5

Incapacity

Causes of contractual incapacity

In the topics which we have so far discussed, we have assumed that the transaction takes place between parties neither of whom is under any contractual disability from making a valid contract. It is now necessary to deal with disabilities, in other words, with the topic of incapacity.

Certain limitations are, by law, placed upon the capacity of certain persons to bind themselves by a promise, or to enforce a promise made to them. These persons are:

(1) The Crown and public authorities;
(2) minors;
(3) corporations;
(4) mentally disordered and drunken persons.

The consequences of incapacity are not, however, always identical. In some cases the contract is void, in others voidable, while in others it is unenforceable at the suit of one or both parties. It is necessary to examine the rules applicable to each particular case.

We shall also see that the policy of protecting those under an incapacity by refusing to enforce contracts against them can inflict hardship upon those who deal with an incapacitated person in good faith and in ignorance of the lack of capacity. Moreover, until recently, the non-recognition of independent restitutionary obligations[1] meant that an incapacitated party to whom money had been paid or property transferred might be unjustly enriched at the expense of the other. Security of transactions between companies and local authorities and those who deal with them has been enhanced by substantial statutory modification of the *ultra vires* doctrine so as to make many contracts enforceable.[2] And the development of the law of restitution means that, even where the contract is void or unenforceable, money paid and property transferred will, in general, be recoverable, unless this would amount to indirect enforcement of the contract.[3]

[1] But see now *Lipkin Gorman* v. *Karpnale Ltd.* [1991] 2 A.C. 548, *ante*, p. 21.
[2] *Post*, pp. 208, 227.
[3] *Westdeutsche Landesbank Girozentrale* v. *Islington L.B.C.* [1994] 4 All E.R. 890, aff'd [1996] 2 A.C. 669 *post*, pp. 211, 221, 228.

I. The Crown and Public Authorities[4]

(a) The Crown

Crown contracts

The Crown may contract with a subject and it has always been possible for the Crown to enforce against a subject a contract so made. But before the passing of the Crown Proceedings Act 1947 no action in contract could be brought against the Crown or against a government department. The reason for this was that the personal immunity of the Crown from legal proceedings—'the King can do no wrong'—was not distinguished from its political immunity. But this procedural barrier was more theoretical than substantive, for the subject could obtain a remedy by means of a process known as Petition of Right.[5] Since 1947, actions by or against the Crown in contract are, for the most part, governed by the same rules of procedure as actions between subjects and the same remedies are available, save that no injunction or order of specific performance can be made against the Crown in 'civil proceedings'.[6] Crown contracts are subject to the procurement procedures and remedies required by European Community law, which are considered later in this chapter.[7]

Although contracts made with government departments or Crown officers are not subject to the *ultra vires* doctrine,[8] rules which arise from the fact that such bodies have statutory and prerogative powers and duties of a public law nature affect contracts made by them. In both Crown contracts and the contracts of public authorities, it is therefore necessary to consider these public law rules as well as the common law and statutory position.

Parliamentary funds

In *Churchward* v. *The Queen*[9] the Admiralty undertook to pay the plaintiff £18,000 a year for the carriage of cross-channel mails from Dover to Calais and Ostend. Appropriation of funds for this contract was expressly forbidden by Parliament. The plaintiff sued for the promised sum but failed on the ground that the contract provided for payment to be 'out of moneys provided by Parliament' and no such moneys were provided. Shee J. went further, stating that 'the providing of funds by Parliament is a condition precedent to [the covenant] attaching'. On the basis of this *dicta* it has been said that 'all obligations to pay money undertaken by the Crown are subject to the implied condition that the funds necessary to satisfy the obligation shall be appropriated by Parliament',[10] but the

[4] See generally Turpin, *Government Contracts* (1989); Arrowsmith, *The Law of Public and Utilities Procurement* (1996). See also Mitchell (1950) 13 M.L.R. 318, 455.

[5] Petitions of Right Act 1860.

[6] Crown Proceedings Act 1947, s. 21. But injunctive relief may be given in proceedings for judicial review: *M.* v. *Home Office* [1994] 1 A.C. 377.

[7] *Post*, p. 210.

[8] But the powers of certain Ministers have been defined by statute (e.g. Supply Powers Act 1975; Ministers of the Crown Act 1975) which may limit the capacity of the Crown (*Cugden Rutile (No. 2) Ltd.* v. *Chalk* [1975] A.C. 520) or the authority of its agents (*post*, p. 207).

[9] (1865) L.R. 1 Q.B. 173, at p. 210.

[10] *N.S. Wales* v. *The Commonwealth (No. 1)* (1932) 46 C.L.R. 155, at p. 176; *Macbeath* v. *Haldimand* (1786) 1 Term R. 172, at p. 176; *Mackay* v. *Att.-Gen. for British Columbia* [1922] 1 A.C. 457, at p. 461; *Att.-Gen.* v. *Great Southern and Western Ry. of Ireland* [1925] A.C. 754, at p.773.

better view, supported by *New South Wales* v. *Bardolph*,[11] a decision of the High Court of Australia, is that the Crown is under no antecedent incapacity in this respect. Parliamentary approval, or the lack of it, in no way affects the validity of a Crown contract, and the provision of funds is simply a condition to be fulfilled before actual payment by the Crown, a condition that is satisfied where there is a fund in existence out of which payment can lawfully be made.

Future executive action

It is an important principle of public law that public bodies, including the Crown, should preserve the discretionary powers granted to them by statute or common law prerogative, and not divest themselves of those powers.[12] In the present context this principle may conflict with the principle of sanctity of contracts. In *Rederiaktiebolaget Amphitrire* v. *The King* Rowlatt J. stated that 'It is not competent for the Government to fetter its future executive action, which must necessarily be determined by the needs of the community when the question arises. It cannot by contract hamper its freedom of action in matters which concern the welfare of the State'.[13] In that case:

> The Swedish owners of the ship *Amphitrite* obtained from the British legation in Stockholm a guarantee that, if the ship sailed to England with an approved cargo, she would be allowed a free passage and not detained as the result of a wartime blockade of Germany. The ship was nevertheless refused a clearance and her owners brought a petition of right against the Crown claiming breach of contract.

Rowlatt J. held that the guarantee was not a contract for the breach of which damages could be sued for in a court of law; it was merely an expression of intention to act in a particular way in a certain event, because the Crown could not by contract fetter its future executive action.

It is difficult to determine the proper scope of Rowlatt J.'s statement, which has been powerfully criticized on the ground that it is expressed too generally.[14] Three issues must be separated; the validity of the contract *ab initio*; secondly, whether, assuming the contract is valid, the Crown is thereafter under a duty to exercise its powers in a manner consistent with it; and thirdly, whether, assuming there is no valid contract, the Crown is nevertheless precluded from exercising its discretion in a particular way by an estoppel or the application of the emerging public law principle of legitimate expectation.[15]

As far as the first issue is concerned, Rowlatt J. acknowledged that the Crown can bind itself by a commercial contract.[16] *The Amphitrite* was not such a case, but

[11] (1934) 52 C.L.R. 455.

[12] See *post* pp. 208–9, and see generally Wade and Forsyth, *Administrative Law*, 7th edn. (1994), p. 366 ff.

[13] [1921] 3 K.B. 500, at p. 503.

[14] *Robertson* v. *Minister of Pensions* [1949] 1 K.B. 227; *per* Denning J. at p. 231; *Ansett Transport Industries (Operations) Pty. Ltd.* v. *Commonwealth* (1977) 139 C.L.R. 54, at pp. 74, 113–14; *A* v. *Hayden (No. 2)* (1984) 56 A.L.R. 82, at p. 86 (Australia). But see *Commissioners of Crown Lands* v. *Page* [1960] 2 Q.B. 274, *per* Lord Evershed M.R. at p. 287.

[15] *Post*, p. 210.

[16] [1921] 3 K.B. 500, at p. 503. See also *Robertson* v. *Minister of Pensions* [1949] 1 K.B. 22; *per* Denning J. at p.231. Estoppels may arise in respect of such contracts: *Attorney-General of Hong Kong* v. *Humphreys Estate (Queen's Gardens)* [1987] A.C. 114, at pp. 127–8.

the distinction between 'commercial' and 'non-commercial' contracts has been criticized as unworkable in practice because commercial contracts tend to conflict with 'governmental' obligations,[17] and it is difficult to see how, for instance, procurement contracts involving large capital expenditure are to be classified.

Where a Crown contract has been validly entered into, the Crown's freedom to exercise its discretionary powers (whether statutory or prerogative) will not, as a matter of construction, be impliedly excluded by the contract. Even in the case of commercial contracts, the Crown must be free to exercise the discretionary powers conferred upon it for the public good.[18] 'No one can imagine, for example, that when the Crown makes a contract which could not be fulfilled in time of war, it is pledging itself not to declare war for so long as the contract lasts.'[19] Thus, it has been held that an *implied* covenant for quiet enjoyment in a Crown lease did not prevent the Crown from requisitioning the premises.[20] The Crown must be at liberty to detain ships, to requisition property, or to perform other essential acts in time of war, and, although the position of an *express* undertaking is less clear,[21] it is submitted that 'no contract would be enforced in any case where some essential governmental activity would be thereby rendered impossible or seriously impeded'.[22] Furthermore, in such cases, a party is unlikely to be able to invoke the principle of estoppel; it is generally recognized that 'estoppel cannot be allowed to hinder the formation of government policy'.[23] A negligent misstatement by the Crown may, however, give rise to liability in tort.[24]

In practice the rule stated in *The Amphitrite* does not often have to be applied since many contracts falling within its scope contain cancellation clauses which usually make provision for compensation.[25]

Crown employees

The general rule is that persons in Crown employment hold office during the pleasure of the Crown, and at common law Crown servants can be dismissed at any time by the Crown and no action lies for wrongful dismissal.[26] In the older

[17] Mitchell, *The Contracts of Public Authorities* (1954), p. 62. See also *Ansett Transport Industries (Operations) Pty. Ltd.* v. *Commonwealth* (1977) 139 C.L.R. 54, at p. 113.

[18] *Commissioners of Crown Lands* v. *Page* (*supra*, n. 14). Cf. *Ansett Transport Industries (Operations) Pty. Ltd.* v. *Commonwealth* (*supra*, n. 14).

[19] *Commissioners of Crown Lands* v. *Page* (*supra*, n. 14), *per* Devlin L.J. at p. 292.

[20] *Ibid.*

[21] In *Commissioners of Crown Lands* v. *Page* (*supra*, n. 14), Devlin L.J. at p. 292 thought nothing turned on this but Evershed M.R. and Ormrod L.J. reserved their position. Devlin L.J.'s view is inferentially supported in *Ansett Transport Industries (Operations) Pty., Ltd.* v. *Commonwealth* (*supra*, n. 14).

[22] Mitchell, *The Contracts of Public Authorities* (1954), p.7. Cf. Holdsworth (1929) 45 L.Q.R. 166.

[23] *Laker Airways Ltd.* v. *Department of Trade* [1977] Q.B. 643, at pp. 680–2, 707, 709, 728. See also *Howell* v. *Falmouth Boat Construction Co. Ltd.* [1951] A.C. 837; *Hughes* v. *D.H.S.S.* [1985] A.C. 776. Cf. *Robertson* v. *Minister of Pensions* [1949] 1 K.B. 227; *per* Denning J. at p. 232.

[24] *Ministry of Housing and Local Government* v. *Sharp* [1970] 2 Q.B. 223. Cf. *Yuen Kun Yeu* v. *Attorney-General of Hong Kong* [1988] A.C. 175.

[25] See generally Turpin, (*supra*, n. 4), at pp. 243–6.

[26] *Shenton* v. *Smith* [1895] A.C. 229; *Dunn* v. *The Queen* [1896] 1 Q.B. 116; *Terrell* v. *Colonial Secretary* [1953] 2 Q.B. 482; *Riordan* v. *War Office* [1959] 1 W.L.R. 1046; *Att.-Gen. for Guyana* v. *Nobrega* [1969] 3 All E.R. 1064; *Thomas* v. *Attorney-General of Trinidad and Tobago* [1982] A.C. 113; *R.* v. *Civil Service Board, ex parte Bruce* [1988] I.C.R. 649 , aff'd. [1989] I.C.R. 171. Cf. *Reilly* v. *R.* [1934] A.C. 176, at p. 179 but note *Terrell* v. *Secretary of State for the Colonies* [1953] 2 Q.B. 482, at pp. 498–9.

cases the reason given for this rule was that the relationship between the Crown and its servants is not one of contract at all, but of status.[27] But this may in fact reflect the absence of an intention to contract on the part of the Crown and more recently it has been said that 'there is nothing unconstitutional about civil servants being employed by the Crown pursuant to contracts of service'.[28] The modern and better view is that there can be a valid contract of employment, although this is always determinable at the pleasure of the Crown.[29] But there are conflicting decisions as to whether the use of language of obligation or even of the word 'contract' suffices to indicate an intention by the Crown to enter into a contractual relationship.[30]

Employment Rights Act 1996

Whether or not the relation is contractual, the power of the Crown to dismiss at pleasure without payment of compensation is now limited by statute. The remedies available for unfair dismissal now contained in the Employment Rights Act 1996 extend to Crown employees, including members of the military services.[31]

Public law remedies

If the relationship is not contractual then, although dismissal in breach of the terms of the appointment will not, according to the bulk of the authorities, give rise to a cause of action at common law, it may be susceptible to the public law remedy of judicial review where it is *ultra vires*, an abuse of discretion, or where the principles of procedural fairness have not been observed.[32]

Liability of employees

Where an intention to contract is established, it is submitted that the Crown can sue its employees for breach of contract.[33] Even where the relationship is not contractual, remedies may be available against the employees in certain circumstances, such as breach of confidence, where restitution of any profits made may be ordered.[34]

Crown agents

If a servant or agent of the Crown assumes an authority which he or she does not possess, and enters into an unauthorized contract, the Crown will not be bound unless it has held the agent out to have authority.[35] 'The right to act for the Crown in any particular matter must be established by statute or otherwise.'[36]

[27] *Shenton* v. *Smith* (*supra*, n. 26); *Rodwell* v. *Thomas* [1944] K.B. 596; *Inland Revenue Commissioners* v. *Hambrook* [1956] 2 Q.B. 641.

[28] *R.* v. *Civil Service Board, ex parte Bruce* [1988] I.C.R. 649, *per* May L.J. at p. 660, aff'd. [1989] I.C.R. 171.

[29] *Kodeeswaran* v. *Att.-Gen. of Ceylon* [1970] A.C. 1111, at p. 1123.

[30] Cf. *McClaren* v. *Home Office* [1990] I.C.R. 84 (no contract) and *R.* v. *Lord Chancellor's Department, ex parte Nangle* [1991] I.C.R. 743 (contract).

[31] Employment Rights Act 1996, s. 192. See also Trade Union and Labour Relations (Consolidation) Act 1992, ss. 152, 273 (dismissal on grounds of trade union membership, activities, or non-membership).

[32] *R.* v. *Secretary of State for the Home Department, ex parte Benwell* [1985] Q.B. 554; *Council of Civil Service Unions* v. *Minister for the Civil Service* [1985] 1 A.C. 374. See also Walsh [1989] P.L. 131; Fredman and Morris (1991) 107 L.Q.R. 298; [1991] P.L. 485. On estoppel, see *ante*, pp. 110, 117; *post*, p. 210.

[33] But see *Fisher* v. *Steward* (1920) 36 T.L.R. 395. The terms are deemed to constitute a contract for the purposes of the economic torts: Trade Union and Labour Relations (Consolidation) Act 1992, s. 245.

[34] *Attorney-General* v. *Blake* [1997] Q.B. 84, aff'd [1998] 1 All E.R. 833.

[35] *Att.-Gen. for Ceylon* v. *Silva* [1953] A.C. 461; *Robertson* v. *Minister of Pensions* [1949] 1 K.B. 227; *per* Denning J. at p. 231.

[36] *Ibid.*, at p. 479.

It is only if the act is within the agent's ostensible authority that the Crown may be estopped from going back on a representation which the agent has made.[37] Furthermore, an agent of the Crown who contracts on behalf of the Crown cannot be sued, either on the contract or for breach of warranty of authority.[38]

(b) Public Authorities

Doctrine of *ultra vires*

Public authorities whose powers are the product of and defined by statute are subject to the doctrine of *ultra vires*, which is a necessary consequence of the statutory nature of the powers of such authorities. So, for instance, at common law the contracts of local authorities will be void unless they relate to functions which the authority is authorized, expressly or impliedly, to perform, or unless the acts are calculated to facilitate, or are incidental to, the discharge of those functions.[39]

The purpose of the *ultra vires* rule is to protect the public funds entrusted to such bodies, in the case of local authorities, by local taxpayers. But it has proved a trap for the unwary and can inflict grave hardship on persons who deal *bona fide* with an authority in ignorance of its lack of capacity. So banks which participated in housing or recreational schemes by local authorities either as a joint venturer or a guarantor, and other banks which entered into interest rate swaps with local authorities, could not sue on their contracts when they were held to be *ultra vires*.[40] The result was uncertainty and concern that private sector companies would be reluctant to enter into transactions with local authorities.

Statutory modification of *ultra vires* doctrine

In the case of contracts by local authorities for the purposes of or in connection with the discharge of any of their functions which are intended to operate for a period of at least 5 years, the matter has been addressed in the Local Government (Contracts) Act 1997. Section 2 of the Act provides that where a local authority has issued a certificate stating that it has power to enter into the contract and containing information about the statutory provisions conferring the power and the purpose of the contract, the contract has effect 'as if the local authority had had power to enter into it (and exercised that power properly in entering into it)'. The purpose of the legislation is to render contracts enforceable, and it will still be possible to challenge the power of an authority to enter a contract in judicial review proceedings or an audit of the authority's activities.[41]

Incompatibility with statutory purpose

Those dealing with public authorities may also encounter the overriding considerations of public utility which we observed in the case of *The Amphitrite*, if a statutory discretion conferred upon a public authority conflicts with the terms of

[37] *Robertson* v. *Minister of Pensions* [1949] K.B. 227. But contrast *ibid.*, at p. 232, and see *Re L. (an infant)* [1971] 3 All. ER. 743; *Laker Airways, Ltd.* v. *Department of Trade* [1977] Q.B. 643. See also, *post*, p. 210.

[38] *Dunn* v. *Macdonald* [1897] 1 Q.B. 555 applied in *The Prometheus* (1949) 82 Ll.L.Rep. 859. For criticism, see Wade and Forsyth, *Administrative Law*, 7th edn. (1994), p. 835.

[39] See e.g. *Hazell* v. *Hamersmith & Fulham L.B.C.* [1992] 2 A.C. 1; *Credit Suisse* v. *Allerdale B.C. and Waltham Forest L.B.C.* [1997] Q.B. 306 and 362. But see Local Government Act 1972, s. 137, and cf. *ibid.*, s.161. See also *ibid.*, s. 135

[40] *Hazell* v. *Hamersmith & Fulham L.B.C.* (*supra*, n. 39) and *Credit Suisse* v. *Allerdale B.C. and Waltham Forest L.B.C.* (*supra*, n. 39).

[41] Local Government (Contracts) 1997, s. 5.

a contract. A public authority is not competent to fetter the discretion entrusted to it by Parliament if this would disable it from fulfilling the primary purpose for which it was created. 'If a person or public body is entrusted by the legislature with certain powers and duties expressly or impliedly for public purposes, those persons or bodies cannot divest themselves of these powers and duties. They cannot enter into any contract or take any action incompatible with the due exercise of their powers or the discharge of their duties.'[42] Thus in *Ayr Harbour Trustees* v. *Oswald*,[43] the House of Lords held that the trustees of Ayr Harbour, who had statutory power to acquire land and build on it, could not fetter this power by a covenant with the former owner of the land not to build on it so as to obstruct his access to the harbour. And in *York Corporation* v. *Henry Leetham & Sons*:[44]

The Corporation entered into a covenant with the defendants to allow them to use two rivers which the Corporation maintained and managed under statutory authority in return for an annual payment of £800 in place of the tolls the Corporation was authorized to charge by the statute.

It was held that this covenant was not one which the Corporation was competent to make because it thereby disabled itself from exercising its statutory powers to increase tolls as necessary in order to perform its statutory duty.

On the other hand, in *Birkdale District Electric Supply Co.* v. *Southport Corporation*:[45]

B, the statutory undertaker for the supply of electricity in Birkdale, was sued by the respondent on an agreement by which B had bound itself not to charge higher prices for electricity than those charged in the borough of Southport. It repudiated this agreement on the ground that it was incompatible with the due discharge of its statutory duties.

The House of Lords held that the agreement was nevertheless binding upon B. It was not wholly incompatible with the fulfilment of the purposes of the statute which empowered B to act as an electricity undertaking. The distinction between this case and the *York Corporation* case is by no means clear but it would seem that a public authority is only incompetent to contract where the contract in question is clearly proved to be incompatible with the full observance of the terms and the full attainment of the purposes for which the statutory powers have been granted. But it possesses contractual capacity where the agreements are mere contracts restricting the undertakers' freedom of action in respect of the business management of their undertaking.[46]

A public authority cannot be estopped by its previous conduct so as to hinder its obligation to carry out its statutory powers or duties. But it has been held that a defect in procedure can be cured, so, if an officer, acting within the scope of his

[42] *Birkdale District Electric Supply Co.* v. *Southport Cpn.* [1926] A.C. 355, *per* Lord Birkenhead at p. 364. But see *Lever (Finance) Ltd.* v. *Westminster Cpn.* [1971] 1 Q.B. 222 (estoppel).

[43] (1883) 8 App. Cas. 623. See also *Cory (William) & Son Ltd.* v. *London Cpn.* [1951] 2 K.B. 476; *Triggs* v. *Staines U.D.C.* [1969] 1 Ch. 10; *Dowty Boulton Paul Ltd.* v. *Wolverhampton Cpn.* [1976] Ch. 13.

[44] [1924] 1 Ch. 557.

[45] [1926] A.C. 355.

[46] [1926] A.C. 355, *per* Lord Sumner at pp. 369, 370.

or her ostensible authority, purports to waive an irregularity, on which another person acts, the public authority may be bound by it.[47]

Estoppel and legitimate expectation

A public authority may also be under a public law duty to act consistently with an arrangement which does not give rise to a contract or an estoppel. This is because a person who, as a result of the words or conduct of a public authority, has a legitimate expectation that a benefit will be granted or continue to be enjoyed, may be able to argue that later inconsistent action is an abuse of power and reviewable on the ground of unfairness.[48] Inconsistency is, however, not necessarily unfair, and the Courts will not let an arrangement that has given rise to a legitimate expectation hinder the formation of policy. For example, an authority that has received and resolved to receive a tender from its own workforce might choose to abandon the project or seek fresh tenders.[49]

Pre-contractual procedures and refusal to contract

Although the general rule, based upon the principle of freedom of contract, is that a person can choose with whom to contract and with whom not to contract,[50] in the case of public authorities this freedom is limited. Both legislation and the regulations implementing European Community Directives on public sector contracts, and the general principles governing the exercise of discretionary powers may invalidate refusals to contract at all or only on particular terms. Such refusals may be based on a policy that amounts to an improper fetter on an authority's discretion or be 'unfair' in the light of an individual's legitimate expectations. For instance, a decision not to contract with a company in part motivated by the wish to procure it to cease trading with South Africa during the apartheid era was held to be *ultra vires*.[51]

Statutory and E.C. controls

Under the Local Government Act 1988, local authorities are required to exercise their contracting functions (including invitations to tender) without reference to 'non-commercial matters'.[52] Public authorities must, furthermore, not discriminate against nationals or products of other European Community states in awarding major contracts.[53] To this end publicity in the form of Community-wide advertising and standard tendering procedures are required, non-discriminatory specifications and standards must be used, and authorities are required either to

[47] *Lever (Finance) Ltd.* v. *Westminster Corp.* [1971] 1 Q.B. 222; *Western Fish Products Ltd.* v. *Penwith D.C.* [1981] 2 All E.R. 204.

[48] *Council for Civil Service Unions* v. *Minister for the Civil Service* [1985] A.C. 374, at p. 408.

[49] *R.* v. *Walsall M.B.C., ex. parte Yapp*, *The Times*, 6 August 1993. See also *Hughes* v. *D.H.S.S.* [1985] A.C. 776.

[50] But there may be a requirement to conform to specified tendering requirements; *Blackpool and Fylde Aero Club* v. *Blackpool B.C.* [1990] 1 W.L.R. 1195, *ante*, p. 35. See also *R.* v. *Lord Chancellor, ex parte Hibbert & Saunders* [1993] C.O.D. 326.

[51] *R.* v. *Lewisham L.B.C., ex parte Shell U.K. Ltd.* [1988] 1 All E.R. 938. See also *Mercury Ltd.* v. *Electricity Corp.* [1994] 1 W.L.R. 521 (reviewability of termination of contract).

[52] s. 17. See *R.* v. *Islington L.B.C., ex parte Building Employers Confederation* [1989] I.R.L.R. 383; *R.* v. *Enfield L.B.C., ex parte T.F. Unwin (Roydon) Ltd.* (1989) 46 Build.L.R. 1. See also Local Government Act 1972, s. 135; Environmental Protection Act 1990, s. 51.

