for legal impossibility, where both parties are oblivious to the fact that the "lessee" is already the legal owner of the land (*Cooper v Phibbs* (1867) LR 2 HL 149). Further, commercial impossibility may void a contract to hire a room to view an event which, at the time of the contract's formation, had already been cancelled (*Griffith v Brymer* (1903) 19 TLR 434).

(c) Mistake as to quality

Whether mistake as to quality fundamentally undermines the contract, so as to render it void, depends on the facts and circumstances. Generally, neither party can rely on his own mistake to void a contract when the issue of quality is engaged.

The starting point when considering mistake as to quality is described in *Bell v Lever Bros Ltd* [1932] AC 224, which stands for the principle that, once a contract has been made (that is to say, once the parties have to all outward appearances agreed with sufficient certainty in the same terms on the same subject matter), then the contract is good, unless and until it is set aside for failure of some condition on which the existence of the contract depends, or for fraud, *or on some equitable ground.* In *Solle v Butcher* [1949] 2 All ER 1107, therefore, a landlord sought to set aside the lease, because it was unfair that the tenant should have the benefit of the lease for the outstanding five years of the term at £140 a year, when the proper rent was £250 a year. The mistake was not operative at common law, but he succeeded in getting the whole transaction set aside in equity, on the ground of this mistake. However, in *Leaf v International Galleries* [1950] 2 KB 86 (*supra*), a contract for

the sale of a painting mistakenly believed by both parties to be by John Constable was not void.

8.5.2 MUTUAL MISTAKE

A mutual mistake occurs when both parties contract, but contemplate different facts. This means that the terms of the agreement are so uncertain that it is impossible to impute any agreement between the parties; both parties are at cross purposes.

In the leading case of *Raffles v Wichelhaus* (1864) 2 H & C 906; 159 ER 375, there was a contract for the sale and purchase of a quantity of cotton. The "Peerless" was designated as the ship that would transport the cotton from India. The buyer arranged to collect the cotton from the quay once it had been unloaded. There were, however, two ships called the "Peerless" due to sail from Bombay; in October and December, respectively. Due to the fluctuation in the price of cotton, a dispute arose. The buyer claimed that he understood the cotton that he was buying was that carried on the October ship. The seller understood the cotton to be the cotton on the December ship. The seller refused to deliver the October shipment to the buyer and the buyer refused to accept the later cotton. Finding for the defendant, the Court of Exchequer found that there was no *consensus ad idem,* and therefore no binding contract.

8.5.3 UNILATERAL MISTAKE

A unilateral mistake occurs where just one party errs regarding a particular fact. Unilateral mistake can take two forms:

(a) Mistaken as to the terms of the offer

This can occur where one party is mistaken as to the terms of the offer and the other party is aware, or ought to be aware, of it. Under these circumstances, the party that is aware of the other party's mistake will be unable to enforce his version of the contract, as he has a duty to disclose the existence of the mistake. For example, in *Hartog v Colin & Shields* [1939] 3 All ER 566, it was customary in the fur trade to sell hare skins per piece. The seller mistakenly offered to sell the skins per pound. This was to the seller's detriment and the buyer's gain. The buyer was considered to have known of the seller's mistake and it was held, under common law rule, that he could not expect to benefit from the gain which would, otherwise, have been made had the contract been valid. Singleton J expressed the view in *Hartog* that:

> "...[T]he offer was wrongly expressed, and the defendants by their evidence, and by the correspondence, have satisfied me that the plaintiff could not reasonably have supposed that the offer contained the offeror's real intention. Indeed I am satisfied to the contrary. That means that there must be judgment for the defendants..."

(b) A unilateral mistake as to the identity of the other party

A unilateral mistake as to the identity of the other party will render the contract void; however, if the mistake is simply one as to the *attributes* of the other party, it will not render the contract void. For example, in *Cundy v Lindsay* (1878) 3 App Cas 459, where a rogue assumed the identity of another person, with fraudulent intent, the contract was held to be void, but in *Kings Norton Metal Co v Edridge* (1897) 14 TLR 98, where a rogue assumed the identity of a fictional person, the contract was held not to be void. For the mistake as to identity to be operative, the mistaken party must be able to show who it was that was the intended contracting party.