[53] 93/36, 93/37, 93/38 E.E.C. O.J. L199/1, 54, 84, implemented by the Public Works Contracts Regulations 1991 (S.I. 1991 No. 2060); Public Supply Contracts Regulations 1991 (S.I. 1991 No. 2679); Utility Supply and Works Contracts Regulations 1992 (S.I. 1992 No. 3279); Utility Contracts Regulations 1996 (S.I. 1996 No. 2911). See generally Arrowsmith, *The Law of Public and Utilities Procurement* (1996).

accept the lowest price or the 'most economically advantageous' tender. Where a contract has been awarded in breach of these requirements, the only remedy open to a disappointed tenderer will be compensation; once concluded, the contract cannot be set aside on the application of a third party.[54]

Recovery of payments made under void contracts

Payments made under an *ultra vires* contract with a public authority, whether made to or by the incapacitated party, are recoverable in a restitutionary action,[55] although where, as in the interest swaps cases, payments have been made both ways, restitution is only available to a party on the basis that credit is given for what has been received.[56]

II. Minors

THE age of majority at common law was 21 years; but, by section 1 of the Family Law Reform Act 1969, it was lowered to 18. All persons under that age are known technically as minors (or infants). On attaining their majority they legally become adults. The rights and liabilities of minors under contracts entered into by them during minority rest upon common law rules as altered by the Minors Contracts Act 1987.[57] We shall see that the desire to protect minors on the one hand and the wish to safeguard the interests of traders on the other has led to a complicated body of law.

(a) Common Law

General rule of common law

At common law, the only class of contract to which minority did not afford some sort of defence was a contract for 'necessaries' in the sense to be explained later. In all other cases, common law treated a minor's contracts as being voidable at the option of the minor, either before or after becoming an adult. But these voidable contracts were divided into two classes.

Positive voidable contracts

First, contracts in which the minor acquired an interest of a permanent or continuous nature were valid and binding until the minor *disclaimed* them, either during minority or within a reasonable time after becoming an adult. Examples of such contracts were those by which a minor acquired shares in a company, or an interest in land. In this chapter we shall refer to them as 'positive voidable contracts'.

Negative voidable contracts

Secondly, in the case of contracts which were not thus continuous in their operation, the common law rule was that they were not binding on a minor unless ratified within a reasonable time after majority. So, for example, a promise by a

[54] See e.g. S.I. 1991 No. 2679, reg. 26(2), (5)(b); S.I. 1992 No. 3279, reg. 30(1), (5)(b)(ii).

[55] *Westdeutsche Landesbank Girozentrale* v. *Islington L.B.C.* [1994] 4 All E.R. aff'd [1996] 2 A.C. 669; *Woolwich B.S.* v. *I.R.C.* [1993] A.C. 70; *Guiness Mahon & Co. Ltd.* v. *Kensington & Chelsea L.B.C.*, *The Times*, 2 March 1998.

[56] *Ibid.*

[57] Implementing the recommendations in Law Com. No. 134, *Minors' Contracts* (1984).

minor to perform an isolated act, such as to pay for goods supplied other than necessaries, or to recompense another for work and labour done, required an express ratification after majority before the minor would be bound. These will be referred to as 'negative voidable contracts'.[58]

But since, at common law, both these classes of contracts were only voidable at the option of the minor and not wholly void, there was no objection to the minor enforcing them, though the other party could not enforce them. Yet in one respect a minor's position as a plaintiff differed from that of other parties of full contractual capacity. Though a minor might recover damages for breach, specific performance of the contract cannot be obtained.[59] Specific performance is an equitable remedy. It is granted at the discretion of the Court; and the Court will not grant it where the element of 'mutuality' is lacking, that is to say, where it would not be prepared to enforce the contract at the suit of either party.[60] Since the contract could not be enforced against the minor, equity would not allow the minor to obtain specific performance against the other party.

Such, in brief, is the common law on the subject. Let us now consider it in more detail and how it has been affected by subsequent legislation.

(b) Contracts for Necessaries and Other Beneficial Contracts

Necessaries

It has already been stated that, at common law, the only class of contract which was not voidable at the option of a minor was a contract for 'necessaries'.[61] The meaning of the term 'necessaries', however, requires further explanation, and it will be convenient in this respect first to consider contracts for necessary goods, and then contracts of service, apprenticeship, and other agreements beneficial to the minor.

Contracts for necessary goods

Part of the common law on this matter has been given statutory form by section 3 of the Sale of Goods Act 1979, which provides as follows:

(1) Capacity to buy and sell is regulated by the general law concerning capacity to contract and to transfer and acquire property.

(2) Where necessaries are sold and delivered to a minor or to a person who by reason of mental incapacity or drunkenness is incompetent to contract, he must pay a reasonable price for them.

(3) In subsection (2) above 'necessaries' mean goods suitable to the condition in life of the minor or other person concerned and to his actual requirements at the time of the sale and delivery.

What are necessaries?

We must first consider what the word 'necessaries' includes. It has always been held that a minor may be liable for the supply, not merely of the necessaries of

[58] It is, perhaps, strictly misleading to refer to these contracts as 'voidable' for the essence of a voidable contract is that it is binding unless repudiated whereas these contracts were not binding unless affirmed. However, the terminology is a convenient one, and it would be inadvisable to reject it merely on purist grounds.

[59] *Flight* v. *Bolland* (1828) 4 Russ 298. [60] Cf. *post*, 598.

[61] But such a contract may be held invalid if the minor was not capable of understanding the nature of the transaction: see *R.* v. *Oldham Metropolitan Borough Council* [1993] 1 F.L.R. 645, *per* Scott L.J. at pp. 661–2.

life, but of things suitable to his or her station in life and particular circumstances at the time. Minors are liable for *necessaries*, and not merely for *necessities*.[62] Certain things may be obviously outside the range of possible necessaries, 'Earrings for a male, spectacles for a blind person, a wild animal, . . . a daily dinner of turtle and venison for a month for a clerk with a salary of £1 a week'.[63] So in *Ryder* v. *Wombwell*:[64]

The defendant, a minor with an income of £500 a year, bought from the plaintiff a pair of crystal, ruby, and diamond solitaires and an antique goblet in silver gilt.

It was held that neither of these articles could be a necessary, even though the defendant was the son of a deceased baronet and 'moved in the highest society'. Other things may be of a useful character but the quality or quantity supplied may take them out of the character of necessaries. Elementary textbooks might be necessary to a student of law, but not a rare edition of Littleton's *Tenures*, or eight or ten copies of this textbook. In *Nash* v. *Inman*:[65]

A tailor supplied a Cambridge undergraduate with clothing which included eleven fancy waistcoats at two guineas each. It was proved that, although he was a minor, he had already a sufficient supply of clothing according to his position in life.

The Court of Appeal held that the tailor had failed to prove that the clothing was suitable to the undergraduate's actual requirements at the time of the sale and delivery.

Necessaries also vary according to the minor's station in life or peculiar circumstances at the time of the contract.[66] The Court must take into consideration the character of the goods supplied, the actual circumstances of the minor, and the extent to which the minor was already supplied with them. It is necessary to emphasize the words 'actual circumstances', because a false impression conveyed to the person dealing with the minor as to the station and circumstances of the minor will not affect the minor's liability. A shop which supplies expensive goods to a minor thinking that the minor's circumstances are better than they really are, or which supplies goods of a useful class not knowing that the minor is already sufficiently supplied, does so at its peril.[67]

Sale of Goods Act, s.3

The Sale of Goods Act 1979, section 3, also requires that the goods should be necessary to the minor 'at the time of the sale *and* delivery'. At first sight, this might seem to indicate that the seller would have to prove them to be necessary at both of these times. But, it is probable that this is simply a reference to the action for goods sold and delivered, which is the normal action for a seller who wishes to recover the purchase price.[68] The seller would have to prove them to be necessary at the time of their delivery alone.

[62] The Law Commission did not consider that the narrowing of the category in this way was, on balance, desirable: Law Com. No. 134, *Minors' Contracts* (1984), §§ 5.4–5.6.

[63] *Ryder* v. *Wombell* (*infra*, n. 64), *per* Bramwell B at p. 96. *Sed quaere* whether, in view of modern fashion, the position of earrings has changed.

[64] (1868) L.R. 3 Ex. 90, affirmed (1869) L.R. 4 Ex. 32.

[65] [1908] 2 K.B. 1.

[66] *Peters* v. *Fleming* (1840) 6 M. & W. 42.

[67] The burden of proof is on the supplier: *Nash* v. *Inman* (*supra*, n. 65), at p.5.

[68] *Post*, p. 219. See also Winfield (1942) 58 L.Q.R. 82, at p. 90.

Loan for necessaries

A loan of money to a minor to pay for necessaries was not recoverable at common law, for 'it may be borrowed for necessaries, but laid out and spent at a tavern'.[69] But in equity it was held that if a minor borrowed money to pay a debt for necessaries, and the debt was actually paid therewith, the lender stood in the place of the person paid and was entitled to recover the money lent.[70] This rule is a branch of the equitable doctrine of subrogation. It is not possible, however, to sue a minor on a negotiable instrument given for the price of necessaries, even though it may have been negotiated to a third party.[71] Also an account stated with a minor is still void although the items in the account may consist of necessaries.[72]

Contracts of employment & apprenticeship

A minor may enter into a contract of employment so as to earn a living or into a contract for the purpose of obtaining instruction or education so as to qualify for a suitable trade or profession. As Coke says: 'An infant may bind himself for his necessary meat, drink, apparel, necessary physic and such other necessaries, and likewise for his good teaching or instruction whereby he may profit himself afterwards'.[73] Such contracts are in fact contracts for 'necessaries' in a wider sense, and are so described in the cases. In *Clements* v. *London and North Western Railway Company*, Kay L.J. said:[74]

> It has been clearly held that contracts of apprenticeship and with regard to labour are not contracts to an action on which the plea of infancy is a complete defence, and the question has always been, both at law and in equity, whether the contract, when carefully examined in all its terms, is for the benefit of the infant. If it is so, the Court before which the question comes will not allow the infant to repudiate it.

Provided that they are beneficial to the minor, these contracts are binding. In the case just cited, a minor entered into a contract of employment with a railway company, promising to accept the terms of an insurance against accidents in lieu of his rights of action under the Employers' Liability Act 1880. It was held that the contract was, taken as a whole, for his benefit and that he was bound by his promise.

On the other hand, a contract of this class which is more onerous than beneficial to the minor will impose no liability. So in *De Francesco* v. *Barnum*:[75]

> A minor, aged 14 years, agreed to become the plaintiff's apprentice in 'the art of choreography' for 7 years. The plaintiff was to teach her stage dancing, and during the period of apprenticeship the minor was not to take any professional engagement without the consent of the plaintiff, nor was she to marry. She was to receive certain payments for any performances she might give, but there was no provision for any other remuneration and the plaintiff did not undertake to find her any engagements. The effect of the deed was to place the minor entirely at the disposal of the plaintiff.

Fry L.J. held that the contract was not beneficial to the minor and was unenforceable. It should, however, be noted that even though a minor's contract

[69] *Earle* v. *Peale* (1711) 1 Salk. 386 (except where necessaries are purchased at minor's request).
[70] *Marlow* v. *Pitfeild* (1719) 1 Peere Wms. 558.
[71] *Re Soltykoff, ex parte Margrett* [1891] 1 Q.B. 413. Cf. Bills of Exchange Act 1882, s. 22.
[72] *Williams* v. *Moor* (1843) 11 M. & W. 256.
[73] Co. Litt. 172a.
[74] [1894] 2 Q.B. 482, at p. 491.
[75] (1890) 45 Ch. D. 430. See also *Leng (Sir W. C.) & Co.* v. *Andrews* [1909] 1 Ch. 763.

of service contains some stipulations which are onerous, the minor cannot necessarily repudiate it, still less select which terms will or will not be followed.[76] As Fry L.J. put it:[77]

> It is not because you can lay your hand on a particular stipulation which you may say is against the infant's benefit, that therefore the whole contract is not for the benefit of the infant. The Court must look at the whole contract, having regard to the circumstances of the case, and determine, subject to any principles of law which may be ascertained by the cases, whether the contract is or is not beneficial.

Other beneficial contracts

The class of contracts under consideration is not, however, limited to contracts of apprenticeship and employment. It includes numerous contracts for 'necessaries' other than goods, for example, for medical attendance,[78] for the preparation of a marriage settlement by a solicitor,[79] or the hire of a car to fetch a minor's luggage from the railway station.[80] Provided that these are reasonable and beneficial to the minor, the other party can enforce them. Yet the class does not include ordinary trading contracts, as, for instance, the hire-purchase of a motor lorry by a haulage contractor who is a minor.[81] Such contracts may be necessary to the minor's business, and so of benefit to the minor, but they are not binding. Thus, in *Cowern* v. *Nield*,[82] a contract to sell a consignment of hay by a hay and straw dealer who was a minor was held not to be a contract for 'necessaries' because it was a trading contract.

The class is thus a limited one although the limits are not easy to state. In *Doyle* v. *White City Stadium Ltd.*,[83] for instance:

> A professional boxer, who was a minor, in consideration of his receiving a licence from the British Boxing Board of Control, agreed to be bound by the rules of the Board in all his professional engagements. A purse of £3,000 was withheld from him by the Board, in accordance with its rules, on the ground that he had been disqualified in a contest for hitting below the belt.

It was held that the agreement was binding on him despite his being a minor. The ground of this decision was that the licence was practically essential in order to enable him to become proficient in his profession, and when the conditions attached to the issue of the licence were incorporated in a particular beneficial contract of employment—in this case, an engagement to box for a heavyweight championship—both contracts became binding on the minor, as they were both for his benefit. Also in *Chaplin* v. *Leslie Frewin (Publishers) Ltd.*:[84]

> The plaintiff, the son of Charlie Chaplin and a minor, had been eking out a Bohemian existence in London. In return for an advance of royalties, he assigned to the defendant publishers the exclusive right to publish an autobiography of himself (entitled *I Couldn't*

[76] *Slade* v. *Metrodent Ltd.* [1953] 2 Q.B. 112.
[77] *De Francesco* v. *Barnum* (*supra*, n. 75), at p. 439.
[78] *Dale* v. *Copping* (1610) 1 Bulst. 39. See also *Gillick* v. *W. Norfolk and Wisbech Area Health Authority* [1986] 1 A.C. 112, at pp. 166–7, 183, 195.
[79] *Helps* v. *Clayton* (1864) 17 C.B.N.S. 553.
[80] *Fawcett* v. *Smethurst* (1914) 84 L.J.K.B. 473.
[81] *Mercantile Union Guarantee Corporation* v. *Ball* [1937] 2 K.B. 498.
[82] [1912] 2 K.B. 419.
[83] [1935] 1 K.B. 110.
[84] [1966] Ch. 71 (Lord Denning M.R. dissenting).

Smoke the Grass on my Father's Lawn) which was to be written by 'ghost' writers. The completed work, so he alleged, showed him to be 'a depraved creature', and he sought to repudiate the assignment.

The Court of Appeal held that he could not do so. The contract was binding on him since it was one which enabled him to make a start as an author and thus to earn money to keep himself and his wife.[85] It was a beneficial contract, because, as Danckwerts L.J. put it[86] 'The mud may cling but the profits will be secured'.

The judgments in these two cases do not set out to define the contracts which are binding when beneficial to a minor, but they perhaps indicate a tendency to enlarge the class; for it might be thought that the contracts which the minors had made were merely incidental to the carrying on of a trade or profession and therefore of a kind which had not hitherto been believed to be binding, even when beneficial.

(c) Negative Voidable Contracts

Common law rule

As explained above, a negative voidable contract is one which is made during minority and which will not bind the minor at common law unless ratified by the minor within a reasonable time after attaining majority. Generally, such contracts were one-offs and not continuous in nature. Until recently this common law rule was displaced by statute which made it impossible for a person of full age to be sued on a contract entered into during minority, even though he or she had ratified such a contract and even though there was some new consideration for the ratification.[87] However, this did not stop the minor enforcing the contract against the other party. The repeal of that statute means that the common law rule as it existed prior to the legislation has again become the law.

It should be clear that this class of contracts is large; it includes all contracts other than contracts for necessaries and contracts falling within the 'positive voidable' category.

(d) Positive Voidable Contracts

Contracts valid until rescinded

Where a minor acquires an interest in permanent property to which obligations attach, or enters into a contract involving continuous rights and duties, benefits and liabilities, and takes some benefit under the contract, the minor will be bound, unless he or she expressly disclaims the contract during the minority or within a reasonable time of coming of age.

Examples of contracts requiring an express disclaimer to avoid them are the acquisition of an interest in land (such as a lease or tenancy), the possession of shares in a company which are not fully paid-up, and marriage settlements to

[85] The Court also held that, even if the contract had been voidable by the minor, it could not have been rescinded because it had been executed by the transfer of the copyright.

[86] At p. 95.

[87] See Infants Relief Act 1874, s. 2 (now repealed) discussed in A.G. Guest, *Anson's Law of Contract*, 26th edn. (1984), pp. 184–92.

which the minor is a party. Up to the time that the minor disclaims such a contract he or she will be bound to carry out the obligations under it, provided that these accrue before repudiation.[88] A minor cannot renounce the liabilities until he or she renounces the interest. So a lessee who is a minor is liable for rent until the lease is disclaimed,[89] and if a shareholder, is under a similar liability in respect of calls on the shares until they are repudiated.[90] In *North Western Railway Co.* v. *M'Michael*:[91]

To an action for calls on railway shares, the defendant pleaded that at the times of application for and allotment of the shares, he was still a minor, and at the time of making the calls in question he had not yet attained majority.

It was held that, in the absence of a plea that he had expressly repudiated the shares, the defence failed and he was bound.

Partnership

The position of a member of a partnership who is a minor differs from that of a shareholder. It is true that partnership is a continuous relationship between the partners, but by becoming a partner a minor does not acquire an interest in a subject of a permanent nature to which obligations are attached. During the minority of a partner, the minor is not liable for debts incurred by the partnership; but equally is not entitled to any share of the partnership assets until the firm's debts have been paid.[92] A minor who continues to act as a partner after majority will be liable, equally with the other partners, for the debts subsequently incurred. A minor may also be liable for such debts if, though ceasing to act as a partner, he or she gives no adequate notice of this withdrawal to persons dealing with the firm.[93] The minor's liability in this case, however, merely illustrates a general rule of the law of partnership applicable to any retired partner, and does not depend on any principle peculiar to the law of minors.

Time of disclaimer

In order that a minor's disclaimer of a permanent interest may take effect, the contract must be repudiated during minority or within a reasonable time of the minor's coming of age. What is a reasonable time will depend upon the circumstances of each particular case. In *Edwards* v. *Carter*[94] the House of Lords held that a minor who entered into a marriage settlement and covenanted to bring into the settlement any property which might come to him under his father's will could not repudiate it nearly 5 years after coming of age and one year after his father died leaving him property by will.

[88] There is some doubt as to whether a minor is bound to pay unpaid calls which accrued due before the repudiation, but the better opinion is that he is so bound. See *Cork & Bandon Ry.* v. *Cazenove* (1847) 10 Q.B. 935. Cf. *N.W. Ry.* v. *M'Michael* (*infra*, n. 91), at p.125, and *Newry and Enniskillen Ry.* v. *Coombe* (1849) 3 Exch. 565.

[89] *Blake* v. *Concannon* (1870) 4 Ir. Rep. C.L. 320. By the Law of Property Act 1925, ss. 1(6), 19 a minor can no longer hold a legal estate in land; but can have an equitable interest, and so be bound in the same way: *Davies* v. *Benyon-Harris* (1931) 47 T.L.R. 424.

[90] *Steinberg* v. *Scala (Leeds) Ltd.* [1923] 2 Ch. 452, at p. 463.

[91] (1850) 5 Exch. 114, affirmed *sub nom. L. & N. W. Ry* v. *M'Michael* (1850) 5 Exch. 855.

[92] *Lovell and Christmas* v. *Beauchamp* [1894] A.C. 607.

[93] *Goode* v. *Harrison* (1821) 5 B. & Ald. 147.

[94] [1893] A.C. 360; *Carnell* v. *Harrison* [1916] 1 Ch. 328.

Effect of disclaimer

The effect of a valid disclaimer of a contract that binds until repudiated is to release the minor from future obligations under it. But it will not entitle the minor to recover anything that may have already been paid under the contract unless there has been a total failure of the consideration for which the money has been paid. In *Steinberg* v. *Scala (Leeds) Ltd.*, for example:[95]

A minor was allotted shares in a company, and paid the amounts due on application and allotment, and also on the first call. She received no dividends and attended no meetings of the company, and after 18 months she claimed to repudiate the allotment and recover the amounts paid.

It was held by the Court of Appeal that, while she was entitled to rescind the contract by having her name removed from the register of shareholders, and thus to avoid liability for the unpaid instalments, she was not entitled to recover back what she had already paid. It was immaterial whether or not she had received any real advantage in the way of dividends or a share of the assets. She had received something which had a marketable value and which was, in any case, 'the very consideration for which she had bargained'.

(e) The Nature of the Liability of Minors

Nature of liability for necessaries

If there is an enforceable obligation against a minor, for example, for necessaries, it remains to characterize that obligation. Two theories have been put forward.

Liability in restitution

The first is that the liability arises in restitution rather than contract. The obligation is imposed by the law because the minor has actually received the benefit of performance, and not as a result of entering a valid contract. This was the view taken by Fletcher Moulton L.J. in *Nash* v. *Inman*:[96]

An infant, like a lunatic, is incapable of making a contract of purchase in the strict sense of the words; but if a man satisfies the needs of the infant or lunatic by supplying to him necessaries, the law will imply an obligation to repay him for the services so rendered, and will enforce that obligation against the estate of the infant or lunatic. The consequence is that the basis of the action is hardly contract. Its real foundation is an obligation which the law imposes on the infant to make a fair payment in respect of needs satisfied. In other words the obligation arises re and not consensu.

Liability in contract

The second theory, as may be gathered, asserts that the minor's liability arises in contract. The minor can, it is said, enter into a valid contract for necessaries just like any other person. 'The plaintiff', said Buckley L.J. in the same case:[97]

when he sues the defendant for goods supplied during infancy, is suing him in contract on the footing that the contract was such as the infant, notwithstanding infancy, could make. The defendant, although he was an infant, had a limited capacity to contract. In order to

[95] [1923] 2 Ch. 452. See also *Holmes* v. *Blogg* (1818) 8 Taunt. 508.

[96] [1908] 2 K.B. 1, at p. 8; *Re Rhodes* (1890) 44 Ch. D. 94, at p. 105; *Re J.* [1909] 1 Ch. 574, at p. 577; *Elkington* v. *Amery* [1936] 2 All E.R. 86, at p. 88.

[97] At p. 12. See also *Gillick* v. *West Norfolk Area Health Authority* [1986] A.C. 112, at p. 169 (child could enter into a 'contract').

maintain his action the plaintiff must prove that the contract sued on is within that limited capacity.

The problem is not wholly an academic one, since, unless the liability is contractual in nature, the minor will not be liable where the contract is executory. In the case of necessary goods, section 3 of the Sale of Goods Act 1979 indicates that the obligation is restitutionary. It deals only with 'necessaries sold and delivered', and says nothing of necessaries sold to a minor and not delivered, that is to say, of a contract of sale which is still executory.[98] There does not seem to be a single case since the seventeenth century[99] in which a minor has been held liable for the non-acceptance of necessaries or on a contract for necessaries bargained and sold but not delivered. Since necessity is in part determined at the time of delivery, it is in fact difficult to know whether an executory contract is or is not one for necessaries.[100] Moreover, even if the goods are delivered, the plaintiff will not necessarily recover the contractual price but only 'a reasonable price for them'. This does not suggest a consensual contract.[101]

Contracts of employment, apprenticeship and the like, provided that they are beneficial to the minor, have, however, always been regarded as merely one variety of contracts for 'necessaries',[102] and there seems to be no authority for regarding the nature of the liability which they create as resting on a different basis from that of contracts for the supply of necessary goods. Nevertheless in *Roberts* v. *Gray*:[103]

The defendant, a minor, entered into a contract by which he agreed to join the plaintiff, a famous billiard player, in a world tour as 'professional billiardists'. The plaintiff incurred certain necessary expenses as a result of preparations for the tour, but, before the tour began, the defendant repudiated the contract.

The Court of Appeal held that to play in company with a noted billiard player like the plaintiff was instruction of the most valuable kind for a minor who wished to make billiard playing his occupation, and they upheld an award of £1,500 damages for the breach. They rejected the view that a contract for necessaries in this wider sense was not binding on a minor while it was still executory. 'I am unable to appreciate', said Hamilton L.J.,[104] 'why a contract which is in itself binding, because it is a contract for necessaries not qualified by unreasonable terms, can cease to be binding merely because it is still executory'. Both this decision, then, and that in *Doyle* v. *White City Stadium Ltd.*,[105] imply that the nature of the liability, when the minor is liable on the contract at all, does not differ from that of

[98] In 1979 Act, s. 3. Cf. the wording of the Infants Relief Act 1874 (now repealed), s. 1 of which might have suggested the contrary: 'contracts . . . for goods supplied *or to be supplied* (other than contracts for necessaries)'. See generally Winfield (1942) 58 L.Q.R. 82.

[99] *Ive* v. *Chester* (1619) Cro. Jac. 560; *Delavel* v. *Clare* (1652) Latch. 156.

[100] *Benjamin's Sale of Goods*, 5th edn. (1997), § 2–031.

[101] *Pontypridd Union* v. *Drew* [1927] 1 K.B. 214, *per* Scrutton L.J. at p. 220. See also Birks, *An Introduction to Restitution* (1985), p. 436.

[102] *Walter* v. *Everard* [1891] 2 Q.B. 369.

[103] [1913] 1 K.B. 520. See also *Hamilton* v. *Bennett* (1930) 94 J.P.N.136.

[104] *Ibid.*, at p. 530.

[105] [1935] 1 K.B. 110; *ante*, p. 215.

a contracting party of full capacity; that it is, in fact, a true contractual liability and not restitutionary.