8.5.4 DOCUMENTS MISTAKENLY SIGNED

A party that signs a contract in the mistaken belief that he is signing a document of a different nature may be able to plead *non est factum* (it is not my deed). A successful plea of *non est factum* may allow the party to avoid the contract. It must be shown, however, that the mistake was made despite all reasonable care being taken (*Saunders v Anglia Building Society* [1971] AC 1004).

8.6 ILLEGALITY

Illegality, where operative, acts as a defence to the general right that a party would otherwise have to enforce a contract; that is, it acts as a defence to what would otherwise be a valid claim for damages for breach of contract, or to an action for the agreed price. The case law draws a distinction between contracts which are rendered unenforceable by the operation of common law and those rendered unenforceable by operation of statute (i.e. where the statute expressly or impliedly provides that a contract which involves the breach of one of its provisions should be unenforceable by either, or both, parties).

8.6.1 CONTRACTS RENDERED UNENFORCEABLE AT COMMON LAW

(a) Contracts to commit a legal wrong or carry out conduct which is otherwise contrary to public policy:

A contract to commit a crime or other act which is contrary to public policy is illegal and unenforceable by either party. Such contracts are held to be illegal, as formed, or illegal in their inception and are, therefore, unenforceable by either party, whether or not either or both are aware that the intended act is contrary to the law or public policy. *J M Allan (Merchandising) Ltd v Cloke* [1963] 2 QB 340 involved a contract in which the parties were innocently involved in the hire of a roulette wheel, with the express purpose, however, that the wheel be used for a game which was unlawful under the Betting and Gaming Act 1960. The Court of Appeal upheld the defendants' claim that the contract was unenforceable, in opposition to the claimants' demand for payment of the next hire instalment due on the roulette wheel.

Similarly, the court applied the same reasoning in *Oom v Bruce* (1810) 12 East 225; 104 ER 87, when it declared a contract unenforceable, as contrary to public policy, where a contract of insurance was made with an alien enemy after the outbreak of hostilities, despite neither party knowing at the time that the contract was made that war had been declared.

(b) Where one or both parties enter into the contract for the purpose of furthering the commission of a legal wrong, or carrying out conduct which is otherwise contrary to public policy:

A party who enters into a contract with the intention of using it for the commission of a legal wrong, or carrying out conduct which is otherwise contrary to public policy, will not be able to enforce it; e.g. in *Edler v Auerbach* [1950] 1 KB 359, where a lessor let property to a lessee, fraudulently misrepresenting that no planning permission was necessary for the lessee's intended use.

(c) Where one or both parties commits a legal wrong, or acts in a manner which is otherwise contrary to public policy in the course of performing the contract:

Generally, it seems that the commission of a legal wrong or acting otherwise contrary to public policy in the course of performing a contract does not, at common law, affect enforcement. For example, in *Wetherell v Jones* (1832) 3 B & Ad 221; 110 ER 82, the claimant succeeded in an action for the price of goods delivered, despite his unlawful performance in providing an irregular statutory invoice. Lord Tenterden CJ said:

> "...[w]here the consideration and the matter to be performed are both legal, we are not aware that a plaintiff has ever been precluded from recovering by an infringement of the law, not contemplated by the contract, in the performance of something to be done on his part...".

Similarly, in *St John Shipping Corporation v Joseph Rank Ltd* [1957] 1 QB 267, the shipper succeeded in his claim for freight, despite his unlawful performance.

(d) Contracts prejudicial to family life and the status of marriage:

Contractual provisions that are prejudicial to the status of marriage are void. This applies to contracts imposing a restraint on marriage (see *Lowe v Peers* (1768) 4 Burr 2225); to contracts imposing liability for marrying (see *Baker v White* (1690) 2 Vern 615; 23 ER 740); and to contracts providing for future separation of married couples (see *Cartwright v Cartwright* (1853) 3 de GM & G 982).

(e) Contracts to commit a crime or tort:

In *Alexander v Rayson* [1936] 1 KB 169, the claimant had documented an agreement for lease in such a way that he could defraud the Inland Revenue (now HM Revenue & Customs) as to the true rent, and it was, thus, unenforceable.

(f) Contracts to defraud the public revenue:

A contract whose object is to defraud the Inland Revenue (now HM Revenue & Customs) cannot be enforced; e.g. a lease drafted in two separate documents to defraud authorities (see *Miller v Karlinski* (1945) 62 TLR 85).

(g) Contracts prejudicial to the administration of justice:

Contracts prejudicial to the administration of justice are illegal; e.g. *Elliot v Richardson* (1870) LR 5 CP 744, where a contract to give false evidence was declared illegal.

(h) Contracts tending to corrupt public officials:

A contract which interferes with the impartial judgement of a public official, including Members of Parliament, will be illegal; see *Parkinson v College of Ambulance Ltd and Harrison* [1925] 2 KB 1, where a promise of a knighthood was not enforceable, because the scheme involved the commission of a fraudulent misrepresentation.

(i) Contracts promoting sexual immorality:

This head requires the court to apply the moral standards of the day; therefore, due to the shifting tides of public morality, it is currently lessened in significance. In *Pearce v Brooks* (1866) LR 1 Exch 213, a contract for the hire of a stagecoach, which the claimant coachbuilder knew the defendant, a prostitute, intended to use to attract customers, was held to be illegal. It should be noted that contracts of this nature *may* have some future application in England, in respect of so-called super-injunctions, in the context of "kiss-and-tell" stories in the national press, whereby one party to an affair contracts with a national newspaper to "reveal all" about a sexual liaison with a public figure. Basically, the "super-injunction" is an interim injunction which would restrain the divulger from: (i) publishing information which concerns the other person and is said to be confidential or private; and (ii) publicising or informing others of the existence of the order and the proceedings.

8.6.2 CONTRACTS RENDERED UNENFORCEABLE BY STATUTE

(a) Express statutory prohibition

A statute may declare, expressly, that a particular contract is void. In *Curragh Investments Ltd v Cook* [1974] 1 WLR 1559, the defendant claimed that a failure by the claimant to

comply with certain statutory requirements relating to company registration had rendered the claimant's contract for the sale of land illegal and unenforceable. Although, on the facts, he rejected this contention, Megarry J accepted that:

> "... [w]here a contract is made in contravention of some statutory provision then, in addition to any criminal sanctions, the courts may in some cases find that the contract itself is stricken with illegality... If the statute prohibits the making of contracts of the type in question, or provides that one of the parties must satisfy certain requirements (e.g. by obtaining a licence or registering some particulars) before making any contract of the type in question, then the statutory prohibition or requirement may well be sufficiently linked to the contract for questions to arise of the illegality of any contract made in breach of the statutory requirement...".

(b) Implied statutory prohibition

Where the court finds that a contract is impliedly prohibited by statute, it may be unenforceable by the claimant, regardless of his intentions or knowledge of the breach. An unmeritorious defendant, who is aware of and might even have induced the breach of statutory provision, may, therefore, be able to rely on a defence of illegality, in order to defeat a claimant's claim. This is illustrated by *Re Mahmoud and Ispahani* [1921] 2 KB 716, in which the claimant had agreed to sell linseed oil to the defendant. A statutory regulation provided that no person should buy or sell linseed oil, except under, and in accordance with, the terms of a licence issued by the Food Controller. The claimant's licence allowed him to sell linseed oil only to persons who were also licensed. The defendant did not have a licence, but induced the claimant to enter into the contract, by fraudulently misrepresenting that he did. The defendant, subsequently, refused to take delivery of the oil and the claimant sought to enforce the contract, in an action for damages for non-acceptance. The Court of Appeal held that the contract was impliedly prohibited by statute and therefore unenforceable. Bankes LJ said:

> "... [a]s the language of the Order clearly prohibits the making of this contract, it is open to a party, however shabby it may appear to be, to say that the Legislature has prohibited this contract and therefore it is a case in which the Court will not lend its aid to the enforcement of the contract...".