In principle there is much to be said for the contractual explanation of the minor's liability for the reasons given by Buckley L.J. The law governing minors' contracts is based on the principle of 'qualified unenforceability';[106] the minor has a limited capacity to contract, and within that limited capacity, there is no reason to deny the contractual nature of liability. Moreover, the other party is liable for non-delivery and other non-performance,[107] and it has been argued that section 3 of the Sale of Goods Act 1979 does not exclude the possibility of liability being contractual. This is because a contract for necessaries only binds a minor where it is not, on balance, onerous to the minor, so that a minor 'will not, in any case, be bound by a contract for necessaries for which more than a reasonable price is charged', a position unaffected by the Sale of Goods Act, the provisions of which 'are consistent with the view that [a minor] may be liable on an executory contract for necessaries provided that the terms are not onerous'.[108] But in the present state of the authorities it is difficult to state the nature of the minor's liability with assurance.

Liability for positive and negative voidable covenants

If the contract is a positive voidable contract not disclaimed in time or a negative voidable contract which has been ratified, it is clear that it may be enforced as a contract. The real issue, however, concerns the non-contractual liability of the minor. That is, the tortious or restitutionary liability of the minor in the case where a positive voidable contract has been disclaimed or a negative voidable contract has not been ratified. On what basis may the minor be liable? We address this below.

(f) Liability of Minors in Tort

No liability by framing contractual action as a tort

A minor is generally liable for torts committed, but a breach of contract may not be treated as a tort so as to make the minor liable; the tort must be more than a misfeasance in the performance of a contract, and must be separate from and independent of it. Thus tort liability may arise whether the obligation of the minor under an alleged contract is an enforceable one, say for necessaries, or an unenforceable one.

For instance, in *Jennings* v. *Rundall*[109] where a minor hired a mare to ride and injured her by over-riding, it was held that he could not be made liable by framing an action really arising out of contract as an action in tort. And in *Fawcett* v. *Smethurst*,[110] it was said that a minor who hired a car to take his luggage from the station would be under no liability in tort if he used the car to drive several miles further than the station, and there met with an accident. Minors who obtain a loan

[106] Law Com. No. 134 (1984), § 1.12.

[107] *Farnham* v. *Atkins* (1670) 1 Sid. 446; *Bruce* v. *Warwick* (1815) 6 Taunt. 118. See also *Cowern* v. *Nield* [1912] 2 K.B. 419, *ante*, p. 215.

[108] Goff and Jones, *The Law of Restitution*, 4th edn. (1993), pp. 525–6. But note the difficulty of ascertaining this at that stage, *ante*, p. 219.

[109] (1799) 8 Term R. 335.

[110] (1914) 84 L.J. K.B. 473, although in that case the minor was, in fact, not guilty of any tort.

by falsely representing their age cannot be made to repay the amount of the loan in the form of damages for deceit,[111] nor can minors who buy goods on credit be forced to pay for them by charging them with conversion.[112] 'One cannot make an infant liable for the breach of a contract by changing the form of action to one *ex delicto*.'[113]

Liable for actual tort, although originating in contract

But this is not to say that every tort of a minor which originates in a contract is not actionable. If the wrongful action is of a kind not contemplated by the contract,[114] the minor may be exposed to tortious liability. So in *Burnard* v. *Haggis*:[115]

A minor hired a mare for riding. He was given strict instructions 'not to jump or lark with her'. He lent her to a friend who jumped and killed her.

It was held that the minor was liable, for, as Willis J. said:[116]

It appears to me that the act of riding the mare into the place where she received her death-wound was as much a trespass, notwithstanding the hiring for another purpose, as if, without any hiring at all, the defendant had gone into a field and taken the mare out and hunted her and killed her. It was a bare trespass, not within the object and purpose of the hiring.

In a more modern case,[117] a minor was successfully sued in detinue for the non-return of a microphone and amplifier which he had hired from the plaintiff and improperly parted with to a friend. The Court of Appeal held that 'the circumstances in which the goods passed from his possession and ultimately disappeared were outside the purview of the contract of bailment altogether',[118] and the minor was liable. In considering the extent of the contract, it seems that the terms of the agreement, the presence or absence of an express prohibition, and the nature of the subject-matter of the contract must all be considered to be relevant, although not necessarily determining, factors.

(g) Liability of Minors in Restitution

Common law

Where, overall, a contract for necessaries is not beneficial to the minor and is not therefore binding, the minor will nevertheless be liable to pay a reasonable price for any necessaries supplied.[119] But a plaintiff who seeks restitution of money paid or benefits in kind conferred on the minor under a contract cannot simply rely on the normal grounds for independent restitutionary recovery, in particular mistake, failure of consideration, and acceptance. This is because the Court will take care not to grant restitution where this would amount to indirectly enforcing the void contract, as it would be if, for example, the minor is ordered to repay a loan.

[111] *Johnson* v. *Pye* (1665) 1 Sid. 258; *Stikeman* v. *Dawson* (1847) De G. & Sm. 90; *Leslie (R.) Ltd.* v. *Sheill* [1914] 3 K.B. 607.
[112] *Manby* v. *Scott* (1659) 1 Sid. 109, at p. 129.
[113] *Burnard* v. *Haggis* (1863) 32 L.J.C.P. 189, *per* Byles J. at p. 191, cited by Lord Sumner in *Leslie (R.) Ltd.* v. *Sheill* [1914] 3 K.B. 607, at p. 611.
[114] *Burnard* v. *Haggis* (1863) 14 C.B., N.S. 45, *per* Willis J. at p. 53; *Fawcett* v. *Smethurst* (1914) 84 L.J.K.B. 473, *per* Atkin J. at p. 474; *Leslie (R.) Ltd.* v. *Sheill* [1914] 3 K.B. 607, *per* Kennedy L. J. at p. 620; *Ballett* v. *Mingay* [1943] K.B. 281, *per* Lord Greene M.R. at p. 283.
[115] (1863) 14 C.B.N.S. 45.
[116] At p. 53.
[117] *Ballett* v. *Mingay* [1943] K.B. 281.
[118] *Ibid.* at p. 283.
[119] *Ante*, p. 212.

There is authority to the effect that a minor can only be made liable in restitution if it can be shown that a wrong quite independent of the contract has been committed,[120] and that otherwise minority affords a good defence.[121] Thus in *Cowen* v. *Nield*[122] a hay and straw dealer who was a minor was held entitled to retain money paid to him as the price of a consignment of hay which he had failed to deliver in accordance with his contract. But these decisions reflect the now discredited 'implied contract' theory of liability in such cases, and should be rejected now that it has been accepted that the basis of restitutionary liability is the unjust enrichment of the defendant, here the minor.[123] There is force in the argument that a restitutionary claim against a minor should be allowed so long as its effect would not be to enforce the contract indirectly.[124]

Fraudulent misrepresentation of full age

Minors who fraudulently represent themselves to be of full age and thereby induce other persons to enter into contracts, are nevertheless not liable under the contracts despite the fraud. Equity, however, does not stand idle and will, in certain circumstances, intervene in order to prevent minors from taking advantage of their own deceit. 'Minors', said Lord Chancellor Hardwicke,[125] 'are not allowed to take advantage of infancy to support a fraud'. This equitable intervention is distinct and separate from the contract. The principle has been succinctly stated by Lord Sumner in *Leslie (R.) Ltd.* v. *Sheill*:[126]

> When an infant obtained an advantage by falsely stating himself to be of full age, equity required him to restore his ill-gotten gains, or to release the party deceived from obligations or acts in law induced by the fraud, but scrupulously stopped short of enforcing against him a contractual obligation, entered into while he was an infant, even by means of a fraud.

It should not be supposed, however, that equity will always provide a remedy in cases of fraudulent misrepresention of age by a minor. It will only relieve in certain situations.

Equitable restitution

The exact extent of this remedy is the subject of some dispute. It is clear that a minor who obtains property, whether consisting of goods or money or any other security, by means of a false representation of full age, can be compelled to restore that property to the person deceived, provided that it is identifiable and still in the minor's possession. It is equally clear that it is impossible to make the minor repay a loan of money which has been borrowed by such a fraud and subsequently spent. In the words of Lord Sumner in *Leslie (R.) Ltd.* v. *Sheill*:[127] 'Restitution stops where repayment begins'. In that case:

[120] *Cowern* v. *Nield* [1912] 2 K.B. 419.
[121] *Leslie (R.) Ltd.* v. *Sheill* [1914] 3 K.B. 607, *post*; *Thavorn* v. *Bank of Credit & Commerce International SA* [1985] 1 Lloyd's Rep. 259.
[122] [1912] 2 K.B. 419.
[123] *Lipkin Gorman* v. *Karpnale Ltd.* [1991] 2 A.C. 548, *ante*, p. 21.
[124] Goff and Jones, *The Law of Restitution* 4th edn. (1993), pp. 530–2.
[125] *Earl of Buckinghamshire* v. *Drury* (1760) 2 Eden 60, at p. 71.
[126] [1914] 3 K.B. 607, at p. 618; Atiyah (1959) 22 M.L.R. 273.
[127] [1914] 3 K.B. 607, at p. 618. 'You take the property to pay the debt': *Vaughan* v. *Vanderstegen* (1854) 2 Drew. 363, *per* Kindersley V.C.

The plaintiffs were a firm of registered moneylenders, and they sued the defendant, to whom they had made two loans of £200 each, to recover £475, being the amount of the loans with interest. At the time of obtaining the loans, the defendant was a minor, but he had falsely represented to the plaintiffs that he was of full age.

The Court of Appeal held that no action could be maintained for the recovery of the money. The loan was rendered void by the Infants Relief Act 1874 then in force and the minor could not be forced to repay:[128]

The money was paid over in order to be used as the defendant's own and he has so used it and, I suppose, spent it. There is no question of tracing it, no possibility of restoring the very thing got by the fraud, nothing but compulsion through a personal judgment to pay an equivalent sum out of his present or future resources, in a word nothing but a judgment in debt to repay the loan. I think this would be nothing but enforcing a void contract.

Once the identity of the property has been lost because it has been dissipated, it is no longer possible to invoke the aid of the equitable doctrine of restitution.

So much is clear; the difficulty arises when the minor has parted with the property obtained by the fraud, but stands possessed of other money or property which represent it. Suppose, for example, that a minor obtains certain goods by the misrepresentation, and then sells the goods and stands possessed of the proceeds of sale. Is it possible to claim that the money represents the goods and so ought to be restored to the person deceived? In *Stocks* v. *Wilson*:[129]

W, a minor, by falsely representing himself to be of full age, induced S to sell and deliver to him certain furniture and other articles, and promised to pay therefor the sum of £300. The goods were not necessaries. He subsequently sold some of the goods for £30, and granted a bill of sale over the remainder as security for the sum of £100 lent to him by a third party. These goods were later sold by him to the grantee of the bill of sale. S claimed, by way of equitable relief, the value of the goods.

Lush J. held that S was not entitled to recover the value of the goods from W as this would be to enforce a void contract. Equity, however, had the power to prevent a minor from retaining the benefit of what had been obtained by reason of his fraud, and since W had obtained the sum of £130 by parting with the goods, he was liable to account to S for this sum. This decision was criticized, but not overruled, by the Court of Appeal in *Leslie (R.) Ltd.* v. *Sheill* on the ground that Lush J. had proceeded in the false assumption that a minor who had obtained money by a false representation of full age could be compelled to refund it. The two decisions may, perhaps, be reconciled on the assumption that it is possible for the party defrauded to 'trace' the value of the goods into the proceeds of their sale.[130] If this is so, then the defrauded party's right is similar to that of a

[128] [1914] 3 K.B. 607, *per* Lord Sumner at p. 619. [129] [1913] 2 K.B. 235.

[130] *Leslie (R.) Ltd.* v. *Sheill* [1914] 3 K.B. 607, at p. 618; *Thavorn* v. *Bank of Credit & Commerce International S.A.* [1985] 1 Lloyd's Rep. 259, at p. 264. Pollock, *Principles of Contract*, 13th edn. (1950), pp. 64–5; Atiyah (1959) 22 M.L.R. 273. *Stocks* v. *Wilson* may fairly be criticized, since it appears that judgment was given *in personam* against the minor and without any proper inquiry as to whether the money had been spent.

beneficiary in respect of a trust fund in the hands of a trustee.[131] It is possible to trace so long as there is an identifiable fund in existence against which the defrauded party can enforce its claim *in rem*; but, once the fund has been dissipated, it is no longer possible to obtain a judgment *in personam* against the infant for the amount.

Other equitable relief

Equity will also relieve the party deceived of obligations imposed upon that party by the minor's fraud. In *Lemprière* v. *Lange*,[132] a minor obtained a lease by falsely representing himself to be of full age. The Court ordered that the lease should be set aside and that the minor should give up possession of the premises. In *Clarke* v. *Cobley*[133] the Court ordered the return of two promissory notes which the minor had obtained by misrepresenting his age and in return for a void bond executed by him. In both cases the Court scrupulously refrained from enforcing the contract, and merely restored the status quo affected by the minor's fraud. In the former case, for example, a claim by the lessor for damages for use and occupation of the premises was dismissed as being inconsistent with this relief.

Where, by a false misrepresentation of age by the minor, a person is thereby induced to lend money, after the minor comes of age the lender is entitled to prove in any bankruptcy proceedings against the minor.[134] The reason seems to be that the lender has a claim, not against the minor personally, but against the minor's assets in competition with the other creditors.[135]

Minors' Contracts Act 1987

We have dealt with rights to restitution that may arise at common law and in equity. There is a further statutory scheme allowing for restitution under the Minors' Contracts Act 1987.[136] Section 3 of that Act provides:

(1) Where—

(a) a person ('the plaintiff') has after the commencement of this Act entered into a contract with another ('the defendant'), and

(b) the contract is unenforceable against the defendant (or he repudiates it) because he was a minor when the contract was made,

the court may, if it is just and equitable to do so, require the defendant to transfer to the plaintiff any property acquired by the defendant under the contract, or any property representing it.

The provision leaves the issue of restitution to the discretion of the court. There is no requirement of fault or fraud. It is also only concerned with property acquired under the contract (or property acquired in exchange for property acquired under the contract) and not property gained in any other way. It appears that money is included within this notion of property. The Law Commission's policy was to extend the equitable remedy available against a fraudulent minor to a case where the minor, though not guilty of fraud, had failed to pay for goods

[131] The representation of full age might be considered to raise an 'equity' in the defrauded party similar to that possessed by a beneficiary of a fiduciary relationship.

[132] (1879) 12 Ch. D. 675. [133] (1789) 2 Cox 173.

[134] *Re King, ex parte Unity Joint-Stock Mutual Banking Association* (1858) 3 De G. & J. 63; *Re Jones, ex parte Jones* (1881) 18 Ch. D. 109, at p. 125.

[135] *Leslie (R.) Ltd.* v. *Sheill* [1914] 3 K.B. 607, at p. 616.

[136] See Law Com. No. 134, *Minors' Contracts* (1984).

obtained on credit.[137] That equitable relief extended, as in *Stocks* v. *Wilson*[138] and as recognized by the Law Commission, to money which was the proceeds of the property sold to the minor and resold by him or her. But if property delivered to a minor has been consumed or lost, there will be no remedy under the 1987 Act; the Law Commission considered that to order the minor to pay to the seller a sum equivalent to the purchase price or the value of the property 'would amount to the enforcement of the contract' against the minor.[139]

(h) Restitution in Favour of Minors

Common law

In order to recover money paid to the other party under a contract which does not bind the minor, a ground for restitution must be established, i.e. that the money was paid by mistake, under compulsion, or that there has been a failure of consideration. In the present state of the authorities, decided before the development of the modern law of restitution, it would appear that what is required is a *total* failure of consideration, so that, as we saw in the case of *Steinberg* v. *Scala (Leeds) Ltd.*,[140] receipt by the minor of any part of the other party's performance will be fatal. But, as we shall see,[141] the indications are that the requirement of totality is being reconsidered, and it is submitted that the authority of the cases requiring it in this context has been fatally undermined. Provided the minor can return what has been received or give recompense for it in a way that does not amount to indirect enforcement of the contract, the minor should in principle be able to recover money paid.

(i) Third Parties

Third parties

An interesting question arises as to the effect the invalidity of a minor's contract has on third parties. So far, we know that although a minor may enforce a contract the other party to the contract can only enforce it if it is a valid contract for necessaries or if it is a positive voidable contract that has not been disclaimed or a negative voidable contract that has been ratified. If the contract is not enforceable what is the position of say a guarantor of the minor's obligations. Section 2 of the Minors' Contracts Act 1987 provides:

> Where—
>
> (a) a guarantee is given in respect of an obligation of a party to a contract made after the commencement of this Act, and
>
> (b) the obligation is unenforceable against him (or he repudiates the contract) because he was a minor when the contract was made,
>
> the guarantee shall not for that reason alone be unenforceable against the guarantor.[142]

[137] *Ibid.*, § 4.21 [138] [1913] 2 K.B. 235, *ante*, p. 223.

[139] See Law Com. No. 134 (1984), § 4.23.

[140] [1923] 2 Ch. 452, *ante*, p. 218. See also *Pearce* v. *Brain* [1929] 2 K.B. 310 (recovery of motorcycle) but cf. *Chaplin* v. *Leslie Frewin (Publishers) Ltd.* [1966] Ch. 71 (property that has passed is irrecoverable).

[141] *Post*, p. 606.

[142] Cf. the position under the Infants Relief Act 1874, s. 1 (now repealed) which rendered loans to infants void rather than unenforceable: see *Coutts & Co.* v. *Browne-Lecky* [1947] K.B. 104. See also Law Com. No. 134 (1984), § 4.15.

III. Corporations and Unincorporated Associations

(a) Corporations

Doctrine of *ultra vires*

The contractual capacity of a corporation incorporated by statute[143] is limited by the fact that any act done by the corporation outside its statutory powers is, at common law, *ultra vires* and void. Since the corporation has no existence independent of the Act of Parliament which creates the corporation or authorizes its creation, it follows that its capacity is limited to the exercise of such powers as are actually conferred by, or may reasonably be deduced from, the language of the statute. Thus at common law a company is bound by the objects listed in its memorandum of association, for it is incorporated for the purposes set out in the memorandum. The company can make no contracts inconsistent with, or foreign to, those objects,[144] and, if it does so, the contract so made is, at common law, void and unenforceable as being *ultra vires* the company.

The leading case on the application of the *ultra vires* doctrine is *Ashbury Railway Carriage and Iron Co.* v. *Riche*:[145]

A company was incorporated with objects (set out in the memorandum of association) as follows: (1) to make, and sell, or to lend on hire, railway wagons and carriages and other rolling stock, (2) to carry on the business of mechanical engineers and general contractors, (3) to purchase, lease, work and sell mines, minerals, land and buildings, and (4) to buy and sell as merchants, timber, coal, metals, or other materials. The company contracted to assign to another company a concession which it had bought for the construction of a railway in Belgium.

The House of Lords held that the contract, being related to the actual construction of a railway, as opposed to railway stock, was *ultra vires* the objects in the memorandum and void. Even if the shareholders subsequently ratified the contract, it could not thereby be rendered binding on the company.

The explanation given in this case for the existence of the *ultra vires* rule was not only that it was a necessary consequence of statutory incorporation but also that the rule was required to protect investors in, and creditors of, the company.[146] 'It ensured that an investor in a gold mining company did not find himself holding shares in a fried fish shop, and it gave those who allowed credit to a limited company some assurance that its assets would not be dissipated in unauthorized enterprises'.[147] Nevertheless, the application of the rule not infrequently led to injustice. Persons who entered into an *ultra vires* contract with a company could not enforce it. If they supplied goods to the company or performed services

[143] A corporation created by charter by virtue of the Royal Prerogative is not so limited. If it exceeds its powers, the effect is not to avoid the contract, but to give cause for forfeiture of the charter by the appropriate procedure, e.g. by *scire facias*, as in the case of the South Sea Bubble companies. See Gower (1952) 68 L.Q.R. 214; *Jenkin* v. *Pharmaceutical Society* [1921] 1 Ch. 392, at p. 398.

[144] Matters which are reasonably incidental to that which is authorized by the memorandum are not *ultra vires* unless expressly prohibited: *Att.-Gen.* v. *Great Eastern Ry.* (1880) 5 App. Cas. 473, at p. 478.

[145] (1875) L.R. 7 H.L. 653.

[146] *Ibid.*, *per* Lord Cairns at pp. 667–8.

[147] Gower, *The Principles of Modern Company Law*, 3rd edn. (1969), p. 87.

under the contract, they could not obtain payment.[148] If they lent money to the company, and the borrowing was *ultra vires*, the non-recognition of restitution as a claim based on unjust enrichment independent of contract meant that in general they could not recover their money.[149] In theory, before entering into the contract with the company, such persons would first scrutinize the memorandum to ascertain the extent of the company's powers. In practice, however, they did not do so, but were nevertheless deemed to have 'constructive notice' of the contents of the memorandum despite the fact that they had no actual knowledge of them. As a result, the doctrine of *ultra vires* proved to be a trap for the unwary and from time to time inflicted grave hardship on persons who dealt *bona fide* with the company in ignorance of its lack of capacity.[150]

Lack of capacity distinguished from abuse of power

An *ultra vires* contract which is 'beyond the capacity of the company and therefore wholly void'[151] should be distinguished from a contract made by the exercise of a power which the company undoubtedly has but for a *purpose* which is unauthorized. Transactions of the latter sort involve an abuse of power rather than a lack of capacity and will be enforceable against the company unless the other party had notice of the abuse of power.[152]

Statutory modification of *ultra vires* doctrine

The *ultra vires* doctrine was criticized by two committees on the reform of company law,[153] and in 1972, although it was not abolished, statutory protection[154] was given to those dealing with a company[155] in good faith in respect of transactions decided upon by the directors which were within the capacity of the company, although in fact unauthorized. In 1989 the second and third requirements were removed in provisions introduced by the Companies Act 1989, amending the Companies Act 1985.

Section 35(1) of the Companies Act 1985 as amended provides that the 'validity of an act done by a company shall not be called into question on the ground of lack of capacity by reason of anything in the company's memorandum'. The effect of this section is that, a transaction entered into by a company cannot be held invalid merely because it appears outside the objects listed in the company's memorandum. There is also provision for the company to ratify an *ultra vires* act, although given the width of section 35(1) this would rarely if ever be needed for the protection of a third party who has dealt with the company.[156] Moreover,

[148] *Re Jon Beauforte (London) Ltd.* [1953] Ch. 131.

[149] e.g. *Wenlock (Baroness)* v. *River Dee Co.* (1885) 10 App. Cas. 354; *Sinclair* v. *Brougham* [1914] A.C. 398. But see now *Westdeutsche Landesbank Girozentrale* v. *Islington L.B.C.* [1994] 4 All E.R. 890 aff'd [1996] 2 A.C. 669, *ante*, p. 211, *post*, p. 228.

[150] e.g. *Re Jon Beauforte (London) Ltd.* (*supra*, n. 148).

[151] This depends solely upon the true construction of the memorandum of association: *Rolled Steel Products (Holdings) Ltd.* v. *B.S.C.* [1986] 1 Ch. 246, at p. 306.

[152] *Ibid.*, at pp. 306–7. On 'notice', see Companies Act 1985, ss. 35A(1) and 35B.

[153] Cohen Committee (Cmnd. 6659), § 12; Jenkins Committee (Cmnd. 1749), §§ 35–42.

[154] European Communities Act 1972, s. 9, implementing Art. 9 of the first Directive 68/151/EEC on Company Law, 1968 O.J. L.65/7. See Collier and Sealy [1973] C.L.J. 1; Farrar and Powles (1973) 36 M.L.R. 270; Prentice (1973) 89 L.Q.R. 518.

[155] The company itself could not enforce an *ultra vires* contract: *Bell Houses Ltd.* v. *City Wall Properties Ltd.* [1966] 1 Q.B. 207 (reversed on other grounds, [1966] 2 Q.B. 656). See Furmston (1961) 24 M.L.R. 715.

[156] Companies Act 1985, s. 35(3).

although a shareholder may apply for an injunction to prevent an act outside the objects of a company, it is not possible for the shareholder to obtain such an injunction in respect of an act to be done by the company in fulfilment of a legal obligation arising from a previous act of the company.[157] A shareholder cannot therefore seek to subvert the effect of section 35(1) by seeking to prevent the company proceeding with a transaction within section 35(1) into which it has already entered and is obliged to carry out.

With respect to 'constructive notice', which was discussed above, by section 35B, a party to a transaction with a company is not bound to enquire as to whether it is permitted by the company's memorandum or as to any limitation on the powers of the board of directors to bind the company or authorize others to do so. In effect therefore the doctrine of constructive notice is now a dead letter.

Powers of directors

At common law not dissimilar limitations also existed in respect of contracts which, though within the powers of the company, were entered into by the directors of the company and other officers without authority or in breach of its internal constitution.[158] The Companies Act 1985, as amended by the 1989 Act, preserves the duty of directors to observe any limitations on their powers flowing from the company's memorandum.[159] But section 35A(1) protects those dealing with a company in good faith by providing that the power of the board of directors to bind the company, or authorize others to do so, shall be deemed to be free of any limitation under the company's constitution.[160]

Form of contracts

Since the passing of the Corporate Bodies' Contracts Act 1960 a corporation can in general contract in the same manner as any natural person of full age and capacity and is not only bound by contracts made under its corporate seal.[161]

Restitution of benefits conferred under an *ultra vires* contract

Payments made to or by a company under an *ultra vires* contract are recoverable in a restitutionary action,[162] and a party which has done work under such a contract will be entitled to reasonable remuneration.[163] But, the provisions of section 35 of the Companies Act 1985 mean that restitutionary obligations will be of less significance in the context of companies.

(b) Unincorporated Associations

Contractual capacity

An unincorporated association has no legal personality. It cannot therefore contract, or sue or be sued in its name, unless such a course is authorized by statute

[157] Companies Act 1985, s. 35(2). See also *ibid.*, s. 35A(4).
[158] See *Royal British Bank* v. *Turquand* (1856) 6 E. & B. 327; Campbell (1959) 75 L.Q.R. 469; (1960) 76 L.Q.R. 115.
[159] s. 35(3).
[160] See *ibid.*, s.35A(2) for the meaning of 'deals with' and 'good faith'. Cf. *ibid.*, s. 322A in respect of contracts involving directors of the company.
[161] On the execution of deeds by companies, see Companies Act 1985, s. 36A and Law Com. C.P. No. 143 (1995).
[162] *Westdeutsche Landesbank Girozentrale* v. *Islington L.B.C.* [1994] 4 All E.R. 890 aff'd [1996] 2 A.C. 669; *Woolwich B.S.* v. *I.R.C.* [1993] A.C. 70. See also *Rover International Ltd.* v. *Cannon Film Sales (No. 3)* [1989] 1 W.L.R. 912.
[163] *Craven-Ellis* v. *Canons Ltd.* [1936] 2 K.B. 403, on which see Birks (1971) 24 C.L.P. 110; *Rover International Ltd.* v. *Cannon Film Sales (No. 3)* (*supra*, n. 162).

or by rules of Court. But a contract which purports to have been entered into by or with an unincorporated association is not necessarily invalid. The person or persons who actually made the contract, for example, the secretary or committee of a club, may be held to have contracted personally and be personally liable on the contract.[164] Further, under the rules of agency, they may be held to have contracted on behalf of the members of the association, and, in certain circumstances, a representative action[165] may be brought by or against one or more of the members, including the trustees of the funds of the association,[166] as representing the others, so as to avoid the necessity of joining numerous persons as parties to the action.

Firms

A partnership firm can normally sue and be sued in the firm's name,[167] and contracts entered into by one of the partners will, as a general rule, bind the firm since each partner has authority to act for the others in the ordinary course of the partnership business.[168]

Trade unions

A trade union stands juridically in a somewhat anomalous position. Section 10 of the Trade Union and Labour Relations (Consolidation) Act 1992 provides that a trade union is not nor is it to be treated as a body corporate. Nevertheless, that sub-section goes on to provide that it is to be capable of making contracts, [169] that it is to be capable of suing or being sued in its own name,[170] and that any judgment, order, or award made in any proceedings of any description brought against a trade union is to be enforceable against any property held in trust for it to the like extent and in the like manner as if the union were a body corporate.[171] The same capacity and liability attaches to an employers' association which is an unincorporated association.[172]

At common law, a member of a trade union who is improperly expelled from the union in breach of union rules or in defiance of the rules of natural justice can bring an action for breach of contract against the union and recover damages.[173] Under the 1992 Act, a member of a union has the right not to be unjustifiably disciplined.[174]

IV. Mentally Disordered and Drunken Persons

Mental patients

UNDER Part VII of the Mental Health Act 1983 the Court of Protection is given wide discretionary powers where, after considering medical evidence, it is satisfied that a person is incapable, by reason of mental disorder, of managing and administering his or her property and affairs. A person as to whom the judge is so

[164] *Bradley Egg Farm, Ltd.* v. *Clifford* [1943] 2 All E.R. 378. [165] R.S.C. Ord. 15, r. 12.
[166] *Ideal Films Ltd.* v. *Richards* [1927] 1 KB. 374. But see *Prudential Assurance Co. Ltd.* v. *Newman Industries Ltd. (No. 2)* [1981] Ch. 257, [1982] Ch. 204; *News Group Newspapers Ltd.* v. *S.O.G.A.T.* (1986) 15 I.R.L.R. 227.
[167] R.S.C. Ord. 81, r.1. [168] See *post*, p. 629. [169] 1992 Act, s. 10(1)(a).
[170] *Ibid.*, s. 10(1)(b). [171] *Ibid.*, s. 12. [172] *Ibid.*, s. 127.
[173] *Bonsor* v. *Musician's Union* [1956] A.C. 104.
[174] 1992 Act, s. 64 (which includes expulsion). See also *ibid.*, ss. 65–7 and s. 174 .

satisfied is referred to as a 'patient' for the purposes of this part of the Act, and it is possible that such a person is absolutely incapable of entering into a valid contract.[175] Otherwise, however, a mentally disordered person has full contractual capacity, although such a person may be entitled to avoid a contract which has been made; and this is also the law in the case of drunken persons.

Voidable contracts

The contract of a mentally disordered or drunken person is not binding if it can be shown that at the time of making the contract he or she was incapable of understanding the general nature of what was being done, and that the other party was aware of this incapacity. This principle was established by Lord Esher M.R. in *Imperial Loan Co.* v. *Stone*:[176]

> When a person enters into a contract, and afterwards alleges that he was so insane at the time that he did not know what he was doing, and proves the allegation, the contract is as binding upon him in every respect, whether it is executory or executed, as if he had been sane when he made it, unless he can prove further that the person with whom he contracted knew him to be so insane as not to be capable of understanding what he was about.

Authority for the view that, even if the condition of the mentally disordered or drunken person was not known to the other party, the contract may be set aside if it was unconscionable[177] was disapproved by the Judicial Committee of the Privy Council in *Hart* v. *O'Connor*.[178]

A contract made in such circumstances is voidable at the option of the incapacitated person, who can elect either to avoid the contract or to affirm it, in which case it is binding. Thus in *Matthews* v. *Baxter*:[179]

> The defendant, while drunk, agreed at an auction sale to purchase from the plaintiff certain houses and land. Afterwards, when sober, he affirmed the contract, and then repented of his bargain. When sued on the contract, he pleaded that he was drunk at the time he made it, and to the plaintiff's knowledge.

The Court held that although he had once an option in the matter and might have avoided the contract, he was now bound by his affirmation of it. 'I think', said Martin B.[180] 'that a drunken man when he recovers his senses, might insist on the fulfilment of his bargain, and therefore that he can ratify it, so as to bind himself to a performance of it'. It will be seen from this case that the contract of a mentally disordered or drunken person is voidable at the option of the incapacitated person and not completely void. Therefore if property is transferred as the result of such a contract and subsequently passes to a *bona fide* purchaser for value, it seems that the innocent purchaser would acquire a good title.

[175] The law on this point is uncertain; see *Re Walker* [1905] 1 Ch. 160; *Re Marshall* [1920] 1 Ch. 284. Contrast *Baldwyn* v. *Smith* [1900] 1 Ch. 588; *In the Estate of Walker* (1912) 28 T.L.R. 466. All of these decisions relate to the Lunacy and Mental Treatment Acts 1890 to 1930 (now repealed). See Fridman (1963) 79 L.Q.R. 502; (1964) 80 L.Q.R. 84. Cf. s.96(1) (h) of the 1983 Act.

[176] [1892] 1 Q.B. 599, at p. 601; *York Glass Co. Ltd.* v. *Jubb* (1925) 134 L.T. 36; *Hart* v. *O'Connor* [1985] A.C. 1000. See also Law Com. No. 231, *Mental Incapacity* (1995), §§ 3.5–3.6, 3.16–3.19.

[177] *Molton* v. *Camroux* (1848) 2 Exch. 487, at p. 503 (affirmed (1849) 4 Exch. 17); *Archer* v. *Cutler* [1980] 1 N.Z.L.R. 386 (New Zealand): mental disorder. *Cooke* v. *Clayworth* (1811) 18 Ves. 12; *Wiltshire* v. *Marshall* (1866) 14 L.T. (N.S.) 396; *Blomley* v. *Ryan* (1956) 99 C.L.R. 362 (Australia): drunkenness. See *post*, p. 288.

[178] [1985] A.C. 1000.

[179] (1873) L.R. 8 Ex. 132.

[180] At p. 134.

Sale of Goods Act, s. 3

Section 3 of the Sale of Goods Act 1979, which has already been quoted in respect of minors' contracts for necessaries, provides that 'where necessaries are sold and delivered to a person who by reason of mental incapacity or drunkenness is incompetent to contract, he must pay a reasonable price for them'. There is little doubt that this liability arises in restitution[181] and that an executory contract for necessaries would therefore be unenforceable.

[181] *Re Rhodes* (1890) 44 Ch. D. 94; *Re F.* [1990] 2 A.C. 1. See also Winfield (1942) 58 L.Q.R. 82, at p. 87.

6

Misrepresentation and Non-disclosure

THIS chapter is concerned with relief for misrepresentation and for the exceptional cases in which there may be relief for non-disclosure. Although, as we shall see, there is some overlap between these two vitiating factors in cases in which there has been partial disclosure, the rationale for the intervention of the law where a false or misleading statement is made is fundamentally different from that for imposing a duty upon a party to disclose to the other party information about the subject-matter of the proposed contract.

Non-disclosure

The general rule of the common law is that a person contemplating entering a contract with another is under no duty to disclose information to that other.[1] A person who visits an antiques shop and sees a rare George II gateleg table being sold as a nineteenth century piece need say nothing to the seller before buying it. Neither does the oil prospector who discovers that there is probably oil under a given piece of land have to inform the land owner. There are, however, both common law and statutory exceptions to the general rule, in particular contracts *uberrimae fidei*, contracts of the 'utmost good faith', the prime example of which are insurance contracts, in which there is a duty to disclose and where failure to do so makes the contract voidable.

Effect of misrepresentation

The effect of a misleading statement made during the negotiations leading to a contract, a misrepresentation, is however, subject to certain limitations which will be referred to later in this chapter,[2] to render the agreement voidable at the suit of the party misled. A person who has been induced to enter into a contract by reason of a misrepresentation can refuse to carry out the undertaking, resist any claim for specific performance, and, if necessary, have the contract set aside by means of the equitable remedy of *rescission*. In addition, the party misled will sometimes be entitled to claim *damages* in respect of any loss which may have been sustained by reason of the misrepresentation. If the representation is fraudulent, damages for deceit can be recovered. If it was made without reasonable care being taken to ascertain its truth, the party misled will likewise be entitled to damages by virtue of statute and at common law. In the exceptional case, however, where the party making the representation believed, and had reasonable ground to believe, that the facts represented were true, although the contract is still voidable at the suit of the party misled, damages in addition to rescission cannot be claimed but it may be possible to claim damages in lieu of rescission.

[1] *Smith* v. *Hughes* (1871) L.R. 6 Q.B. 597, *ante*, p. 31, *post*, p. 310.

[2] See *post*, p. 248.

A pre-contractual misrepresentation therefore may give rise to contractual, tortious, statutory, and equitable remedies. Before we examine these remedies in detail, it is necessary to consider the conditions which a statement must fulfil in order to be an operative misrepresentation.

I. Misrepresentation

(a) Puffs, Representations, and Terms

Puffs, representations and terms

A misleading statement made during the negotiations leading to a contract may fall into one of three categories. First, it may be a mere 'puff', a commendatory expression which by virtue of its vagueness or extravagance would not be expected to and does not ground any form of liability. Secondly, the preliminary statement may be intended by neither party to have contractual effect, but nevertheless may seriously affect the inclination of one party to enter into the contract. It is then known as a 'representation'. If it proves false, the party misled will not be entitled to claim damages for breach of contract, for no contractual stipulation has been broken; but will be entitled to claim the relief accorded by the law in the case of misrepresentation. Thirdly, the preliminary statement may be a term of the contract, or constitute a warranty collateral to the contract, if the party making the statement undertakes or guarantees that it is true.[3] There is an overlap between the second and third categories because a statement that is a misrepresentation may become a term of the contract. In such cases there will be a choice of remedy since the party misled will be entitled to claim damages for breach of contract and to relief for misrepresentation.

(b) Requirements of Liability

Meaning of operative misrepresentation

An operative misrepresentation consists in a false statement of existing or past fact made by one party (the 'misrepresentor') before or at the time of making the contract, which is addressed to the other party (the 'misrepresentee') and which induces the other party to enter into the contract.

(i) There must be a false representation

Need for a representation

English law has always taken the view that there is no general duty imposed on one party to a contract to apprise the other of facts which might affect the other party's inclination to enter into the contract. Apart from the case of contracts *uberrimae fidei*, which will be referred to later, 'the failure to disclose a material fact which might influence the mind of a prudent contractor does not give the right to avoid the contract'.[4] The parties must look out for their own interests and ensure that they acquire the information necessary to avoid a bad bargain. There

[3] See *ante*, pp. 125–30.

[4] *Bell* v. *Lever Bros. Ltd.* [1932] A.C. 161, *per* Lord Atkin at p. 227.

must therefore be some positive statement, or some conduct from which a statement can be implied,[5] in order to amount to an operative misrepresentation.

In *Keates* v. *Lord Cadogan*[6] the plaintiff sued for damages arising from the defendant's fraud in letting to the plaintiff a house which he knew to be required for immediate occupation without disclosing that it was in a ruinous condition. It was held that no such action would lie.[7] Jervis C.J. said:[8]

> It is not pretended that here was any warranty, expressed or implied, that the house was fit for immediate occupation: but, it is said, that, because the defendant knew that the plaintiff wanted it for immediate occupation and knew that it was in an unfit and dangerous state, and did not disclose that fact to the plaintiff, an action of deceit will lie. The declaration does not allege that the defendant made any misrepresentation, or that he had reason to suppose that the plaintiff would not do what any man in his senses would do, *viz.* make proper investigation, and satisfy himself as to the condition of the house before he entered upon the occupation of it. There is nothing amounting to deceit.

Mere silence does not therefore constitute a misrepresentation.

Partial non-disclosure may suffice

A partial non-disclosure may, however, do so. Suppression of material facts can render that which is stated false, as where a vendor of land told a purchaser that all the farms on the land were fully let, but omitted to inform him that the tenants had given notice to quit.[9] Further, if a person makes a representation which is true at the time when it is made, but which the representor knows has subsequently become false, the representor is bound to disclose the change in circumstances to the other party.[10]

Active concealment

There is also some authority for the view that if, for example, a seller of goods does some positive act in order deliberately to conceal defects in the goods, as where the seller of a ship takes the vessel from the slipway into the water in order to conceal its rotten hull,[11] or the seller of a gun inserts a plug to conceal a weak spot in its workmanship,[12] such active concealment will constitute a misrepresentation.

[5] 'A nod or a wink, or a shake of the head or a smile' may suffice: *Walters* v. *Morgan* (1861) 3 De G.F. & J. 718, *per* Lord Campbell at p. 725. So may a photograph, *Atlantic Estates plc* v. *Ezekiel* [1991] 2 E.G.L.R. 202. See also *R.* v. *Charles* [1977] A.C. 177; *R.* v. *Lambie* [1982] A.C. 449; *R.* v. *Gilmartin* [1983] Q.B. 953 (use of a cheque guarantee card, credit card, or cheque implies that such use is authorized by the bank or credit card company).

[6] (1851) 10 C.B. 591. See also *Smith* v. *Hughes* (1871) L.R. 6 Q.B. 597, *post*, p. 310.

[7] Where a house is let furnished, there is an implied condition that it is fit for human habitation when let: *Collins* v. *Hopkins* [1923] 2 K.B. 617. See also now the Landlord and Tenant Act 1985, s. 8; Defective Premises Act 1972, s. 4.

[8] At p. 600.

[9] *Dimmock* v. *Hallett* (1866) L.R. 2 Ch. App. 21; *Southwestern General Property Ltd.* v. *Martin* [1982] 263 E.G. 1090. But cf. *Sindell* v. *Cambridgeshire C.C.* [1994] 1 W.L.R. 1016 (answer not disclosing facts of which vendor of land had neither knowledge nor means of knowledge not a misrepresentation). On duties to disclose, see *post*, p. 257.

[10] *Davies* v. *London & Provincial Marine Insurance Co.* (1878) 8 Ch. D. 469, at p. 475; *With* v. *O'Flanagan* [1936] Ch. 575; *Dietz* v. *Lennig Chemicals Ltd.* [1969] 1 A.C. 170. See also Misrepresentation Act 1967, s. 2(1). Cf. *Turner* v. *Green* [1895] Ch. 205; *Wales* v. *Wadham* [1977] 1 W.L.R. 199; *English* v. *Dedham Vale Properties Ltd.* [1978] 1 W.L.R. 93.

[11] *Schneider* v. *Heath* (1813) 3 Camp. 505; *Cottee* v. *Douglas Seaton (Used Cars) Ltd.* [1972] 1 W.L.R. 1408, at p. 1417. See also *Tradex Export S.A.* v. *Dorada Comp. Nav. S.A.* [1982] 2 Lloyd's Rep. 140, at pp. 157–8 (thwarting contracting party's attempts to discover true position).

[12] *Horsfall* v. *Thomas* (1862) 1 H. & C. 90. But in this case the misrepresentation was held not to have induced the contract; see *post*, p. 238.

(ii) The representation must be one of fact

A representation of fact and not of opinion

In order that the party misled should be able to rescind the contract, the representation must be one of fact. A mere expression of opinion, which turns out to be unfounded, will not invalidate a contract. There is a wide difference between the vendor of property saying that it is worth so much, and a statement that the vendor gave so much for it. The first is an opinion which the buyer may or may not choose to adopt; the second is an assertion of fact which, if false to the knowledge of the seller, is also a fraudulent misrepresentation.[13] Thus in *Bisset* v. *Wilkinson*:[14]

> The respondents agreed to purchase from the appellant certain lands at Avondale, in the Southern Island of New Zealand, for the purpose of sheep-farming, and in reliance on the appellant's statement that he estimated the lands would carry two thousand sheep. The appellant had not, and no other person had at any time, carried out sheep-farming on the lands in question. When the appellant claimed the balance of the purchase price, the respondents counter-claimed rescission of the contract on the ground of misrepresentation.

The Judicial Committee of the Privy Council held that the statement was merely of an opinion which the appellant honestly held and accordingly the claim for rescission failed. Again, in *Economides* v. *Commercial Union Assurance Co. plc*[15] a statement that the cost of replacing the contents of a flat was £16,000 made by a 21-year-old student with no special knowledge was a statement of opinion. It should not be imagined, however, that a statement of opinion can never constitute a representation of fact. In one sense it always does so, for it asserts that the opinion is actually held. Also the opinion will usually be based upon facts; so the person making the representation impliedly states that facts are known which justify that opinion. This is especially the case where the situation is such that the representor must know the facts much better than the other party. If it is shown that the representor had no reasonable grounds for that opinion, or failed to investigate the facts which gave rise to it, there may well be an actionable misrepresentation.[16]

Mere commendatory 'puffs'

Commendatory expressions, such as advertisements to the effect that a certain brand of beer 'refreshes the parts that other beers cannot reach', or that a perfume will irresistibly attract the opposite sex, are not dealt with as serious representations of fact. A similar latitude is allowed in private contracts to a person who wants to gain a purchaser, though it must be admitted that the borderline of permissible assertion is not always easily discernible. At a sale by auction, land was stated to be 'fertile and improvable'; it was in fact partly abandoned and useless. This was held to be 'a mere flourishing description by an auctioneer'.[17] But where

[13] *Lindsay Petroleum Co.* v. *Hurd* (1874) L.R. 5 P.C. 221, at p. 243.

[14] [1927] A.C. 177. See also *Anderson* v. *Pacific Fire and Marine Insurance Co.* (1872) L.R. 7 C.P. 65.

[15] [1997] 3 W.L.R. 1066. See also Marine Insurance Act 1906, s. 20(3), (4).

[16] *Smith* v. *Land and House Property Corporation* (1884) 28 Ch. D. 7; *Brown* v. *Raphael* [1958] Ch. 636. Cf. *Economides* v. *Commercial Union Assurance Co. plc* (*supra*, n. 15).

[17] *Dimmock* v. *Hallett* (1866) L.R. 2 Ch. App. 21. See also *Lambert* v. *Lewis* [1982] A.C. 225, at pp. 262–3.

in a sale of a hotel the property was said to be let to 'a most desirable tenant', whereas the rent could only be obtained under pressure and was currently much in arrears, such a statement was held to entitle the purchaser to rescind the contract.[18]

Expression of intention or prediction

Again we must distinguish a representation of present or past fact from a promise or prediction about the future. Neither a promise nor a prediction can be regarded as true or false at the time when it is made, except in so far as a person may misrepresent the state of the maker's own mind or power to bring an event to pass.[19] Thus there is a distinction between a promise which the promisor intends to perform and one which the promisor intends to break or knows cannot be performed. In the first case the represention is truly one of an intention that something shall take place in future. In the second case there is a misrepresention of the representor's existing intention: not only is a promise made which is ultimately broken, but when it is made, the maker of the statement's ability to perform or state of mind is represented to be something other than it really is. Such a misrepresentation is one of fact. Bowen L.J. said:[20]

> The state of a man's mind is as much a fact as the state of his digestion. It is true that it is very difficult to prove what the state of a man's mind at a particular time is, but, if it can be ascertained, it is as much a fact as anything else. A misrepresentation as to the state of a man's mind is, therefore, a misstatement of fact.

Thus it has been held that, if a person buys goods having at the time no means to pay or having formed an intention not to pay for them, that person makes a fraudulent misrepresentation.[21] There may also be a misrepresentation of fact behind a negligent misprediction. Thus, it has been held that a forecast of sales potential by a person with special knowledge and skill contains a representation of fact that the maker of the statement had exercised reasonable care in making it.[22] Again, a prediction by a bank manager that the granting of a loan facility would be a formality once supported by insurance from the Export Credit Guarantee Department has been held to contain a statement of fact as to the existing policy of the bank.[23]

Representation of law

It is also said that a misrepresentation of law does not render the contract voidable as against the person making it,[24] and this is undoubtedly true in most cases. But it is not easy to see why this should always be true, for there is no reason why a *wilful* misrepresentation of law should not be treated in the same way as a state-

[18] *Smith* v. *Land and House Property Corporation* (1884) 28 Ch. D. 7.
[19] *R.* v. *Sunair Holidays Ltd.* [1973] 1 W.L.R. 1105, at p. 1109; *British Airways Board* v. *Taylor* [1976] 1 W.L.R. 13, at pp. 17, 21, 23, 27. See also *Beckett* v. *Cohen* [1972] 1 W.L.R. 1593; *R.* v. *Gilmartin* [1983] Q.B. 953.
[20] *Edgington* v. *Fitzmaurice* (1885) 29 Ch. D. 459, at p. 483. See also *Goff* v. *Gauthier* (1991) 62 P. & C.R. 388.
[21] *Re Shackleton* (1875) L.R. 10 Ch. App. 446; *Ray* v. *Sempers* [1974] A.C. 370. On credit and cheque cards and cheques, see *ante*, p. 234, n. 5.
[22] *Esso Petroleum Co.* v. *Mardon* [1976] Q.B. 801, on which see *ante*, p. 129.
[23] *Box* v. *Midland Bank Ltd.* [1979] 2 Lloyd's Rep. 391, at p. 399; [1981] 1 Lloyd's Rep. 434.
[24] *Beattie* v. *Lord Ebury* (1872) L.R. 7 Ch. App. 777; *Solle* v. *Butcher* [1950] 1 K.B. 671, *post*, p. 297.

ment of opinion which is not actually held.[25] The greatest difficulty, however, arising in this sphere is to distinguish between a representation of law and one of fact. Many statements of fact contain implicit propositions of law and vice versa.[26] If a dwelling-house is represented to be a 'new' dwelling-house for the purposes of the Rent Acts, is this a representation of fact or of law?[27] A misrepresentation that planning permission exists for the business use of premises has been treated as a representation of fact.[28] Misrepresentations as to private rights (as distinct from the general law)[29] or as to the content or effect of deeds and documents[30] have also been held to entitle the party misled to rescind the contract. A misrepresentation of foreign law has also been treated as a representation of fact.[31] Statements of mixed law and fact, or statements of law which carry an implication of fact, may therefore be construed as representations of fact.

(iii) Addressed to the party misled

Addressed to the representee

The representation must have been addressed by the representor to the party misled.

In *Peek* v. *Gurney*:[32]

The promoters of a company were sued by the appellant who had purchased shares on the faith of false statements contained in a prospectus issued by them. The appellant was not a person to whom shares had been allotted on the first formation of the company; he had merely purchased shares from such allottees.

The House of Lords held that the prospectus was only addressed to the first applicants for shares; that it could not be supposed to extend to others than these; and that on the allotment 'the prospectus had done its work; it was exhausted'.

A statement made directly to the party misled is clearly addressed to that party; but will also be held to have been so addressed where the person is one to whom the representor intended the statement to be passed on.[33] If this fact is established, it is immaterial that the party misled is merely one of a class of persons, even of the public at large. Thus, if a prospectus is only part of a scheme of fraud maintained by false statements deliberately inserted from time to time in the press, its effect is not held to be exhausted by the allotment of shares, and its falsehoods will afford ground for an action for deceit to others than the allottees; for the whole mass of false statement is intended to induce the public at large to continue to purchase shares and thus keep their value inflated.[34]

[25] *West London Commercial Bank* v. *Kitson* (1884) 13 Q.B.D. 360, at p. 362.
[26] See Winfield (1943) 59 L.Q.R. 327, *post*, pp. 296, n. 13, 330.
[27] *Solle* v. *Butcher* (*supra*, n. 24).
[28] *Laurence* v. *Lexcourt Holdings Ltd.* [1978] 1 W.L.R. 1128.
[29] *Cooper* v. *Phibbs* (1867) L.R. 2 H.L. 149, *post*, p. 330.
[30] *Hirschfield* v. *L.B. & S.C. Ry.* (1876) 2 Q.B.D. 1; *Wauton* v. *Coppard* [1899] 1 Ch. 92; *Re Roberts* [1905] 1 Ch. 704; *Horry* v. *Tate & Lyle Refineries Ltd.* [1982] 2 Lloyd's Rep. 416.
[31] *Andre & Cie S.A.* v. *Ets. Michel Blanc & Fils* [1979] 2 Lloyd's Rep. 427.
[32] (1873) L.R. 6 H.L. 377, applied in *Al Nakib Investments Ltd* v. *Longcroft* [1990] 1 W.L.R. 1390.
[33] *Pilmore* v. *Hood* (1838) 5 Bing. N.C. 97; *Commercial Banking Co. of Sydney Ltd.* v. *R. H. Brown & Co.* [1972] 2 Lloyd's Rep. 360 (Australia). See also *Yianni* v. *Edwin Evans & Sons* [1982] Q.B. 438; *Smith* v. *Eric S. Bush* [1990] 1 A.C. 831. Contrast *Gross* v. *Lewis Hillman Ltd.* [1970] Ch. 445.
[34] *Andrews* v. *Mockford* [1896] 1 Q.B. 372.