The decision in *Re Mahmoud and Ispahani* was further underlined by Devlin J in *St John Shipping Corporation v Joseph Rank Ltd* [1957] 1 QB 267, 283, who remarked that:

> "... [t]he court will not enforce a contract which is expressly or impliedly prohibited by statute. If the contract is of this class it does not matter what the intent of the parties is; if the statute prohibits the contract, it is unenforceable whether the parties meant to break the law or not".

8.6.3 EXCEPTIONS

Illegal contracts may be enforceable, in deference to the following three situations:

(a) Where the parties are not at equal fault or in pari delicto

In *Hughes v Liverpool Society* [1916] 2 KB 482, an innocent claimant who had paid premiums on an illegal contract of life insurance was allowed to recover what she had paid, on the ground that the defendants had, fraudulently, misrepresented to her that the transaction was legal.

(b) Where the claimant has repudiated the illegal purpose in time

This is where the claimant relies on the doctrine of *locus poenitentiae*, or, where the claimant withdraws from the illegal contract during "the time for repentance". This "repentance" exception mitigates the harshness of the illegality doctrine, which is founded in restitution. In *Taylor v Bowers* (1876) 1 QBD 291, the claimant had handed over certain goods to his nephew, in order to deceive his creditors, one of whom was found to have been a party to the intended fraud. Before any composition with the creditors had been concluded, the nephew assigned the goods without the claimant's consent. No creditors had actually been defrauded, and the claimant successfully sued the defendant in detinue, for the return of the goods. Without early withdrawal from the illegal act, however, the claimant's case will be undermined.

In *Kearley v Thomson* (1890) 24 QBD 742, the claimant had paid money to a firm of solicitors, in return for their agreement not to appear at the public examination of a bankrupt friend, and not to oppose the order for his discharge. After the first part of the agreement had been carried out, the claimant changed his mind and tried to recover his money. The Court of Appeal held that, where the purpose of the contract is simply frustrated by the refusal of the other party to play his part, the exception will not apply. *Taylor v Bowers* was distinguished, on the basis that, in this case, despite performance occurring, no element of the illegal purpose (the fraud on the creditors) had been achieved. Fry LJ noted that:

> "...[w]here there has been a partial carrying into effect of an illegal purpose in a substantial manner, it is impossible, though there remains something not performed, that the money paid under that illegal contract can be recovered back...".

(c) Where the claimant does not found his claim on the illegality

Bowmakers Ltd v Barnet Instruments Ltd [1945] KB 65 stands for the principle that a party can still rely upon some other cause of action, e.g. conversion, if that cause of action does not rely upon having to prove the existence of the contract.

Note that restitutionary recovery may have the same effect as enforcing the contract. Further, if a statute specifically provides for the consequences of a contract contravening one of its provisions, the express statutory language will prevail.

8.6.4 SEVERANCE

Severance allows the court to eliminate the objectionable parts of a contract, while enforcing the remainder. Severance of a clause will only be allowed if the clause forms a subsidiary, rather than substantial, part of the contract. This power is seldom used, as the fear is that it may be considered tantamount to condoning illegal actions. For example, in *Goodinson v Goodinson* [1954] 2 QB 118, a husband and wife entered into an agreement, whereby the husband was to pay the wife maintenance, in consideration for the wife covenanting to indemnify the husband against all debts to be incurred by her, not to pledge the husband's credit, and not to commence or prosecute any matrimonial proceedings against the husband. This third covenant was contrary to public policy, as being a covenant to oust the jurisdiction of the court. However, the court held that this covenant did not vitiate the rest of the agreement, since it was not the only, nor the main, consideration provided by the wife. She was, therefore, able to sue on the agreement, when her husband fell into arrears with the maintenance payments.

8.6.5 CONTRACTS IN RESTRAINT OF TRADE

Generally, contracts in restraint of trade are *prima facie* void and will only be enforceable if reasonable. This means that the contract must go no further than necessary to protect the interest involved, both temporally and geographically. It must be reasonable in terms of the public interest and this will be determined as a matter of law by the court, which may take into account such matters as trade practices and customs. The common law is reluctant to impose restrictions on a person's ability to earn a living (see *Faccenda Chicken Ltd v Fowler* [1987] Ch 117, CA).