(iv) The representation must induce the contract

Must induce the contract

The representation must form a real inducement to the party to whom it is addressed, and whether or not a person who has entered into a contract was induced to do so by a particular representation is in each case a question of fact.

The burden of proving that the representation induced the contract rests upon the party misled.[35] But such inducement may be inferred. Thus it was said by Lord Blackburn:[36]

> I think that if it is proved that the defendants with a view to induce the plaintiff to enter into a contract made a statement to the plaintiff of such a nature as would be likely to induce a person to enter into a contract, and if it is proved that the plaintiff did enter into the contract, it is a fair inference of fact that he was induced to do so by the statement.

It will not be inferred that a representation induced the contract where it would not have induced a reasonable person to contract but, in such a case, a representee who proves that he or she was in fact so induced will be entitled to relief.[37]

On the other hand a person who was not actually influenced by a false representation cannot be said to have been induced to enter a contract by it. The representation may have been immaterial, in the sense that the representee's judgment was never affected[38] or the representee did not become aware, until after the conclusion of the contract, that a representation had been made.[39] In *Horsfall* v. *Thomas*,[40] for example:

> Thomas bought a cannon which had been manufactured for him by Horsfall. The cannon had a defect which made it worthless, which Horsfall had endeavoured to conceal by inserting a metal plug into the weak spot in the gun. Thomas never inspected the gun and upon using it the gun burst.

It was held that, the attempted concealment having had no operation upon Thomas's mind or conduct, he could not successfully set up a plea of fraud. 'If the plug, which it was said was put in to conceal the defect, had never been there, his position would have been the same; for, as he did not examine the gun or form any opinion as to whether it was sound, its condition did not affect him.'[41]

Opportunities for inspection

The mere fact that the party misled has had the opportunity of investigating and ascertaining whether the representation is true or false will not necessarily deprive that person of the right to claim to have been deceived by it;[42] but if the

[35] *Arkwright* v. *Newbold* (1880) 17 Ch. D. 301, at p. 324.
[36] *Smith* v. *Chadwick* (1884) 9 App. Cas. 187, at p. 196.
[37] *Museprime Properties Ltd.* v. *Adhill Properties Ltd.* (1991) 61 P. & C.R. 111, at p. 124; *Goff* v. *Gauthier* (1991) 62 P. & C.R. 388. On causation see also *Downs* v. *Chappell* [1997] 1 W.L.R. 426, at p. 435; *South Australia Asset Management Cpn.* v. *York Montague Ltd.* [1997] A.C. 191, at pp. 212–15; *Bristol & West B.S.* v. *Mothew* [1997] 2 W.L.R. 436.
[38] *Smith* v. *Chadwick* (*supra*, n. 36); *JEB Fasteners* v. *Marks, Bloom & Co.* [1983] 1 All E.R. 583.
[39] *Re Northumberland and Durham District Banking Co.* (1858) 28 L.J. Ch. 50.
[40] (1862) 1 H. & C. 90. Cf. *Smith* v. *Hughes* (1871) L.R. 6 Q.B. 597, at p. 605.
[41] At p. 99, *per* Bramwell B.
[42] *Central Ry. Co. of Venezuela* v. *Kisch* (1867) L.R. 2 H.L. 99, at p. 120; *Redgrave* v. *Hurd* (1881) 20 Ch. D. 1; *Laurence* v. *Lexcourt Holdings Ltd.* [1978] 1 W.L.R. 1128; *Alliance & Leicester B.S.* v. *Edgestop* [1993] 1 W.L.R. 1462.

representee does investigate, and consequently relies not so much upon the misrepresentation as upon the accuracy of those investigations, the action will fail, as it can no longer be said that the representation was the reason for entering the contract.[43] The representation need not, however, be the sole or decisive inducement, provided that it did, in fact, materially affect the other party's intention to enter into the agreement.[44] Thus a person who bought shares in a company on the faith of certain fraudulent statements contained in a prospectus, and also in the erroneous belief that he would be entitled to the benefit of a charge on the company's assets, was nevertheless able to rescind on the ground that he had been materially misled by the statements.[45]

(c) Fraudulent Misrepresentation

Fraudulent misrepresentation

Once it has been established that there is an operative misrepresentation, the next step is to inquire into the state of mind of the party making the misrepresentation. At common law a *fraudulent* misrepresentation not only renders the contract voidable at the suit of the party misled, but also gives rise to an action for damages in respect of the deceit.[46] If, therefore, the misrepresentation was made fraudulently, the injured party will be entitled to recover damages in respect of any loss which may have been suffered by reason of the fraud.

What constitutes fraud?

The meaning of fraud is given in the leading case of *Derry* v. *Peek*:[47]

A company obtained a statutory right to run trams by animal power or, if the consent of the Board of Trade was obtained, by steam or mechanical power. The directors believed that the Board would give this consent as a matter of course, as they had already submitted plans to the Board without any objection being made. They therefore issued a prospectus saying that the company had the right to run trams by steam or mechanical power. The respondent took up shares in the company on the faith of the representation. The Board of Trade ultimately refused its consent, and the company was wound up.

The respondent sued in tort for deceit, and to succeed in such an action fraud had to be proved. The law was thus stated by Lord Herschell:[48]

First, in order to sustain an action of deceit, there must be proof of fraud, and nothing short of that will suffice. Secondly, fraud is proved when it is shewn 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. Although I have treated the second and third as distinct cases, I think the third is but an instance of the second, for one who makes a statement under such circumstances can have no real belief in the truth of what he states.

Lord Herschell went on to point out that making a false statement through want of care falls far short of fraud; so too does a false representation honestly believed,

[43] *Attwood* v. *Small* (1838) 6 Cl. & Fin. 232, 395.
[44] *Barton* v. *Armstrong* [1976] A.C. 104, at p. 119.
[45] *Edgington* v. *Fitzmaurice* (1885) 29 Ch. D. 459.
[46] Statutory remedies in respect of fraudulent statements have been created by the Financial Services Act 1986, s. 47 (restitution order) and Banking Act 1987, s. 35 (criminal remedy).
[47] (1889) 14 App. Cas. 337 (but see *post*, p. 261).
[48] At p. 374.

though on insufficient grounds. But he also pointed out that when a false statement has been made, the question whether there were reasonable grounds for believing it, and what were the means of knowledge in the possession of the person making it, are weighty matters for consideration, for the ground upon which an alleged belief is founded is an important test of its reality. In the present case, there were obviously present reasons which had led the directors to make the untrue statement, and they 'honestly believed what they stated to be a true and fair representation of the facts'.[49] The respondent's action therefore failed.

Negligence does not amount to fraud; but motive is irrelevant

Derry v. *Peek* thus establishes that a negligent misrepresentation will not amount to deceit, however gross the negligence may be.[50] Nothing short of fraud will suffice. On the other hand, it also shows that it is not necessary to constitute fraud, that there should be a clear knowledge that the statement made was false. What is essential is the absence of any belief in its truth. Further, it has been held that the motive of the person making the representation is irrelevant. It is no justification to show that the representation was made without bad motive, or that there was no intention to cheat or cause loss to another by the deception.[51]

False impression

With regard to the statement itself, it is not necessary to prove any specific representation to have been false. It is fraud intentionally to give a false impression and induce a person to act upon it, even though each fact stated taken by itself may be literally true.[52] So it is possible by stating a thing partially to make a statement which, in the sense that it must be known it will be understood, is really false.[53] A half-truth may be fraudulent because further relevant facts are suppressed. Also a statement which is believed to be true when made and which is subsequently discovered to be false, will be considered to be fraudulent if the mistake is not communicated to the other person before that person acts on it.[54]

Remedies

The remedies for fraudulent misrepresentation are several. The injured party may either affirm the contract and bring an action for damages for deceit or may elect to rescind the contract, i.e. have it set aside, and sue for damages for any loss suffered. If the injured party is sued for specific performance or damages, the fraud may be set up as a defence and a counterclaim for damages for any loss suffered may be brought. If the contract has not yet been executed, the injured party may repudiate it and recover any money paid in an action for money had and received,[55] but it has been held that an account of profits made by the fraudster does not lie.[56]

[49] *Ibid.*, at p. 376.

[50] *Angus* v. *Clifford* [1891] 2 Ch. 449, at p. 464; *Thomas Witter Ltd.* v. *T.B.P. Industries Ltd.* [1996] 2 All E.R. 573, at pp. 587–8.

[51] *Polhill* v. *Walter* (1832) 3 B. & D. 114; *Bradford Building Socy.* v. *Borders* [1941] 2 All E.R. 205, at p. 211; *Brown Jenkinson & Co. Ltd.* v. *Percy Dalton (London) Ltd.* [1957] 2 Q.B. 621.

[52] *Jewson & Sons Ltd.* v. *Arcos Ltd.* (1933) 39 Com. Cas. 59.

[53] *Peek* v. *Gurney* (1873) L.R. 6 H.L. 377, at pp. 400, 403; *R.* v. *Kylsant* [1932] 1 K.B. 442.

[54] *Davies* v. *London and Provincial Marine Insurance Co.* (1878) 8 Ch. D. 469, at p. 475. See also *ante*, p. 233.

[55] *Vaughan* v. *Matthews* (1849) 13 Q.B. 187, at p. 190; *Kettlewell* v. *Refuge Assurance Co.* [1908]1 K.B. 545, [1909] A.C. 243.

[56] *Halifax B.S.* v. *Thomas* [1996] Ch. 217. But in so far as doubts were cast on the availability of restitutionary damages for fraud, *sed quaere*. See *South Australia Asset Management Cpn.* v. *York*

Measure of damages

Although fraud is discussed here in a contractual context, the measure of damages recoverable is essentially that applicable to the tort of deceit. A wider liability is imposed upon an intentional wrongdoer than a negligent or innocent one in order to deter fraud, because 'moral considerations militate in favour of requiring the fraudster to bear the risk of misfortunes directly caused by his fraud',[57] and also because damages for fraud are frequently a restitutionary remedy.[58] Accordingly, all actual losses directly flowing from the fraud are recoverable even if they could not reasonably have been foreseen[59] and, as contributory negligence is not a defence to fraud, damages will not be reduced on this ground[60] but the defrauded party is required to mitigate the loss once aware of the fraud.[61]

Damages in tort are assessed in accordance with what we may call the 'out of pocket' rule, that is to say, the amount by which the injured party is worse off by entering into the contract than if he had not contracted at all.[62] Unless the representation has become a term of the contract, there is no entitlement, as there would be on breach of the contract, to recover 'the loss of the bargain', that is to say, an amount which serves to put the injured party into the position in which that party would have been had the representation been true.[63] This can be illustrated by an example loosely based on the facts in *Smith New Court Securities Ltd.* v. *Citibank N.A.* in which the House of Lords stated the applicable principles.[64]

Suppose a person has been fraudulently induced to buy shares for £24 million. They are in fact worth £12 million at the date of the contract. If the representation had been true they would have been worth £26 million. The injured party will be entitled to recover the amount by which it is out of pocket (£12 million), but not for the loss of the bargain (£14 million). The injured party must give credit for any benefits received as a result of the transaction, including, as a general rule, the market value of the property acquired. Account will not generally be taken of a fall in the market value after the date of the contract unless, as in the case of *Smith New Court Securities Ltd.*, the fraudulent misrepresentation continued to operate after that date or the party misled is unable to sell the property because of the fraud.[65] On the other hand, the party misled can undoubtedly recover in respect of consequential damage, such as injury to the person or

Montague Ltd. [1997] A.C. 191, at p. 215; Law Com. No. 247 (1997), § 3.24 ff.. See also *Attorney-General* v. *Blake* [1998] 1 All E.R. 833.

[57] *Smith New Court Securities Ltd.* v. *Citibank N.A.* [1997] A.C. 254, *per* Lord Steyn at p. 280.

[58] *South Australia Asset Management Cpn.* v. *York Montague Ltd.* [1997] A.C. 191, *per* Lord Hoffmann at p. 215.

[59] *Doyle* v. *Olby (Ironmongers) Ltd.* (*infra*, n. 66); *East* v. *Maurer* (*infra*, n. 68); *Smith New Court Securities Ltd.* v. *Citibank N.A.* (*supra*, n. 57) at pp. 267, 279.

[60] *Alliance & Leicester B.S.* v. *Edgestop Ltd.* [1993] 1 W.L.R. 1462. Cf. the position on claims under the Misrepresentation Act 1967, s. 2(1), *post*, p. 243.

[61] *Smith New Court Securities Ltd.* v. *Citibank N.A.* (*supra*, n. 57) at p. 266.

[62] *Peek* v. *Derry* (1887) 37 Ch. D. 541, at p. 594; *McConnell* v. *Wright* [1903] 1 Ch. 546, at p. 554; *Broome* v. *Speak* [1903] 1 Ch. 586, at pp. 605, 623 (affirmed [1904] A.C. 342).

[63] The anomalous restriction of damages for failure to complete a land sale because of a defective title to reliance losses, *Bain* v. *Fothergill* (1874) L.R. 7 H.L. 158 abolished by the Law of Property (Miscellaneous Provisions) Act 1989, s. 3, did not, however, apply where there was fraud: (1874) L.R. 7 H.L. 158, at p. 207.

[64] [1997] A.C. 254, *per* Lord Browne Wilkinson at p. 267.

[65] *Ibid.*

property, or, say, the expense involved in moving into a house which that party has been fraudulently induced to buy,[66] or even for distress caused by the fraud.[67] The party misled may also recover in respect of opportunities foregone as a result of entering the contract. Thus, in *East* v. *Maurer*,[68] the purchasers of a hair salon bought in reliance on a fraudulent representation that the vendor had no intention of regularly working at another salon he owned in the same town recovered *inter alia* the profit they would have made if the false representation had not been made, i.e. the profit they might have been expected to make in another hairdressing business bought for a similar sum.

(d) Negligent Misrepresentation

Common law

A person who has been induced to enter into a contract as the result of a negligent misrepresentation made to him or her by the other party to the contract is entitled to rescind as in the case of fraud.[69] But before the passing of the Misrepresentation Act 1967, in the absence of a fiduciary relationship,[70] there was no definitive authority for the proposition that there was also an entitlement to claim damages. In 1963, in the case of *Hedley Byrne & Co. Ltd.* v. *Heller & Partners Ltd.*[71] the House of Lords extended liability in damages in tort to negligent misstatement and held that a duty of care could exist where there was a 'special relationship' between the person making the statement and the person to whom it was made. The principle is not restricted to statements that induce a contract[72] and the effect of this decision on such statements and the law relating to misrepresentation was not directly considered,[73] nor were the tests advanced by their Lordships for determining the existence of this special relationship uniform in their terminology.[74] Nevertheless, it is clear that the existence of a contract between the parties does not exclude a parallel or concurrent duty of care in tort.[75] Moreover, it has been held that a negligent misrepresentation made by one party to the other preparatory to entering into a contract can give rise to an action for damages in tort for negligent misstatement if the person making it has or professes to have special knowledge or skill in respect of the facts stated[76] or if the representation, in the context in which it is made, is to be regarded as neither casual nor unconsidered, but to be relied on.[77] The burden of proving negligence rests on the party alleging it, i.e. on the representee.

[66] *Doyle* v. *Olby (Ironmongers) Ltd.* [1969] 2 Q.B. 158.
[67] *Shelley* v. *Paddock* [1979] Q.B. 120; *Archer* v. *Brown* [1985] Q.B. 401.
[68] [1991] 1 W.L.R. 461. See also *Smith New Court Securities Ltd.* v. *Citibank N.A.* (*supra*, n. 57) at p. 282.
[69] On rescission, see *post*, p. 248.
[70] See *post*, p. 261.
[71] [1964] A.C. 465.
[72] *Box* v. *Midland Bank Ltd.* [1979] 2 Lloyd's Rep. 391.
[73] But see Lord Pearce, *ibid.*, at p. 539.
[74] [1964] A.C. 465, at pp. 486, 503, 514, 528, 529.
[75] *Henderson* v. *Merrett Syndicates Ltd.* [1995] 2A.C. 145, *per* Lord Goff at pp. 186–91.
[76] *Esso Petroleum Co. Ltd.* v. *Mardon* [1976] Q.B. 801; *Cornish* v. *Midland Bank plc* [1985] 3 All E.R. 512; *Gran Gelato Ltd.* v. *Richcliff (Group) Ltd.* [1992] Ch. 560. Contrast *Oleificio Zucchi S.p.A.* v. *Northern Sales Ltd.* [1965] 2 Lloyd's Rep. 496, at p. 519; *Argy Training Development Co. Ltd.* v. *Lapid Developments Ltd.* [1977] 1 W.L.R. 444.
[77] *Howard Marine and Dredging Co. Ltd.* v. *A. Ogden & Sons (Excavations) Ltd.* [1978] Q.B. 574, at pp. 592, 600. See also *post*, p. 263.

Measure of damages

Again, the tort measure applies, but for a negligent misstatement only losses that are foreseeable can be recovered. Recent cases have considered the position where the duty is to take care that information is correct, for example the valuation of a property by a surveyor or information given by a solicitor to a client. In such cases the damages are not based on an assessment of what the injured party's position would have been had accurate information been given, which might, where that party would not have entered into the transaction at all, have included a fall after the date of the contract in the market value of the property purchased. It has been held[78] that because the duty of a valuer is to take care to ensure that information regarding value is correct, a valuer is only liable for the foreseeable loss of the information being wrong, so that the damages are the difference between the valuation given and the true value of the property at the time of the breach. This has been criticized as inappropriately capping the tort measure by reference to the contractual bargain.[79]

Statute

The uncertainties concerning the way in which the principle laid down in the case of *Hedley Byrne & Co. Ltd.* v. *Heller & Partners Ltd.* operated in respect of pre-contractual statements were largely removed by section 2(1) of the Misrepresentation Act 1967,[80] which establishes a statutory right to damages:

> Where a person has entered into a contract 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.

The use of the words 'reasonable ground to believe' might suggest that the duty imposed upon the representor is equivalent to the duty of care in negligence, the extent of which may vary according to the circumstances in which the representation is made. But in *Howard Marine and Dredging Co. Ltd.* v. *A. Ogden & Sons (Excavations) Ltd.*:[81]

> The defendant entered into a charterparty by which it chartered from the plaintiff two barges. In the course of negotiations leading to the contract, the plaintiff's manager represented to the defendant that the barges had a payload of 1,600 tonnes. He based this figure on his recollection of a statement in Lloyds Register that the deadweight capacity of the barges was 1,800 tonnes. That statement was in fact erroneous and the German shipping documents (which the manager had seen) relating to the barges gave the true deadweight capacity at 1,055 tonnes. The defendant refused to pay the agreed hire charges

[78] *South Australia Asset Management Cpn.* v. *York Montague Ltd.* [1997] A.C. 191. See also *Bristol & West B.S.* v. *Mothew* [1997] 2 W.L.R. 436; *Swindle* v. *Harrison* [1997] 4 All E.R. 705 (breach of fiduciary duty).

[79] Stapleton (1997) 113 L.Q.R. 1. See also McLaughlan *ibid.* at p. 421; [1997] J.C.L. 114, cf. Dugdale [1995] J.B.L. 533.

[80] See also the Tenth Report of the Law Reform Committee (Cmd. 1782, 1962), § 17. The precedent for s. 2(1) was in s. 43 of the Companies Act 1948. See now Financial Services Act 1986, ss. 150, 166; *post*, p. 264.

[81] [1978] Q.B. 574.

and the plaintiff withdrew the barges and sued for the balance due. The defendant counterclaimed £600,000 on the ground of misrepresentation, being the loss which it alleged it had sustained because of the low carrying capacity of the barges.

The Court of Appeal was divided as to whether the circumstances were such as to impose a duty of care in negligence at common law.[82] But a majority of the Court held[83] that the plaintiff was liable under section 2(1), since the sub-section goes further than the common law, does not require a special relationship or special skill and does not depend upon the representor being under a duty of care the extent of which may vary according to the circumstances in which the representation is made. The statute imposes an absolute obligation not to state facts which the representor cannot prove it had reasonable ground to believe were true. The burden thus lies on the representor and not, as at common law, on the representee and it may be a heavy one to discharge, particularly since reasonable ground for belief in the truth of the statement must be shown to exist up to the time the contract is made.

It should, however, be noted that the sub-section is narrower than the common law because it only applies where a person has (a) entered into a contract after a misrepresentation has been made to that person and (b) the misrepresentation is made by another party to the contract, and not by a third party. Thus if A enters into a contract with B as a result of a misrepresentation made to B by C, no action will lie under the sub-section unless C is B's agent; nor will C be liable to A under this provision, though C might be liable in tort for negligent misstatement if a special relationship of care or reliance is shown to exist.[84]

Liability in damages has also been imposed in respect of negligent statements in the listing of particulars of securities,[85] and misleading information in literature concerning package holidays.[86] It is also a criminal offence for an estate agent or property developer to make false or misleading statements concerning the description of property.[87]

Measure of damages

The effect of section 2(1) of the 1967 Act is to confer upon the representee a right to damages for misrepresentation in circumstances in which there would have been such a right had the misrepresentation been fraudulent. This equation with fraud has given rise to certain problems.[88] Despite suggestions that the sub-section gave damages for loss of bargain[89] it is now clear that the measure of damages is the tortious measure, i.e. reliance losses so as to put the representee in the

[82] Lord Denning M.R. and Shaw L.J. Bridge L.J. expressed no concluded view on this issue.
[83] Bridge and Shaw L.JJ. (Lord Denning M.R. dissenting).
[84] Or under a collateral warranty: see *ante*, p. 128.
[85] Financial Services Act 1986, s. 150. On statements in prospectuses for unlisted securities see *ibid.*, ss. 166–7 (not yet in force). It is for those responsible to show they had reasonable grounds for believing the statement was true.
[86] Package Travel, Package Holidays and Package Tours Regulations 1992 (S.I. 1992 No. 3288) implementing Council Directive 90/314/EC.
[87] Property Misdescription Act 1991, s. 1.
[88] See generally Atiyah and Treitel (1967) 30 M.L.R. 369, 372–5. Cf. the different formulation in Financial Services Act 1986, ss. 150, 166.
[89] e.g. *Watts* v. *Spence* [1976] Ch. 165, at p. 178.

position he would have been in had he never entered into the contract.[90] Indeed it also appears to be settled that under the sub-section it is the fraud measure rather than that for negligent misstatement at common law which applies. This allows the recovery of all damages directly flowing from the misrepresentation even if not foreseeable. In *Royscott Trust Ltd.* v. *Rogerson*:[91]

A finance company was induced to advance a greater sum than it would otherwise have done by a car dealer's misrepresentation that a 20 per cent deposit had been paid by a prospective hire-purchaser of a car. The hire-purchaser later ceased to pay the instalments due and dishonestly sold the car. It was held that whether or not the sale by the hire-purchaser was foreseeable, the loss to the finance company of the unpaid instalments was recoverable under section 2(1) of the 1967 Act from the car dealer.

The argument that as a matter of policy it was undesirable to adopt the fraud measure for what is basically negligence liability since fools should not be treated as if they were rogues,[92] was rejected by the Court of Appeal as incompatible with the literal words of the statute. The point is, however, not beyond argument because it was not necessary in the above case to choose between the tort and the fraud measures. This was because the act of disposing of the car by the hire-purchaser was held to be foreseeable so the unpaid instalments would have been recoverable in any event. Moreover, it has been held that damages under section 2(1) may be reduced for contributory negligence where the loss was partly the fault of the representee.[93] As has been seen,[94] common law damages for fraudulent misrepresentation may not be reduced for contributory negligence. It therefore appears that not all the consequences of fraud follow in the case of liability under section 2(1) of the 1967 Act,[95] and there are indications that the House of Lords would be reluctant to find that what Lord Steyn described as 'the rather loose wording' of the statute 'compels the court to treat a person who was morally innocent as if he was guilty of fraud when it comes to the measure of damages'.[96]

[90] *Sharneyford Supplies Ltd.* v *Edge* [1987] Ch. 305; *Naughton* v. *O'Callaghan* [1990] 3 All E.R. 191, at p. 196; *Royscott Trust Ltd.* v. *Rogerson* [1991] 2 Q.B. 297. See also *André et Cie S.A* v. *Ets. Michel Blanc et Fils* [1977] 2 Lloyd's Rep. 166, at p. 181. On the effect of a fall in market value, see *ante*, pp. 241, 243.

[91] [1991] 2 Q.B. 297. See also *F. & B. Entertainments Ltd.* v. *Leisure Enterprises Ltd.* [1976] 240 E.G. 455; *Chesneau* v. *Interhome Ltd.*, *The Times*, 9 June 1983; *William Sindall plc* v. *Cambridgeshire C.C.* [1994] 1 W.L.R. 1016, at p. 1037; *South Australia Asset Management Cpn.* v. *York Montague Ltd.* [1997] A.C. 191, at p. 216.

[92] Fairest [1967] C.L.J. 239, at p. 244; Taylor (1982) 45 M.L.R. 139, at p. 141 ff; Hooley (1991) 107 L.Q.R. 547, at pp. 549–51. Cf. Atiyah and Treitel (1967) 30 M.L.R. 369, at p. 373; Cartwright, *Unequal Bargaining* (1991), pp. 131–2.

[93] *Gran Gelato Ltd.* v *Richcliff (Group) Ltd* [1992] Ch. 560, at p. 574. But note that Nicholls V-C. stated, at p. 573, that 'in short liability under the Misrepresentation Act 1967 is essentially founded on negligence' and see Cane (1992) 108 L.Q.R. 539, at p. 544.

[94] *Ante*, p. 241.

[95] In a fraud case the period of limitation runs from the time the fraud is discovered or could with reasonable diligence be discovered not the date the damage is suffered. Notwithstanding *Royscott Trust Ltd.* v *Rogerson*, *Chitty on Contracts*, 27th edn. (1994), para. 28–058 suggests that the fraud period would not apply, and see *Garden Neptune Shipping Ltd.* v. *Occidental Worldwide Investment Cpn.* [1990] 1 Lloyd's Rep. 330, at p. 335.

[96] *Smith New Court Securities Ltd.* v. *Citibank N.A.* [1997] A.C. 254, at p. 283. See also *ibid.*, *per* Lord Browne Wilkinson at p. 267.

(e) Innocent Misrepresentation

No fraud or negligence

Before the advent of a remedy in damages for negligent misrepresentation, all contractual misrepresentations which merely induced the formation of a contract could be divided into two categories: first, misrepresentations which were fraudulent, and, secondly, misrepresentations in which the element of fraud was lacking. The latter were known as 'innocent misrepresentations'. For historical reasons, the remedies available for an innocent misrepresentation were quite distinct from those available for fraud, the main point of distinction being that only rescission, but not damages could be awarded.[97] Now that a liability in damages for negligent misrepresentation has been created both by the common law and by section 2(1) of the Misrepresentation Act 1967, the term 'innocent misrepresentation' must be understood to mean a misrepresentation in which *no element of fraud or negligence is presented.* A person who has been induced to enter into a contract as the result of an innocent misrepresentation made to him by the other party to the contract is entitled to the remedy of rescission or to damages in lieu of rescission; but, in contrast with cases of fraudulent or negligent misrepresentation, he cannot obtain damages in addition to rescission, only an indemnity.

Common law and equity

The reason why damages of this nature cannot be awarded is due to the fact that, at common law, no remedy whatsoever was available for innocent misrepresentation. The common law recognized fraud, or the breach of a contractual term, but gave no relief whatsoever for an innocent misrepresentation which merely induced the formation of a contract.[98] It was left to the Court of Chancery to grant relief by the application of equitable principles. In equity, a contract could be set aside for innocent misrepresentation. But it was not a ground for an award of damages, for damages are a legal remedy and they were not available in the Court of Chancery.

The Judicature Act 1873[99] did little to change this situation. Thus, while it enabled equitable remedies to be granted in any division of the High Court it in no way affected the substantive rule that damages in addition to rescission cannot be awarded for innocent misrepresentation. So strict is this rule that damages cannot be claimed even obliquely, e.g. by claiming specific performance of the contract with a reduction of the price to offset the loss suffered.[100]

Refusal of specific performance

Where there has been an innocent misrepresentation, the party misled may plead the misrepresentation as a defence to an action against him for specific performance of the contract. Specific performance is a discretionary remedy and it will be refused where it would be inequitable for one party to insist on performance of the contract by the other. Thus it will be refused where the party against whom it is sought would not have entered into the contract but for the misrepresentation.[101]

[97] *Heilbut Symons & Co.* v. *Buckleton* [1913] A.C. 30, at p. 48.
[98] *Kennedy* v. *Panama, New Zealand, and Australian Royal Mail Co. Ltd.* (1867) L.R. 2 Q.B. 580, at p. 587.
[99] 1873 Act, ss. 24(1), (2), and 25(11). See now the Supreme Court Act 1981, s. 49.
[100] *Gilchester Properties Ltd.* v. *Gomm* [1948] 1 All E.R. 493. But cf. misdescription (*post*, p. 266).
[101] *Lamare* v. *Dixon* (1873) L.R. 6 H.L. 414.

Rescission

The ability to resist specific performance may not, however, suffice to protect the party misled who does not wish to perform, since, if the contract remains on foot, it may leave that person exposed to an action for damages. The party misled may therefore also obtain rescission of the contract, either as a defence to an action brought by the misrepresenter or by bringing proceedings. Thus in *Redgrave* v. *Hurd*:[102]

R induced H to enter into a contract for the purchase of his house and, together with the house, his practice as a solicitor. He misstated the value of his practice and H refused to complete the purchase of the house. When sued for specific performance, H counter-claimed for rescission of the contract and for the return of the deposit which he had paid.

The Court of Appeal held that specific performance should be refused and the contract rescinded; H accordingly recovered his deposit.

Indemnity

When a contract is rescinded, each party is entitled to be relieved of the obligations under the contract and to recover any benefit which he may have conferred upon the other party. The object of rescission is to restore the *status quo ante*, and with this end in view the party misled can claim an indemnity against any obligations which may be incurred, or which have been incurred, as a result of the contract.

The exact principle upon which an indemnity is to be assessed is not, however, entirely clear. In *Newbigging* v. *Adam*:[103]

The plaintiff entered into a partnership with the defendants and provided £10,000 of new capital. He was induced to enter into the partnership agreement by a material innocent misrepresentation as to the capacity of certain machinery. The business failed, and the plaintiff sued for rescission of the agreement, for recovery of his capital, and for an indemnity against all claims which might be made against him by virtue of his having become a partner.

All members of the Court of Appeal agreed that the plaintiff was entitled to the relief for which he asked. They were also agreed that the right to an indemnity must be less extensive than the right to damages, and that the principle underlying the award of an indemnity is to restore the party misled to his old position. But they differed in their conclusion as to how the *status quo ante* should in general be achieved. Fry L.J. was inclined to hold that 'the plaintiff is entitled to an indemnity in respect of all obligations entered into under the contract when those obligations are within the necessary or reasonable expectation of both of the contracting parties at the time they made the contract'.[104] But an award made on this basis would differ in no way from damages, and it is submitted that a narrower and more satisfactory test was propounded by Bowen L.J. when he said: 'he is not to be replaced in exactly the same position in all respects, otherwise he would be entitled to recover damages, but he is to be replaced in his position so far as

[102] (1881) 20 Ch. D. 1.

[103] (1886) 34 Ch. D. 582, affirmed *sub nom. Adam* v. *Newbigging* (1888) 13 App. Cas. 308.

[104] At p. 596. See also Cotton L.J. at p. 589: 'an indemnity against the obligations which he has contracted under the contract which is set aside'.

regards the rights and obligations which have been *created by the contract* into which he has been induced to enter'.[105]

The distinction between damages and an indemnity as it works out in practice may be illustrated by the case of *Whittington* v. *Seale-Hayne*,[106] where the Court adopted the narrower principle suggested by Bowen L.J.:

Poultry farmers had been induced to take a lease by the defendant's innocent oral misrepresentation that the premises were sanitary. This was not the case, and in consequence of the contamination of the water supply, their manager fell ill and the poultry died. They claimed rescission of the lease, and an indemnity to cover the value of the stock, loss of profit on sales, loss of breeding season, medical expenses of the manager, rates, rent, and money spent on outbuildings, etc. They had also been compelled by the local council to renew the drains, and this item, too, was included.

It was held that the poultry farmers were entitled to have the lease rescinded, and to recover what they had spent on rent, rates, and the renewal of the drains, since these were expenses incurred under the covenants in the lease or arising necessarily out of the occupation of the property, and thus 'obligations created by the contract'. Their claim for payment in respect of the other items of loss was not allowed, since these were damages, there being no obligation to carry on a poultry farm on the leased premises.

(f) Rescission

Right of rescission

The remedy of rescission is common to all classes of operative misrepresentation.[107] When a person has been induced to enter into a contract by a misrepresentation of any description, the effect on the contract is not to make it void, but to give the party misled an option, either to avoid it, or, alternatively, to affirm it.

A party who is misled and elects to avoid the contract may take steps to have it set aside by the Courts or may resist an action for specific performance, or for damages, brought by the representor, and rescind by way of counterclaim.[108] Rescission, however, is not merely a judicial remedy. The party misled can therefore rescind without seeking the assistance of a Court, and any property transferred under the contract will revest in the party who has so rescinded the contract.

Mode of rescission

As a normal rule, rescission must be communicated to the other party.[109] But where a seller of goods has a right to avoid the contract for fraud, it suffices if the seller at once, on discovering the fraud, takes all possible steps to regain the goods. In *Car and Universal Finance Co. Ltd.* v. *Caldwell*:[110]

[105] At p. 593.
[106] (1900) 82 L.T. 49.
[107] Rescission for misrepresentation is governed by similar principles to rescission for undue influence, on which see *post*, p. 284.
[108] The setting up of the misrepresentation by way of defence has in some instances been treated as equivalent to rescission: *Clough* v. *London & N.W. Ry.* (1871) L.R. 7 Ex. 26. Contrast *Berg* v. *Sadler & Moore* [1937] 2 K.B. 158.
[109] *Scarfe* v. *Jardine* (1882) 7 App. Cas. 345, at pp. 360, 361.
[110] [1961] 1 Q.B. 525. Cf. *Newtons of Wembley Ltd.* v. *Williams* [1965] 1 Q.B. 560.

The defendant was fraudulently induced to sell a motor car to a purchaser in return for a bad cheque. When the cheque was dishonoured, the defendant immediately informed the police and the Automobile Association, but the purchaser had deliberately absconded and could not be found. The purchaser subsequently sold the car. It came into the hands of the plaintiff which bought it in good faith.

The Court of Appeal held that the defendant had effectively rescinded the contract even though he had not communicated his rescission to the purchaser. The title to the car had revested in the defendant on rescission and so the plaintiff had no claim to the vehicle.

Limits to right to rescind

Certain limitations have been placed by the law on the right to rescind. In a number of situations, the party misled may be precluded from rescinding the contract. It is important to note, however, that the loss of the remedy of rescission will not prevent a claim for damages for fraud or negligent misstatement or under section 2(1) of the Misrepresentation Act 1967. The right to damages, where this exists, still survives.

There are five limitations on the right to rescind.

(i) Affirmation

First, if after becoming aware of the misrepresentation the representee affirms the contract either by express words or by an act which shows an intention to affirm it, rescission cannot be obtained. So, for example, if persons who have purchased shares on the faith of a misrepresentation subsequently become aware of its falsity, but neglect to remove their name from the register of shareholders,[111] or accept dividends paid to them,[112] they will not be permitted to avoid the contract. In *Long* v. *Lloyd*:[113]

The plaintiff was induced to purchase a lorry by the defendant's representation that it was 'in excellent condition'. On the first journey after the sale, the dynamo broke and the plaintiff noticed several other serious defects. The defendant was informed of these and offered to pay half the cost of some of the repairs. On the next long journey, the lorry broke down completely and the plaintiff realized that it was in a deplorable condition. He claimed to rescind the contract.

The Court of Appeal held that, although the first journey did not amount to an affirmation of the contract as it had been undertaken merely to test the truth of the defendant's representation, the second journey did constitute such an affirmation since the plaintiff then had knowledge that the representation was untrue.

It has been held that the right to rescind will not be lost by affirmation unless the representee has knowledge of the facts and that these give rise to the right to rescind.[114] Where there is no such knowledge, however, the conduct of the

[111] *Re Scottish Petroleum Co.* (1883) 23 Ch. D. 413, at p. 434.
[112] *Scholey* v. *Central Ry. Co. of Venezuela* (1867) L.R. 9 Eq. 266.
[113] [1958] 1 W.L.R. 753.
[114] *Peyman* v. *Lanjani* [1985] Ch. 457, at pp. 486–7. Cf. the right to reject for breach of condition in contracts for the sale of goods which may be lost by 'acceptance' without such knowledge: Sale of Goods Act 1979, s. 35 as amended by the Sale and Supply of Goods Act 1994, *ante*, p. 142. In *Long* v. *Lloyd* (*supra*, n. 113), where there may not have been such knowledge, the Court may have considered that rescission for misrepresentation should be barred where the right to reject for breach of condition has been lost. See *Leaf* v. *International Galleries* [1950] 2 K.B. 86, at p. 91 and see Atiyah (1959) 22 M.L.R. 76; Davies (1959) 75 L.Q.R. 32.

representee may, if relied on by the representor, give rise to an estoppel precluding rescission.[115]

(ii) Lapse of time

Secondly, lapse of time may in certain circumstances bar the right to rescind. It may be treated as evidence of affirmation where the party misled fails to exercise the right to rescind for a considerable time after discovering the representation to be untrue.[116] But, since knowledge is required for affirmation, mere lapse of time does not normally have this effect.[117] Exceptionally, however, the passage of time may operate so as to preclude rescission even though the representee has no knowledge of the untruth of the representation. Thus, in the case of an executed contract of sale of goods, it has been held that rescission for innocent misrepresentation may be barred where the lapse of time amounts to an acceptance of the goods.[118] In *Leaf* v. *International Galleries*:[119]

> The plaintiff bought from the defendants a picture of Salisbury Cathedral which the defendants innocently represented to him at the time of the purchase to have been painted by Constable. Five years later, when he tried to sell it, he discovered this was not the case. He endeavoured to return the picture and recover the price. The defendants refused, whereupon he brought an action claiming rescission of the contract of sale.
>
> The Court of Appeal held that the right to rescind had been lost.

iii) Right of third parties

Thirdly, since the contract is voidable and not void, being valid until rescinded, if third parties *bona fide* without notice and for value acquire rights in the subject-matter of the contract, those rights are valid against the party misled, provided that the contract has not before that time been rescinded.[120] The standard illustration of this principle is provided by a shareholder who wishes to rescind a contract to take up shares in a company; this must be done before winding-up, for once winding-up commences, the rights of the creditors become fixed, since they stand in the position of *bona fide* purchasers for value.[121] Also where goods are obtained by means of a fraud, a person who, before rescission, acquires the goods in good faith and for value from the fraudulent purchaser cannot be displaced by the party defrauded.[122]

(iv) Ability to restore

Fourthly, it has been said that when a party 'exercises his option to rescind the contract, he must be in a state to rescind; that is, he must be in such a situation to be able to put the parties into their original state before the contract'.[123] Each must give back what has been restored. But this limitation should not be too strictly construed, and the mere fact that the subject-matter of the contract may have deteriorated before the truth is discovered is not sufficient to prevent a *resti-*

[115] *Peyman* v. *Lanjani* [1985] Ch. 457, at p. 488; *Motor Oil Hellas (Corinth) Refineries S.A.* v. *Shipping Corp. of India* [1990] 1 Lloyd's Rep. 391, at pp. 398–9, *per* Lord Goff.
[116] *Clough* v. *L. & N.W. Ry.* (1871) L.R. 7 Ex. 26, at p. 35. Cf. *Allen* v. *Robles* [1969] 1 W.L.R. 1193.
[117] *Armstrong* v. *Jackson* [1917] 2 K.B. 822, at p. 830.
[118] See *post*, p. 254.
[119] [1950] 2 K.B. 86.
[120] *Babcock* v. *Lawson* (1880) 5 Q.B.D. 284. On actual and constructive notice see *post*, p. 286.
[121] *Oakes* v. *Turquand* (1867) L.R. 2 H.L. 325.
[122] Sale of Goods Act 1979, s. 23; *Phillips* v. *Brooks Ltd.* [1919] 2 K.B. 243. Contrast *Car and Universal Finance Co. Ltd.* v. *Caldwell* (*ante*, p. 248)—acquired after rescission.
[123] *Clarke* v. *Dickson* (1858) E.B. & E. 148, *per* Crompton J. at p. 154; 'You cannot both eat your cake and return your cake', Kinglake Serjt. *arguendo*.

tutio in integrum and so to destroy the right to rescind a contract.[124] Thus in *Adam* v. *Newbigging*[125] rescission was granted of a partnership agreement even though the partnership business was then 'worse than worthless'. The Courts have refrained from defining the scope of this equitable remedy by any rigid rules:[126]

The general rule is that as a condition of rescission there must be *restitutio in integrum*, but at the same time the Court has full power to make all just allowances. It was said by Lord Blackburn in *Erlanger* v. *New Sombrero Phosphate Co.*[127] that the practice had always been for a Court of Equity to give relief by way of rescission whenever by the exercise of its powers it can do what is practically just by directing accounts, ordering equitable compensation[128] and making allowances, though it cannot restore the parties precisely to the state they were in before the contract.

How this goal of doing 'what is practically just' may be reached depends on the circumstances of the case. For instance, the Court may think that justice requires the making of some allowance for the deterioration, or the improvement, as the case may be, of the subject-matter of the contract. Again, it may require compensation for losses incurred by the representor[129] or recompense for services rendered to the representee.[130] The Court will be more drastic in exercising its discretionary powers in a case of fraud than in a case where no fraud is present; it will be 'less ready to pull a transaction to pieces where the defendant is innocent, whereas in the case of fraud the Court will exercise its jurisdiction to the full in order, if possible, to prevent the defendant from enjoying the benefit of his fraud at the expense of the innocent plaintiff'.[131] But, even in a case of fraud, rescission will not be ordered where it is not possible to achieve a broadly just result by orders for monetary adjustment to reflect benefits and detriments which have accrued under the contract since to do so would unjustly enrich the defrauded party.[132]

No power to award partial rescission

Nothwithstanding the flexibility of equity, it was held in *T.S.B. Bank plc* v. *Camfield*[133] that because, save as is otherwise provided by statute, the right to rescind is that of the representee and not of the Court, there is no power to order partial rescission. In that case, as a result of an innocent misrepresentation, a woman charged her interest in a house to a bank to secure the debts of her husband's business believing that the maximum liability under the charge was

[124] *Armstrong* v. *Jackson* [1917] 2 K.B. 822, at p. 829; *Lagunas Nitrate Co.* v. *Lagunas Syndicate* [1899] 2 Ch. 392; *Alati* v. *Kruger* (1955) 94 C.L.R. 216 (Australia).

[125] (1888) 13 App. Cas. 308, *ante*, p. 297.

[126] *Hulton* v. *Hulton* [1917] 1 K.B. 813, *per* Swinfen Eady L.J. at p. 821.

[127] (1878) 3 App. Cas. 1218, at p. 1278.

[128] See *Mahoney* v. *Purnell* [1996] 3 All E.R. 61 (undue influence).

[129] *Spence* v. *Crawford* [1939] 3 All E.R. 271, *per* Lord Thankerton at 283 (loss to representor from sale by bank of shares held as security conceded to be recoverable). See also *Cheese* v. *Thomas* [1994] 1 W.L.R. 129 (undue influence).

[130] *Atlantic Lines & Navigation Co. Inc.* v. *Hallam Ltd.* [1983] 1 Lloyd's Rep. 188, *per* Mustill J. at p. 202 (services of chartered ship). See also *O'Sullivan* v. *Management Agency and Music Ltd.* [1985] 1 Q.B. 428.

[131] *Spence* v. *Crawford* [1939] 3 All E.R. 271, *per* Lord Wright at p. 288.

[132] *Society of Lloyd's* v. *Wilkinson (No. 2)* (1997) 6 Re. L.R. 214, at p. 222, *ibid.* 289, at p. 296.

[133] [1995] 1 W.L.R. 430.

£15,000 when it was in fact unlimited. Despite her willingness to charge the property for £15,000, the charge was set aside in its entirety. This result, which has not been followed in Australia,[134] is in marked contrast to the position in analogous situations[135] and the statutory power in the Court to award damages in lieu of rescission, to which we now turn.[136]

(vi) Damages in lieu of rescission

Except in cases of fraud,[137] the Court has a discretion to refuse to allow rescission and to award damages in lieu of this remedy. This power is conferred by section 2(2) of the Misrepresentation Act 1967, which 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.

The reason for this provision is that rescission in some situations may be too drastic a remedy; for example, a car might be returned to the vendor because of a trifling misrepresentation about the mileage done since the engine was last overhauled.[138] Section 2(2) allows the Court to take into account the relative importance or unimportance of the facts which have been misrepresented. It also allows the Court to take into account the relationship of the loss caused to the representee by the misrepresentation and the loss which would be caused to the representor if the contract is rescinded. Where the former is significantly less than the latter it is likely that damages in lieu of rescission will be awarded.[139]

Is there power to award damages of this nature where the right to rescind, though once in existence, has become barred, e.g. by reason of affirmation, lapse of time, the intervention of third party rights, or an inability to make *restitutio in integrum*? Neither the sub-section nor its legislative history are unambiguous,[140]

[134] *Vadasz* v. *Pioneer Concrete (S.A.) Pty. Ltd.* (1995) 184 C.L.R. 102.

[135] See Ferguson (1995) 111 L.Q.R. 555 citing *inter alia Bristol & West B.S.* v. *Hemming* [1985] 1 W.L.R. 778 and *Skipton B.S.* v. *Clayton* (1993) 66 P. & C.R. 233 (mortgagee's claim upheld to extent of other party's understanding of extent of mortgage). See also *O'Sullivan* v. *Management Agency and Music Ltd.* [1985] 1 Q.B. 428; *Cheese* v. *Thomas* [1994] 1 W.L.R. 129; *Barclays Bank plc* v. *Caplan*, *The Times*, 12 December 1997; Jones and Goodhart, *Specific Performance*, 2nd edn. (1996), p. 293 (purchaser's action for specific performance with compensation).

[136] Misrepresentation Act 1967, s. 2(2), which appears not to have applied in *T.S.B. Bank plc* v. *Camfield* because the Act does not affect the position between misrepresentee (the wife) and third party (the bank): the right to rescind arose against the husband and the bank, which had constructive notice of this, although a party to the charge, was a third party to the transaction between husband and wife.

[137] It is uncertain whether fraud will embrace cases of constructive fraud in equity, e.g. the breach of a fiduciary duty: see *post*, p. 261.

[138] See the Tenth Report of the Law Reform Committee (Cmnd. 1782, 1962), § 11.

[139] *William Sindall plc* v. *Cambridgeshire C.C.* [1994] 1 W.L.R. 1016, at p. 1038 (loss to representee £18,000 to divert a sewer; loss to representor some £6 million in return of purchase price and interest for land the value of which had substantially fallen).

[140] Atiyah and Treitel (1967) 30 M.L.R. 369, at pp. 375–9.

and no such power was proposed by the Law Reform Committee.[141] Statements in the cases indicate a divergence of view but it is submitted that the better view is that, while a power to award damages although rescission is barred might be desirable, no such power was created by the sub-section.[142] Although it has been suggested that the time for determining entitlement to rescind is the time of the Court's order,[143] the better view is that the relevant time is the commencement of proceedings, or the time the representee purports to rescind the contract. The reasons that preclude rescission are often practical and have no relevance to the question whether damages should be awarded and the Law Reform Committee's report, which relied on the analogy of damages in lieu of specific relief,[144] supports the earlier time. The Court's discretion, however, appears unimpaired where the misrepresentation has subsequently been incorporated as a term of the contract. As we shall see,[145] a misrepresentation retains its character as such even though it is incorporated as a contractual term, so that the representee continues to enjoy a right to rescind. The Court in this case could still refuse to allow rescission for misrepresentation and award damages in lieu.[146]

Measure of damages

The measure of damages to be awarded under this sub-section is the loss caused by the misrepresentation as a result of the refusal to allow rescission of the contract not the loss caused by entering into the contract.[147] This, in a contract for the sale of land, for example, would be the difference in value between what the representee was misled into thinking was being bought and the value of what was received. It has been stated that the damages under the sub-section should never exceed what the plaintiff would have got had the representation been a term. As section 2(2) was enacted because it was thought it might be a hardship to the representor to be deprived of the whole of the benefit of the bargain on account of a minor misrepresentation, 'it could not possibly have been intended the damages in lieu be assessed on a principle which would invariably have the same effect'.[148] Moreover, account is not taken of losses due to a general fall in market values after the contract is made. It will be remembered, moreover, that, where a misrepresentation is made without reasonable ground for belief in its truth, damages can be claimed under section 2(1) of the 1967 Act,[149] and that the measure of these damages is that applicable in tort, i.e. an amount which puts the party misled in the position in which that party would have been had he never entered into the

[141] Tenth Report (Cmd. 1782, 1962), § 27.

[142] *Atlantic Lines & Navigation Co. Inc.* v. *Hallam Ltd.* [1983] 1 Lloyd's Rep. 188. Cf. *Thomas Witter Ltd.* v. *T.B.P. Industries Ltd.* [1996] 2 All E.R. 573 relying (at p. 590) on a statement of the Solicitor-General on the third reading of the Bill (741 H.C. Deb. col. 1387, 20 February 1967) but contrast the Lord Chancellor and Viscount Colville of Culross (274 H.L. Deb., col 929, 17 May 1966; 277 H.L. Deb., col 53, 18 October 1966). See further Beale (1995) 111 L.Q.R. 385.

[143] *Atlantic Lines & Navigation Co. Inc.* v. *Hallam Ltd.* [1983] 1 Lloyd's Rep. 188.

[144] Tenth Report (Cmd. 1782, 1962), § 11. See also *William Sindall plc* v. *Cambridgeshire C.C.* (*supra*, n. 139) at p. 1037.

[145] Misrepresentation Act 1967, s. 1(a); *post*, p. 254.

[146] The right of the representee to repudiate for breach of condition, if the misrepresentation has become a condition, would not, it seems, be affected.

[147] *William Sindall plc.* v. *Cambridgeshire C.C.* [1994] 1 W.L.R. 1016.