8.6.5.1 Employment Contracts

Employment contracts are contracts entered into voluntarily by employer and employee. The two main issues an employer is concerned to protect are: (i) trade secrets; and (ii) business connection.

(i) Trade secrets

A restraint against competition may be justified if the aim of the employer is to prevent the use by the employee of trade secrets acquired in the course of his employment. If the area and duration of restraint is considered to be disproportionate it is likely to be invalid. In *Forster and Sons Ltd v Suggett* (1918) 35 TLR 87, a five-year restraint on a glass maker who had been instructed in confidential glass making techniques by the company was deemed reasonable. Employers cannot prohibit former employees from using their personal skill and knowledge even if acquired in the course of their employer's business, since employees should be free to exploit their assets in the marketplace (see *Faccenda Chicken Ltd v Fowler* (*supra*)).

(ii) Business connection

An employer may use a covenant against solicitation of persons with whom the employer does business. The longer the duration of the covenant, the higher the burden on the employer to show it is reasonable. In *Home Counties Dairies v Skilton* [1970] 1 All ER 1227, the Court of Appeal upheld a one-year restriction on a milkman from serving or selling milk or dairy produce to persons who were customers of his employers six months before leaving his employment. On the other hand, a restriction that precluded the defendants from soliciting clients of their former employer for a six-month period and restricted them from opening a rival employment agency within 3,000 metres of the branch of the company at which they had been employed went beyond what was reasonable, because the area covered most of the City of London where there were already hundreds of other employment agencies concentrated in the same area (see *Office Angels v Rainer-Thomas and O'Connor* [1991] IRLR 214).

8.6.5.2 Sale of Business

Any restraint will be void unless it is necessary to protect the business sold and not to hinder competition. Restraints against mere competition will not be allowed by the courts, such as in the case of *British Reinforced Concrete Co v Schelff* [1921] 2 Ch 563, where a restraint to not sell any road reinforcement in any part of the UK was far too wide in the context of a small business. In *Nordenfelt v Maxim Nordenfelt Guns and Ammunition Co Ltd* [1894] AC 535, however, a worldwide restraint against the seller of a business from competing with the buyer anywhere in the world for 25 years, in consideration of the worldwide connections of the business sold and the fact that its main customers were governments, was valid and enforceable.

8.6.5.3 Exclusive Dealing Agreements

These may be prohibited under Article 101 of the Treaty of the Functioning of the European Union (TFEU) as anti-competitive and may also be challenged under the common law. In order to increase the efficiency of distribution, manufacturers or wholesalers may impose certain conditions on distributors. These agreements are void subject to reasonableness.

In *Esso Petroleum v Harpers Garage* [1968] AC 269; [1967] 1 All ER 699, the owner of two petrol stations entered into a 'solus' agreement to buy all its petrol from Esso, to keep the garages open at all reasonable hours, and to give preference to Esso's oil products. In return, Esso provided a discount on the petrol supplied and provided a mortgage loan. At petrol station A, the solus agreement was to remain in force for four years and five months. At petrol station B, the solus agreement was to remain in force for 21 years. The loan contained a tie covenant and forbade redemption for the 21-year period. When Harpers' offer to pay off the loan was refused by Esso, the former responded by disabling the petrol pumps at petrol station B. Esso applied for an injunction forbidding Harpers from buying or selling any fuel products other than its own as long as either agreement subsisted. The House of Lords refused the injunction and held that the public policy against reasonable restraints of trade applied to both the loan and the solus agreements. While the agreement with petrol station A was reasonable and therefore valid, the agreement with petrol station B for the loan and the 21-year solus agreement were invalid.

The Court of Appeal subsequently upheld a 21-year solus agreement in *Alec Lobb Garages v Total Oil (GB) Ltd* [1985] 1 All ER 303, where the restrained party had received a substantial sum from the restraining party. The court applied the dicta in the *Nordenfelt* case, namely that "...the quantum of consideration may enter into the question of the reasonableness of the contract".