[148] *Ibid.*, *per* Hoffmann L.J at p. 1038.

[149] See *ante*, p. 243.

contract.[150] In certain transactions there may be no difference between the damages recoverable under section 2(1) and section 2(2); but since consequential damage can be recovered under section 2(1)[151] and account may be taken of losses due to a general fall in the market after the contract,[152] damages under that sub-section will in many cases be more extensive than those recoverable under section 2(2). It is not possible to recover damages twice over under both section 2(1) and section 2(2), for the Act provides that any award under section 2(2) shall be taken into account in assessing the liability of the representor under section 2(1).[153]

Where the misrepresentation is innocent, but the Court refuses rescission, the representee is, of course, not entitled to an indemnity in addition to damages under section 2(2). An indemnity is part of the remedy of rescission and is awarded so that the restoration of the *status quo ante* may be achieved. Since, however, the representee would have been entitled to an indemnity had rescission been granted, the Court should, in assessing the damages under section 2(2), take account of any sum recoverable as an indemnity[154] in computing the loss which has been suffered as a result of the refusal of rescission.

Limitations removed by the 1967 Act: (i) executed contracts

Before the passing of the Misrepresentation Act 1967 there were two further limitations imposed on the right to rescind. First, in the case of innocent misrepresentation, there could be no rescission of a contract after it had been executed by the transfer of property under it. This principle was usually known as the 'rule in *Seddon* v. *North Eastern Salt Co. Ltd*'.[155] The extent of this rule was somewhat uncertain and it was the subject of much criticism,[156] for in many cases the falsity of a misrepresentation cannot be discovered until, for example, a lease of a house has been executed and the tenant has moved into occupation of the premises. Section 1(b) of the Act therefore provides that a contract is to be capable of rescission notwithstanding that it has been performed. This in no way affects the other bars to rescission, and in particular it must be noted that the circumstances in which a Court will exercise its discretion under section 2(2) of the 1967 Act are more likely to be present when a contract has been executed than when it is still executory.

(ii) Incorporation as term

Secondly, if a misrepresentation, first made independently, is subsequently incorporated as a term of the contract, it was previously believed that the right to rescind was lost: the situation was treated simply as involving the breach of a contractual term, for 'the representation becomes merged in the higher contractual right'.[157] This rule was criticized because the representee would be worse off if the misrepresentation were incorporated in the contract as a mere warranty. The

[150] See *ante*, p. 243.

[151] *Davis & Co. (Wines) Ltd.* v. *Alfa-Minerva (E.M.I.) Ltd.* [1974] 2 Lloyd's Rep. 27.

[152] *Ante*, pp. 241, 243.

[153] 1967 Act, s. 2(3).

[154] *Ante*, p. 247.

[155] [1905] 1 Ch. 326. See also *Wilde* v. *Gibson* (1848) 1 H.L.C. 605; *Angel* v. *Jay* [1911] 1 K.B. 666; *Edler* v. *Auerbach* [1950] 1 K.B. 359.

[156] See *Armstrong* v. *Jackson* [1917] 2 K.B. 822, at p. 825; *Lever Bros. Ltd.* v. *Bell* [1931] 1 K.B. 557, at p. 588, aff'd [1932] A.C. 161; *Solle* v. *Butcher* [1950] 1 K.B. 671, at pp. 695, 703; *Leaf* v. *International Galleries* [1950] 2 K.B. 86, at pp. 90, 91, 95; Tenth Report of the Law Reform Committee (Cmd. 1782, 1962), §§ 6–10.

[157] *Pennsylvania Shipping Co.* v. *Compagnie Nationale de Navigation* [1936] 2 All E.R. 1167, at p. 1171.

representee would then have no right to rescind the contract but only to claim damages. The rule is now abrogated by section 1(a) of the 1967 Act which provides that rescission is still open notwithstanding that the misrepresentation has become a term of the contract. The present rule is: 'once a misrepresentation, always a misrepresentation'. It is doubtful, however, whether the representee can both rescind the contract and claim damages for breach of a contractual term, since, by rescinding it, the contract is effectively set aside for all purposes, including the right to claim damages for the breach of it.

(g) Exclusion of Liability

At common law

At common law, a party to a contract was entitled, by means of an appropriately drafted exemption clause, to limit or exclude his liability for misrepresentation, except in cases of personal fraud.[158]

Under statute

This freedom has now been restricted by the Misrepresentation Act 1967, the Unfair Contract Terms Act 1977 (in respect of liability under *Hedley Byrne & Co. Ltd.* v. *Heller & Partners Ltd.*[159]) and the Unfair Terms in Consumer Contracts Regulations 1994.[160] Section 3 of the 1967 Act provides:

> If any 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 in so far as it satisfies the requirement of reasonableness as stated in section 11(1) of the Unfair Contract Terms Act 1977; and it is for those claiming that the term satisfies that requirement to show that it does.[161]

The exemption clause is therefore *prima facie* invalid, but the Court is empowered to give effect to it if it was a fair and reasonable term to be included in the contract having regard to all the circumstances which were, or ought reasonably to have been, known to or in the contemplation of the parties when the contract was made.[162] In *Walker* v. *Boyle*,[163] where a vendor in response to preliminary enquiries represented to the purchaser that she was not aware of any disputes regarding the boundaries of the property to be sold, although she should have been aware of such a dispute, it was held that condition 17 of the National Conditions of Sale which stated that 'no error, misstatement or omission in any preliminary answer concerning the property . . . shall annul the sale' did not

[158] *Pearson (S.) & Son Ltd.* v. *Dublin Corporation* [1907] A.C. 351; *Boyd & Forrest* v. *Glasgow & S.W. Ry.* 1915 S.C. (H.L.) 21, at p. 36; *Toomey* v. *Eagle Star Insurance Co. Ltd. (No. 2)* [1995] 2 Lloyd's Rep. 88, at pp. 91–2.

[159] [1964] A.C. 465; *ante*, p. 242 and 243.

[160] S.I. 1994 No. 3159 implementing the Directive on Unfair Terms in Consumer Contracts 93/13/EEC, as to which see *ante*, p. 196.

[161] Substituted by of the Unfair Contract Terms Act 1977, s. 8(1).

[162] *Ibid.*, s. 11(1); see *ante*, p. 190.

[163] [1982] 1 W.L.R. 495. Cf. *McCullagh* v. *Lane Fox & Partners* (1996) 49 Con. L. R. 124 (estate agent's disclaimer about size of plot reasonable).

satisfy the test of reasonableness required by the 1977 Act even though it was a long-standing common-form clause.[164] This was a case where the purchaser was a private individual; but, even as between businesses, a term excluding or restricting liability for misrepresentation may be held unreasonable.[165]

Avoidance of s. 3

The question arises whether it is possible to avoid the application of section 3 of the 1967 Act by means of a contract term, for example, that statements made are 'not to be construed as assertions of fact', or that they are 'statements of opinion or belief only'. In *Cremdean Properties Ltd.* v. *Nash*,[166] the defendants, by whom it was alleged a misrepresentation had been made, relied on the following clause:

> These particulars are prepared for the convenience of an intending purchaser or tenant and although they are believed to be correct their accuracy is not guaranteed and any error, omission or misdescription shall not annul the sale or the grounds on which compensation may be claimed and neither do they constitute any part of an offer of a contract. Any intending purchaser or tenant must satisfy himself by inspection or otherwise as to the correctness of each of the statements contained in these particulars.

The Court of Appeal rejected the defendants' argument that the effect of this clause was to bring about a situation as if no representation at all had been made. The Court further doubted whether, even if the defendants' argument were correct, it would be possible thus to defeat the application of section 3 of the 1967 Act. It would therefore seem that, if a representation has in fact been made, a contract term which purports to deny one or more of the conditions to be fulfilled before a representation is effective[167] will be subject to section 3, and to the test of reasonableness provided for in that section. It should, however, be noted that in this case, the Court of Appeal left open the question of the effect of the final part of this clause on the issue as to whether the plaintiffs in fact relied upon the representation, although in *Walker* v. *Boyle* it was held that a similar admonition did not negative a representation of fact which the vendor knew was likely to be relied on.[168]

In *Overbrook Estates Ltd.* v. *Glencombe Properties Ltd.*,[169] on the other hand:

> An auctioneer sold property belonging to the plaintiff to the defendant, and in the course of so doing made a misrepresentation as to local authority plans with respect to the property. The defendant refused to proceed with the sale because of the misrepresentation and the plaintiff brought an action for specific performance of the contract. The plaintiff relied upon a term in the conditions of sale which stated that the auctioneer had no authority to make any representation in relation to the property.

[164] It was not the product of negotiation between the representatives of those affected, on which see *ante*, p. 192.

[165] *Howard Marine and Dredging Co. Ltd.* v. *Ogden & Sons (Excavations) Ltd.* [1978] Q.B. 574, *ante*, p. 243.

[166] (1977) 244 E.G. 547.

[167] See *ante*, pp. 233–9.

[168] [1982] 1 W.L.R. 495, at p. 501. See also *Southwestern General Property Ltd.* v. *Martin* [1982] 263 E.G. 1090; *Goff* v. *Gauthier* (1991) 62 P. & C.R. 388, at p. 401.

[169] [1974] 1 W.L.R. 1355. This decision was accepted as correct by Bridge L.J. in *Cremdean Properties Ltd.* v. *Nash* (*supra*, n. 166), at p. 549. See also *Collins* v. *Howell-Jones* (1980) 259 E.G. 331.

Brightman J. held that section 3 of the 1967 Act did not operate to qualify the right of a principal publicly to limit the authority of an agent and was therefore inapplicable. Where, despite a term limiting an agent's actual or ostensible authority, the principal expressly authorizes the agent to make the representation in question, section 3 should apply.[170] The cases permitting the limitation of an agent's authority concern auctioneers and estate agents, and it is not clear whether an employer could rely on a term limiting an employee's actual or ostensible authority to avoid the operation of section 3.[171]

The Unfair Terms in Consumer Contracts Regulations 1994, which apply to all unfair terms and not only to exclusion or limitation clauses, will also affect clauses excluding or restricting a consumer's remedies for misrepresentation.[172] A term limiting the seller or supplier's obligation to respect commitments undertaken by his agents is one of those included in the indicative and illustrative list of terms which may be regarded as unfair[173] and it therefore appears that clauses such as that in *Overbrook Estates Ltd.* v. *Glencombe Properties Ltd.*[174] will only be effective if they satisfy the tests of good faith and absence of a significant imbalance in the parties' rights to the detriment of the consumer.

II. Duties of Disclosure

(a) No General Duty to Disclose

No general duty to disclose

We have already noted that silence does not normally amount to a misrepresentation and that at common law there is in general no duty of disclosure of material facts before the contract is made. At the beginning of this chapter the examples were given of the person who visits an antiques shop and sees a rare George II gateleg table being sold as a nineteenth century piece and the oil prospector who discovers that there is probably oil under a given piece of land. Neither have to inform the other party. The justification for the general rule is said to be the need to give people an incentive to invest in the acquisition of skill and knowledge and consequently to allow 'good deals' to the more intelligent or the hard-working.[175] This economic argument does not obviously apply to information which has been acquired by pure chance or without any investment. Nor can it be dispositive where the information is acquired by a method regarded by the law as illegitimate—for example where it is 'insider' information about the position of a

[170] *Museprime Properties Ltd.* v. *Adhill Properties Ltd.* (1991) 61 P. & C.R. 111. Cf. *Collins* v. *Howell-Jones* (1980) 259 E.G. 331, *per* Waller L.J., at 332; but note Murdoch (1981) 97 L.Q.R. 518, at p. 524.
[171] Cf. *Mendelssohn* v. *Normand Ltd.* [1970] 1 Q.B. 177, *ante*, p. 180.
[172] See generally, *ante*, p. 196 ff.
[173] S.I. 1994 No. 3159, Sched. 3, para. 1(o).
[174] *Supra*, n. 169.
[175] See generally Duggan, Bryan, and Hanks, *Contractual Non-Disclosure* (1994); Kronman (1978) 7 J.L.S. 1; Nicholas in Harris and Tallon eds., *Contract Law Today* (1989); Fried, *Contract as Promise* (1981), p. 77 ff; Trebilcock, *The Limits of Freedom of Contract* (1993), p. 106 ff; Kötz, *European Contract Law* (1996), pp. 198–205.

company. There may also be situations where it may be economically efficient to impose a duty of disclosure. In the case of house sales, the present rule means that it is the intending purchaser who commissions the survey and where several people are interested in a property each will have to invest in the search for information, whereas if sellers were obliged to disclose key elements concerning the state of their houses to all potential buyers, the cost of surveying would in many cases be incurred only once.[176] Less compellingly, the rule has also been justified by the great difficulty in imposing any sensible limits on a duty of disclosure,[177] and because the information which had to be disclosed may be unreliable or doubtful or inconclusive, and that disclosure may expose the informer to criticism or litigation.[178]

(b) Contracts '*Uberrimae Fidei*'

Contracts in which disclosure is required

There are some contracts in which more is required than a discreet reticence, i.e. abstinence from misrepresentation. They are known as contracts *uberrimae fidei*—of the utmost good faith—and they may be avoided unless there has been a full disclosure of all material facts. Also, in certain situations, a duty of disclosure is imposed by statute.

Two reasons can be advanced for the existence of a duty of disclosure. The first is that, in certain classes of contract, one of the parties is presumed to have means of knowledge which are not accessible to the other, either at all or only by incurring disproportionately high costs. The party who is presumed to have the information is therefore bound to disclose everything which may be supposed likely to affect the judgment of the other party. Contracts of marine, fire, and life insurance, and indeed contracts of insurance of every kind are of this nature.[179] The second reason is that, in certain situations, the relationship between the contracting parties is not a pure arms' length commercial relationship but one of trust and confidence or one of dependence which imposes upon the party in whom confidence is reposed a duty to make disclosure. The clearest examples of such situations arise where there is a fiduciary relationship. It is true to say that: 'Whether the contract be one requiring *uberrima fides* or not must depend on its substantial character and how it came to be effected'.[180] But these two reasons would account for most situations where, at common law or in equity, or by statute, contracts have been held to be *uberrimae fidei*.

[176] Fabre-Magnan, in *Good Faith and Fault in Contract Law* (eds. Beatson and Friedmann), pp. 117–18.

[177] *Laidlaw* v. *Organ* 15 US (2 Wheat) 178 (1817), extensively discussed in the literature, *ante*, p. 257 n. 175.

[178] *Banque Financiere de la Cite S.A* v. *Westgate Insurance Co. Ltd.* [1991] 2 A.C. 249, where a narrower range of policy issues relevant to the imposition of a duty of disclosure were addressed in the leading speech by Lord Templeman who concluded that 'A professional should wear a halo but need not wear a hairshirt'.

[179] *Carter* v. *Boehm* (1766) 3 Burr. 1905, *per* Lord Mansfield at p. 1909. See also *Cornfoot* v. *Fowke* (1840) 6 M. & W. 358, *per* Lord Abinger C.B. (dissenting) at p. 379.

[180] *Seaton* v. *Heath* [1899] 1 Q.B. 782, *per* Romer L.J. at p. 792.

Effect of 1967 Act

The Misrepresentation Act 1967 does not apply in its terms to cases of non-disclosure as opposed to a 'misrepresentation made'. The remedies for non- disclosure are therefore not affected by the provisions of the Act.[181]

(c) Contracts of Insurance[182]

Insurance contracts

The intending assured is under an obligation to disclose to the insurer all material information affecting the risk.[183] This duty to disclose is mutual and the insurer must also disclose all material information although disclosure by the insurer will in practice be rare because the material circumstances are normally known only to the intending assured.[184] While the foundation of this obligation was in the past regarded as an implied term in the contract itself,[185] the weight of modern authority is that the obligation, like the duty not to misrepresent, arises before the contract is made and is therefore non-contractual[186] and probably based on equity's jurisdiction to prevent imposition.[187] The difference may lie in different perceptions of the nature of an implied term: 'it is often said that a term is implied in a contract when in truth a positive rule of law is applied because of the category in which a particular contract falls'.[188] If there has been non-disclosure by one party, the other party is entitled to avoid the contract[189] if it has been induced to enter into the policy on the relevant terms,[190] but is not entitled to damages.

Marine insurance

So far as regards marine insurance, the common law rules are now codified in the Marine Insurance Act 1906. Section 18 of the Act provides that:

[181] *Banque Keyser Ullman S.A.* v. *Skandia (U.K.) Insurance Co. Ltd.* [1990] 1 Q.B. 665, at p. 789, aff'd. on other grounds [1991] 2 A.C. 249. Cf. Hudson (1969) 85 L.Q.R. 524.

[182] See Hasson (1969) 33 M.L.R. 615; Clarke, *Policies and Perceptions of Insurance* (1996) pp. 80–108.

[183] *Carter* v. *Boehm* (1766) 3 Burr. 1905.

[184] *Carter* v. *Boehm* (*supra*, n. 183); *Banque Keyser Ullman S.A.* v. *Skandia (U.K.) Insurance Co. Ltd.* [1990] 1 Q.B. 665, at p. 770; [1991] 2 A.C. 249, at pp. 268 and 281.

[185] *Blackburn, Low & Co.* v. *Vigors* (1886) 17 Q.B.D. 553, at pp. 578, 583; (1886) 12 App. Cas. 531, at p. 539. Cf. *ibid.*, at pp. 536 and 542; *Pickersgill (W.) & Sons Ltd.* v. *London and Provincial Marine and General Insurance Co. Ltd.* [1912] 3 K.B. 614, *per* Hamilton J. at p. 621; *Black King Shipping Corp.* v. *Massie* [1985] 1 Lloyd's Rep. 437, *per* Hirst J. at pp. 518–19; *Bank of Nova Scotia* v. *Hellenic Mutual War Risks Association (Bermuda) Ltd.* [1988] 1 Lloyd's Rep. 514, *per* Hobhouse J. at p. 547 (marine insurance).

[186] *Joel* v. *Law Union and Crown Insurance Co.* [1908] 2 K.B. 863, at p. 886; *March Cabaret Club & Casino Ltd.* v. *London Assurance* [1975] 1 Lloyd's Rep. 169, at p. 175; *Banque Keyser Ullman S.A.* v. *Skandia (U.K.) Insurance Co. Ltd.* [1990] 1 Q.B. 665, at pp. 777–8, aff'd on other grounds [1991] 2 A.C. 249 (non-marine insurance); *Pryke* v. *Gibbs Hartley Cooper Ltd.* [1991] 1 Lloyd's Rep. 602, at p. 615.

[187] *Merchants' and Manufacturers' Insurance Co.* v. *Hunt* [1941] 1 K.B. 295, at pp. 313 and 318. See also *Bell* v. *Lever Brothers Ltd.* [1932] A.C. 161, *per* Lord Atkin at p. 277; *Trade Indemnity plc* v. *Försäkringsaktiebolaget Njord* [1995] 1 All E.R. 796, at p. 957.

[188] *Banque Keyser Ullman S.A.* v. *Skandia (U.K.) Insurance Co. Ltd.* [1990] 1 Q.B. 665, *per* Steyn J. at p. 702. See generally *ante*, p. 143.

[189] *Morrison* v. *Universal Marine* (1872) L.R. 8 Exch. 197. See also *Black King Shipping Corp.* v. *Massie* [1985] 1 Lloyd's Rep. 437, at pp. 514–16.

[190] *Pan Atlantic Insurance Co. Ltd.* v. *Pine Top Insurance Co. Ltd.* [1995] 1 A.C. 501. See *St. Paul Fire & Marine Insurance Co. Ltd.* v. *McConnell Dowell Constructors Ltd.* [1996] 1 All E.R. 96.

(1) The assured must disclose to the insurer, before the contract is concluded, every material circumstance which is known to the assured, and the assured is deemed to know every circumstance which, in the ordinary course of business, ought to be known by him. If the assured fails to make such disclosure, the insurer may avoid the contract.

(2) Every circumstance is material which would influence the judgment of a prudent insurer in fixing the premium, or determining whether he will take the risk.

So if the assured insures goods upon a voyage for an amount largely in excess of their value,[191] or fails to inform the insurer that they will be carried on deck, where it is unusual for such goods to be carried,[192] the contract may be avoided even though the non-disclosure was made without any fraudulent intention.

Non-marine insurance

It will be observed that under the Act the assured is, for the purpose of communication, 'deemed to know' every circumstance which, in the ordinary course of business ought to be known by it. Although section 18 of the 1906 Act is one of a group of sections which apply to all classes of insurance because they codified the common law,[193] in non-marine insurance the duty of disclosure extends only to material facts which are actually known to the assured.[194] But the test of what is material and the degree of good faith which is required is otherwise the same in all classes of insurance:[195] was the fact one that would have an effect on the mind of the prudent insurer in estimating the risk even if it did not have a decisive effect on the acceptance of the risk or the amount of the premium?[196] Thus the fact that the assured has been so unlucky as to have had several previous fires,[197] or several previous burglaries[198] is material to a fire or theft policy, as is also the fact that the risk has been declined by another company.[199] It has even been held that, in a proposal for fire insurance, the non-disclosure of a conviction for robbery[200] or of the refusal of another insurance company to insure the proposer's motor vehicle[201] may amount to the non-disclosure of a material fact entitling the insurer to repudiate the policy.

Practice of insurers

In practice, however, insurance companies frequently insert a 'basis of the contract' clause in the proposal form by which the proposer is made to warrant the accuracy of the information supplied by him to the company, with a proviso that the company may avoid the agreement and forfeit the premium if any part of the information proves untrue. The assured is thus compelled to assume respons-

[191] *Ionides* v. *Pender* (1874) L.R. 9 Q.B. 531.

[192] *Hood* v. *West End Motor Car Packing Co. Ltd.* [1917] 2 K.B. 38.

[193] *P.C.W. Syndicates* v. *P.C.W. Reinsurers* [1996] 1 W.L.R. 1136, *per* Staughton L.J. at 1140. See also *Economides* v. *Commercial Union Assurance Co. plc* [1997] 3 W.L.R. 1066, at p. 1074.

[194] *Joel* v. *Law Union and Crown Insurance Co.* [1908] 2 K.B. 863, at p. 884; *Economides* v. *Commercial Union Assurance Co. plc* (*supra*, n. 193).

[195] *Lambert* v. *Co-operative Insurance Society Ltd.* [1975] 2 Lloyd's Rep. 485.

[196] *Pan Atlantic Insurance Co. Ltd.* v. *Pine Top Insurance Co. Ltd.* [1995] 1 A.C. 501. Cf. the 'risk presented is different from true risk' test: [1995] 1 A.C. 501, at pp. 515 and 559 (Lord Templeman and Lord Lloyd dissenting) and [1993] 1 Lloyd's Rep. 496, *per* Steyn L.J. at pp. 505–6.

[197] *Marene Knitting Mills Pty. Ltd.* v. *Greater Pacific General Insurance Ltd.* [1976] 2 Lloyd's Rep. 630.

[198] *Rozanes* v. *Bowen* (1928) 32 Ll. L.R. 98.

[199] *London Assurance Co.* v. *Mansel* (1879) 11 Ch. D. 363.

[200] *Woolcott* v. *Sun Alliance and London Insurance Ltd.* [1978] 1 W.L.R. 493.

[201] *Locker and Woolf Ltd.* v. *West Australian Insurance Co. Ltd.* [1936] 1 K.B. 408.

ibility for the truth of even non-material facts,[202] and of facts which he did not know, or did not appreciate, were false. Thus where an applicant for life insurance declared that she had not had any 'operation' when, in fact, she had given birth to a child by Caesarian section, the insurance company was held to be entitled to avoid the policy on the ground that there was a breach of a condition precedent to the company's liability.[203] Such provisions may work injustice to the assured by conferring on insurers a discretion to repudiate the policy on technical grounds alone. Lord Greene M.R. described them as 'particulary vicious' and 'mere traps' which should be construed strictly[204] and the insurance industry's statements of practice provide *inter alia* that insurers should not repudiate liability on grounds of non-disclosure of a fact which the assured could not reasonably be expected to disclose. The Law Commission's recommendation that such clauses should be ineffective[205] has not been implemented, but in consumer contracts they will now be subject to the fairness tests in the Unfair Terms in Consumer Contracts Regulations 1994,[206] which few are likely to satisfy.

(d) Fiduciary Relationships

Fiduciary relationship

Where one person stands in a fiduciary or confidential relationship with another, the person in whom confidence is reposed is under an equitable duty to ensure that this confidence is not abused, and to use due care and skill in the conduct of affairs.

In equity the term 'fraud' has from early times been given a more extended meaning than at common law. This is not to say that equity does not recognize the type of fraud defined in *Derry* v. *Peek*;[207] but it goes further and takes account of any 'breach of the sort of obligation which is enforced by a Court that from the beginning regarded itself as a Court of conscience'.[208] Fraud in equity, or 'constructive fraud' as it is sometimes called, covers a variety of situations and is not confined to cases of actual misrepresentation or even of dishonesty. Breach of confidence in equity will entitle the innocent party to rescind the contract or transaction, to be restored to the pre-contractual position, and to recover any profit made by the other party as a result of the breach.

Negligence

A high standard of conduct is required where a fiduciary relationship exists. The person in whom confidence is reposed must not only act honestly, but exercise diligence and skill. In *Nocton* v. *Lord Ashburton*:[209]

A solicitor advised his client to release part of a mortgage. The client took his advice, so that the security became insufficient and he suffered loss. The client brought an action

[202] *Thomson* v. *Weems* (1884) 9 App. Cas. 671, at p. 689; *Dawsons Ltd.* v. *Bonnin* [1922] 2 A.C. 413.
[203] *Kumar* v. *Life Insurance Cpn. of India* [1974] 1 Lloyd's Rep. 147.
[204] *Zurich General Accident and Liability Insurance Co. Ltd.* v. *Morrison* [1942] 2 K.B. 53, at p. 58. See also *Joel* v. *Law Union and Crown Insurance Co.* (*supra*, n. 194), at p. 885.
[205] Law Com. No. 104, *Non-Disclosure and Breach of Warranty* (1980), paras. 7.1–7.11.
[206] S.I. 1994 No. 3159, *ante*, p. 196.
[207] (1889) 14 App. Cas. 337; *ante*, p. 239.
[208] *Nocton* v. *Lord Ashburton* [1914] A.C. 932, *per* Viscount Haldane at p. 954.
[209] [1914] A.C. 932.

against the solicitor, claiming that the advice given was fraudulent and improper, and that he was entitled to be compensated for his loss.

The House of Lords held that, though there had been no fraud sufficient to found an action for deceit, the client might still claim relief in equity for constructive fraud, and, since the advice had been given without sufficient skill and care, he was entitled to be indemnified for the loss which he had suffered.

Duty of disclosure

Persons in fiduciary positions also owe a duty to those who repose confidence in them to act with the utmost good faith and to make a full disclosure of all material facts known to them which might be considered likely to affect the transaction between them. A broker, for example, who is employed to buy shares for a client, cannot sell his own shares unless a full and accurate disclosure of this fact is made to the client and the client's consent is obtained;[210] and the promoters of a company, who stand in a fiduciary relationship with the company, are likewise required to make a full disclosure of their interest either to an independent board of directors or to the intended shareholders.[211]

Traditional examples of a fiduciary relationship include those of principal and agent, solicitor and client, guardian and ward, and trustee and beneficiary. In some situations, all that equity requires is disclosure of material facts; in others, however, where the fiduciary relationship gives rise to a presumption of undue influence,[212] disclosure in itself may be insufficient, and it must be shown that the transaction is the result of the act of a free and independent mind.

Employment

The relationship between an employer and employee is in a sense 'fiduciary', but this does not impose upon the employee an obligation to disclose his own misconduct. In *Bell* v. *Lever Brothers Ltd.*[213] the respondent, Lever Brothers, had entered into an agreement with two of its employees whereby it promised to pay, and did in fact pay, considerable sums to them in compensation for the premature termination of their contracts of employment. This contract, however, was strictly unnecessary, for during their employment the two men had been guilty of certain breaches of duty which would have entitled Lever Brothers to dismiss them immediately. When Lever Brothers discovered this fact, it claimed to avoid the contract and recover the money paid on the ground, *inter alia*, that the employees were bound to disclose to them these breaches of duty. No member of the House of Lords was prepared to accept this contention,[214] and Lord Atkin said[215] that he was aware of no authority which placed contracts of service within the limited category of contracts *uberrimae fidei*. Nevertheless, it has subsequently

[210] *Armstrong* v. *Jackson* [1917] 2 K.B. 822. See also *Regier* v. *Campbell-Stuart* [1939] Ch. 766; *English* v. *Dedham Vale Properties Ltd.* [1978] 1 W.L.R. 93, and *post*, p. 636. Cf. *Kelly* v. *Cooper* [1993] A.C. 205 (express or implied contractual modification of fiduciary duty).

[211] *Erlanger* v. *New Sombrero Phosphate Co.* (1878) 3 App. Cas. 1218; *Lagunas Nitrate Co.* v. *Lagunas Syndicate* [1899] 2 Ch. 392; *Gluckstein* v. *Barnes* [1900] A.C. 240. See now Financial Services Act 1986, ss. 146–7, 163–4, *post*, p. 264.

[212] See *post*, p. 279.

[213] [1932] A.C. 161; *post*, p. 296.

[214] Although it was accepted by the Court of Appeal: [1931] 1 K.B. 337.

[215] At p. 227.

been held that in certain circumstances an employee may be under a duty to report to the employer misconduct on the part of fellow employees.[216]

Special relationships

We have seen that, under the principle enunciated in *Hedley Byrne & Co. Ltd.* v. *Heller & Partners Ltd.*,[217] a special relationship, giving rise to a duty of care, may arise between parties negotiating a contract. That duty may be more extensive than merely to refrain from making negligent misstatements without reasonable care, and may impose upon the party in whom confidence is reposed an obligation to disclose to the other party information relevant to the contract[218] or to provide an adequate explanation of the contract into which the other party is about to enter.[219] *Prima facie* the breach of such a duty would give rise to an action in damages in tort only, and not to a claim that the contract be rescinded. But it could be argued that, at least in some situations, the presence of such a duty made the contract one requiring *uberrima fides*, so that its breach would entitle the party to whom the duty was owed to avoid the contract.

(e) Contracts Preliminary to Family Settlements

Family settlements

An example of a situation of confidence recognized by equity is that of contracts for family settlements and arrangements. These require not only an absence of misrepresentation by the parties entering into them, but also a full disclosure of all material facts within their knowledge. Thus in *Gordon* v. *Gordon*,[220] a family arrangement entered into without a secret marriage being disclosed by one side to the other was set aside under this principle. And parties who are divorcing and make an agreement about the division of the property which is to be embodied in a Court order are under a statutory obligation to make a full and frank disclosure *to the Court which made the order*. But, although the duty was owed to the Court and not to the other party it has been held that a party affected by such non-disclosure could rely on it as a ground for setting the agreement aside.[221]

(f) Contracts for the Allotment of Shares

Purchase of shares

Promoters and directors of a company have information at their disposal which is not available to the general public. When they invite the public to subscribe for shares they:[222]

[216] *Swain* v. *West (Butchers) Ltd.* [1936] 1 All E.R. 224; *Sybron Cpn.* v. *Rochem Ltd.* [1984] Ch. 112. See also *P.C.W. Syndicates* v. *P.C.W. Reinsurers* [1996] 1 W.L.R. 1136.

[217] [1964] A.C. 465, *ante*, p. 242.

[218] *Al-Kandari* v. *J. R. Brown & Co.* [1988] Q.B. 665, at p. 674; *Banque Keyser Ullman S.A.* v. *Skandia (U.K.) Insurance Co. Ltd.* [1990] 1 Q.B. 665, at pp. 790–805; aff'd. on other grounds [1991] 2 A.C. 249; *Morrison-Knudson International Co.* v. *Commonwealth* (1972) 46 A.L.J.R. 265. Cf. *Dillingham Construction Pty. Ltd.* v. *Downs* [1972] 2 N.S.W.R. 49 (Australia). See also *Horry* v. *Tate & Lyle Refineries Ltd.* [1982] 2 Lloyd's Rep. 416.

[219] *Rust* v. *Abbey Life Assurance Co. Ltd.* [1978] 2 Lloyd's Rep. 386, at p. 391; aff'd. [1979] 2 Lloyd's Rep. 334.

[220] (1821) 3 Swan. 400.

[221] *Jenkins* v. *Livesey* [1985] A.C. 424, at p. 439. But cf. *Wales* v. *Wadham* [1977] 1 W.L.R. 199 (no disclosure required at common law).

[222] *New Brunswick and Canada Railway Co.* v. *Muggeridge* (1860) 1 Drew. & Sm. 363, at p. 381, approved in *Central Ry. Co. of Venezuela* v. *Kisch* (1867) L.R. 2 H.L. 99, at p. 113.

are bound to state everything with strict and scrupulous accuracy, and not only to abstain from stating as fact that which is not so, but to omit no one fact within their knowledge, the existence of which might in any degree affect the nature, or extent, or quality of the privileges and advantages which the prospectus holds out as inducements to take shares.

'[T]he duty of disclosure is not the same in a prospectus inviting share subscriptions as in the case of a proposal for marine insurance',[223] nor is there any fiduciary relationship between those issuing the prospectus and the public. In an honest prospectus, except under statute, the non-disclosure even of facts which some intending shareholders might regard as material in influencing their judgment, will be no ground for rescission, unless the omission makes what is stated actually misleading.

Further protection to persons applying for shares is, however, afforded by sections 150 and 151 and 166 and 167 of the Financial Services Act 1986.[224] These apply respectively to listed and unlisted securities and give a right to compensation[225] from those responsible to persons who have sustained loss by subscribing for shares on the faith of an untrue statement in the listing particulars unless those responsible can show that up to the time of the allotment they had reasonable ground to believe and did believe the statement to be true.[226] Also, the Act sets out certain matters which the listing particulars must contain,[227] and thus requires a full disclosure of those.

(g) Other Investment Business

The Financial Services Act 1986 also establishes a regulatory regime over those conducting investment business in order to protect the purchasers of the products of the financial services industry, namely insurance policies, investments, and advice. Detailed treatment of this area would be out of place in the present textbook,[228] but a brief summary may be given. Protection is achieved by a licensing system and by close control of the way those licensed conduct their businesses, including statutory 'cooling-off' periods after an agreement has been made. It is required that financial services practitioners, many of whom will be in a fiduciary relationship with their clients,[229] subordinate their own interests to those of their clients and make proper provision for disclosure of interests in and facts material to transactions entered into or advice given.[230] Unless they are transacting business on an 'execution-only' basis, practitioners are under an obligation to 'know' their customers so they can give appropriate advice, and they must explain the risks of a particular investment. They must also disclose the basis, method and frequency of payment by the customer and in certain cases termination provisions. Particularly detailed disclosure is required in the case of long-term con-

[223] *Aaron's Reefs Ltd.* v. *Twiss* [1896] A.C. 273, at p. 287.
[224] There has been statutory protection for over 100 years; see the Directors Liability Act 1890.
[225] Financial Services Act 1986, ss. 150 and 166. [226] *Ibid.*, ss. 151 and 167.
[227] *Ibid.*, ss. 146, 147 and 163–4.
[228] See generally Lomnicka and Powell, *Encyclopaedia of Financial Services Law* (1987).
[229] *Ante*, p. 261. [230] Financial Services Act 1986, Sched. 8, paras. 3, 5–8.

tracts such as those for life assurance. Private investors are given a right to civil damages for contravention of regulatory rules.[231]

(h) Suretyship

Suretyship

Contracts of suretyship or guarantee are not *uberrimae fidei* and therefore non-disclosure, to avoid such a contract, must amount to a misrepresentation. The creditor may be bound to disclose unusual circumstances which the surety would expect not to exist, for the omission to mention such a circumstance can amount to an implied misrepresentation that the circumstance does not exist.[232] Such contracts do not, however, require the same fullness of disclosure as is necessary in a contract *uberrimae fidei*.

Nevertheless it is not always easy in practice to draw the line between contracts of guarantee in the strict sense of contracts to answer for the debt, default, or miscarriage of another and contracts of insurance taking the form of contracts to indemnify against some risk stated in the contract.[233] It was pointed out by Romer L.J., in *Seaton* v. *Heath*,[234] that many contracts may with equal propriety be called contracts of insurance or contracts of guarantee, and that whether a contract requires *uberrima fides* or not depends not upon what it is called, but upon its substantial character and how it came to be effected. Generally in a contract of insurance the person desiring to be insured has means of knowledge of the risk which the insurer does not possess, and he puts the risk before the insurer as a business transaction. In a contract of guarantee, on the other hand, the creditor does not as a rule go to the surety, explain the risk, and ask the surety to undertake it. The surety is often a friend or relation of the debtor and knows the risk to be undertaken, or the circumstances indicate that as between the creditor and the surety it is contemplated that the surety will ascertain what the risk is. Only in the exceptional cases when a contract of guarantee has the characteristics which occur normally in a contract of insurance is the former a contract *uberrimae fidei*.

Accordingly it is settled that there is no duty of full disclosure where a surety guarantees to a bank the account of one of the bank's customers.[235] On the other hand, when an employer takes a bond from a surety for the 'fidelity', i.e. honesty, of an employee, he must disclose to the surety any previous acts of dishonesty of the employee within his knowledge,[236] and even any subsequent acts of dishonesty which would entitle the surety to withdraw the guarantee.[237] Similarly, where the creditor is put on inquiry that the surety may be subjected to undue influence or misrepresentation by the principal debtor, as is the case where the surety is a wife or cohabitee, the creditor must take reasonable steps to satisfy

[231] *Ibid.*, s. 62A. Private investor is defined by S.I. 1991 No. 489.
[232] *Lee* v. *Jones* (1864) 17 C.B.N.S. 482, at pp. 503, 504.
[233] *Trade Indemnity Co. Ltd.* v. *Workington Harbour and Dock Board* [1937] A.C. 1.
[234] [1899] 1 Q.B. 782, at p. 792.
[235] *National Provincial Bank* v. *Glanusk* [1913] 3 K.B. 335; *Cooper* v. *National Provincial Bank* [1946] K.B. 1.
[236] *London General Omnibus Co. Ltd.* v. *Holloway* [1912] 2 K.B. 72.
[237] *Phillips* v. *Foxall* (1872) L.R. 7 Q.B. 666.

itself that the surety entered into the obligation freely and in knowledge of the true facts.[238]

(i) Partnership

Partnership

There seems to be no rule requiring full disclosure in the formation of a contract of partnership, but since, when the partnership has been formed, the parties stand to one another in the confidential relation of principal and agent, each partner is bound to disclose to the others all material facts, and to exercise the utmost good faith in all that relates to their common business. The duties of partners are, however, for the most part regulated by the provisions of the Partnership Act 1890.[239]

(j) Contracts for the Sale of Land[240]

Sale of land

Contracts for the sale of land have been said in some respects to be contracts *uberrimae fidei*; but no special relationship of confidence exists between the parties. *Caveat emptor* is just as much the general rule in contracts for the sale of land as it is in contracts of sale of goods.

Misdescription

Nevertheless, a vendor must be able to convey precisely that which he has contracted to sell. If the land or the nature of the vendor's right or interest in the land, has been *misdescribed*, so that the purchaser is unable to obtain that which he contracted to purchase, the purchaser will be entitled to refuse to complete the sale and to the return of the deposit. A vendor, for example, who has contracted to sell absolute freehold property cannot enforce the contract if his title is possessory only and not absolute[241] or if the land is subject to restrictive covenants of which the purchaser was not made aware.[242] Further, a vendor cannot, by a condition of the contract, compel the purchaser to accept a title which the vendor knew to be a bad title, but did not disclose,[243] unless the defect is patent.[244] This means that it is virtually impossible to exclude liability for failure to disclose latent defects in the title. The consequence is that in effect a 'duty of disclosure' is imposed on the vendor.[245]

[238] *Barclays Bank plc* v. *O'Brien* [1994] 1 A.C. 180, *post*, p. 278.
[239] Partnership Act 1890, ss. 28–30.
[240] See generally Harpum (1992) 108 L.Q.R. 280, 320–33.
[241] *Re Brine and Davies' Contract* [1935] Ch. 388.
[242] *Flight* v. *Booth* (1834) 1 Bing. N.C. 370; *Nottingham Patent Brick Co.* v. *Butler* (1887) 16 Q.B.D. 778; *Charles Hunt Ltd.* v. *Palmer* [1931] Ch. 287.
[243] *Re Banister* (1879) 12 Ch. D. 131, at pp. 146, 147; *Nottingham Patent Brick Co.* v. *Butler* (*supra*, n. 242), at p. 786; *Farugi* v. *English Real Estates Ltd.* [1979] 1 W.L.R. 963; *Walker* v. *Boyle* [1982] 1 W.L.R. 495.
[244] *Bowles* v. *Round* (1800) 5 Ves. 508; *Yandle & Sons* v. *Sutton* [1922] 2 Ch. 199, at p. 204. Where the contract is to sell free from incumbrances it is irrelevant that the defect is patent: Harpum (1992) 108 L.Q.R. 280, 284.
[245] *Reeve* v. *Berridge* (1888) 20 Q.B.D. 523, *per* Fry L.J. at p. 528; *Carlish* v. *Salt* [1906] 1 Ch. 335; *Peyman* v. *Lanjani* [1985] Ch. 457. Cf. *William Sindall plc* v. *Cambridgeshire C.C.* [1994] 1 W.L.R. 1016 (National Conditions of Sale only required vendor to disclose incumbrances of which it had knowledge or means of knowledge).

Remedies

If the defect is a serious one, equivalent, in fact to a substantial misdescription, it can legitimately be claimed that the purchaser has not got what was contracted for. The purchaser is then entitled to resist specific performance and, if necessary, to rescind the contract while it is still executory;[246] and will not be prevented from doing so by a stipulation which provides that errors, misstatements, or omissions shall not annul the sale but are to be a matter of compensation only.[247] Alternatively, the purchaser can affirm the contract and claim specific performance with an abatement of the purchase price.[248]

If, however, the defect is slight, and the purchaser gets substantially what was contracted for, he can be compelled to complete the sale subject to compensation to be made by the vendor.[249]

The right of the purchaser to rescind the contract or to resist specific performance on the ground of substantial misdescription is available, not only where the misdescription is a term of the contract of sale, but also where it arises from a misrepresentation made in the course of negotiations leading to the contract.[250] But if the misdescription is the result of a misrepresentation, even though this is subsequently embodied as a contractual term,[251] the right to rescind can be exercised after conveyance.[252] A claim for damages may also lie under section 2(1) of the Misrepresentation Act 1967.[253]

(k) The Future

Although there is no serious move away from the general rule of non-disclosure, there are concerns about its scope. In other words, should a more liberal approach be taken to the exceptions? Are they too narrow? Take the case of the couple who are divorcing and make an agreement about the division of the property. If the negotiations prior to the agreement proceeded on the basis of the husband's belief, based on the wife's conscientious and religious objections to divorce, that the wife would never remarry, is the agreement vitiated in any way by the failure of the wife to disclose that she had earlier become engaged to be married? On pure common law analysis, on such facts, after considering whether any of the common law and equitable exceptions applied, it has been held that none did and there was no duty to disclose.[254] Although, as we have seen, the common law position has been

[246] *Re Russ and Brown's Contract* [1934] Ch. 34. If the contract is executed by conveyance, the purchaser must rely on the covenants as to title contained in the conveyance, for the contract is merged in the conveyance: see *post*, p. 532 and Law of Property (Miscellaneous Provisions) Act 1994, ss. 2–5.

[247] *Flight* v. *Booth* (1834) 1 Bing. N.C. 370, at p. 377; *Re Arnold* (1880) 14 Ch. D. 270; *Lee* v. *Rayson* [1917] 1 Ch. 613; *Walker* v. *Boyle* [1982] 1 W.L.R. 495.

[248] Cf. *Gilchester Properties Ltd.* v. *Gomm* [1948] 1 All E.R. 433; *ante*, p. 246.

[249] *McQueen* v. *Farquhar* (1805) 11 Ves. 467. But the purchaser may be deprived of his right to compensation by a term of the contract.

[250] *Charles Hunt Ltd.* v. *Palmer* [1931] Ch. 287; *Laurence* v. *Lexcourt Holdings Ltd.* [1978] 1 W.L.R. 1128; *Walker* v. *Boyle* (*supra*, n. 247).

[251] See *ante*, p. 125.

[252] See *ante*, p. 254 (subject to the Misrepresentation Act 1967, s. 2(2), *ante*, p. 252).

[253] *Watts* v. *Spence* [1976] Ch. 165; *Walker* v. *Boyle* (*supra*, n. 247).

[254] *Wales* v. *Wadham* [1977] 1 W.L.R. 199 .

affected by statute where the property settlement is embodied in a Court order, it was said that this *contractual* aspect of the decision is not open to criticism in any way.[255] But is it right in principle that there should be no duty to disclose in such a case? The economic arguments do not appear applicable, let alone compelling, and it was certainly very difficult and probably impossible for the husband to acquire the information from another source. One commentator who supports the general rule has described the decision as 'quite unreasonable'.[256] The position might have been different if a broader view had been taken of the concept of 'fiduciary' relationship or if it had been possible to look at the statutory as well as the common law exceptions to the rule. But, as Nicholas comments, the statutory provisions have been regarded as isolated irruptions into the body of the Common Law and have not been seen as expressing a policy from which a principle could be synthesized.[257]

We have mentioned section 18 of the Marine Insurance Act 1906 and the requirements of the Financial Services Act 1986. Other examples are to be found in the Consumer Credit Act 1974,[258] in the labelling and advertising provisions in the Medicines Act 1968,[259] the Hallmarking Act 1973,[260] and in the Energy Act 1976,[261] and the Package Travel, Package Holiday and Package Tours Regulations 1992.[262]

The financial services and consumer credit statutes reflect a legislative decision that consumers buying on credit and the purchasers of the products of the financial services industry require protection. Although there are many differences between the financial services and the consumer credit regimes, they have similar disclosure and 'cooling-off' provisions. Both regimes also exercise close control over the content of advertisements. The fact that the legislative schemes are so detailed means that it is not unreasonable to see them as self-contained codes. However, that part of the regimes which relates to disclosure might arguably be of wider significance. In both contexts the relationship is one of inequality; in financial services (and probably in consumer credit) there is also imbalance of information in the sense that the professional has information that the client cannot acquire from any other source—or cannot do so without incurring considerable expense. We have noted that this imbalance is also at the root of the duty of disclosure in contracts *uberrimae fidei* and the other non-statutory exceptions.

[255] *Jenkins* v. *Livesey* [1985] AC 424, at p. 439, *ante*, p. 263.

[256] Atiyah, *An Introduction to the Law of Contract*, 5th edn. (1995), p. 252. The decision, but not the reasoning, may, however, be justified on the merits since the husband had not made a full disclosure of his assets.

[257] In Harris and Tallon eds., *Contract Law Today* (1989), p. 178. Cf. the different approach in France, Ghestin, in Harris and Tallon eds., pp. 153–5. See also Legrand (1986) 6 O.J.L.S. 322.

[258] s. 55 empowers regulations to be made requiring pre-contractual disclosure of specified information but none have been made, perhaps because the requirement that credit agreements subject to the Act contain specified information (*ibid.* s. 60 and S.I. 1983 No. 1533, amended by S.I. 1984 No. 1600, S.I. 1985 No. 666, S.I. 1988 No. 2047) when coupled with the right of consumers to cancel the agreement within a specified period (s. 67 and S.I. 1987 No. 2117, amended by S.I. 1988 No. 958) achieves the same end. See further, *Chitty on Contracts* 27th edn. (1994), ch. 36.

[259] e.g. ss. 85(2), 95(4)(a) and 96.

[260] s. 11 (disclosure of information explaining hallmarks).

[261] s. 15 and see S.I. 1983 No. 1486, r. 14.

[262] S.I. 1992 No. 3288, rr 7–8.

It is submitted that it is arguable that the fact that the legislature has imposed a duty of disclosure in the specified cases can be seen, alongside the cases in which a duty exists at common law, as an indication of the underlying rationale and principle of such a duty. If so, such legislative duties could therefore assist a Court which is considering the scope of the exceptions or the extension of the duty to a new fact situation.[263] We have seen that the Marine Insurance Act 1906 is used in this way for all types of insurance; it is either 'directly applicable, or else indirectly because the Act codified the common law applicable to all classes of insurance'.[264]

[263] Beatson [1997] C.L.J. 291. See also *Malik* v. *Bank of Credit & Commerce International S.A.* [1997] I.C.R. 606, *per* Lord Steyn at p. 628. Cf. the different approach in *Banque Financiere de la Cite SA* v. *Westgate Insurance Co. Ltd.* [1991] 2 A.C. 249, 273–4.

[264] *P.C.W. Syndicates* v. *P.C.W. Reinsurers* [1996] 1 W.L.R. 1136, *per* Staughton L.J. at 1140. See also *Economides* v. *Commercial Union Assurance Co. plc* [1997] 3 W.L.R. 1066, at p. 1074.

7

Duress, Undue Influence, and Unconscionable Bargains

I. Introduction

In this chapter we consider three vitiating factors based on the improper conduct of one party, the vulnerability of the other, or a combination of the two. Because of their narrow scope these were, in the past, considered to be relatively unimportant in the law of contract, but they are of more significance in the modern law.

Duress and undue influence occur where one party to a contract has coerced the other or exercised such domination that the other's independence of decision was substantially undermined. Although in some respects undue influence is the equitable equivalent of common law duress, we shall see that in equity, owing to the development of constructive fraud, relief would be granted in cases of coercion where the common law provided no remedy, and also that in some cases the primary concern of equity was to protect certain relationships and did so by a presumption of undue influence. Since the Judicature Act 1873, it has been the duty of the Courts to apply the common law and equitable rules concurrently, and in the event of any conflict or variance between them, the equitable rules are to prevail. The common law and equitable rules have, therefore, now to be treated in the light of their combined effect.[1] Duress, like fraud and misrepresentation, is primarily concerned with the process by which the contract was made (procedural impropriety) rather than whether the terms of the contract are in fact harsh or unconscionable (substantive impropriety). We shall see that, while undue influence is also said to be primarily concerned with procedural impropriety, because of its role in protecting the excessively vulnerable, the position is more complicated and it has significant substantive aspects.

In the limited category of cases in which the doctrine of unconscionable bargains operates, it is necessary to show not only that the process by which the contract was made was unfair but that there is contractual imbalance, i.e. the doctrine extends to the actual substance of the contract and the fairness of its terms. The role of unconscionability was restricted in the nineteenth century by the assumption that parties enjoy freedom of economic decision when entering into contracts which enables them to choose to enter into a contract on whatever terms they may consider advantageous to their interests, or to choose not to,[2] and

[1] *United Scientific Holdings, Ltd.* v. *Burnley B.C.* [1978] A.C. 904. [2] *Ante*, p. 16.

more recently by the view that the task of limiting such freedom so as to relieve inequality of bargaining power is essentially a legislative task for Parliament.[3]

II. Duress[4]

(a) Types of Duress

A contract which has been induced by unlawful or illegitimate forms of pressure or intimidation is voidable[5] on the ground of duress. A restitutionary claim lies for the recovery of money paid under duress, and in many cases the duress will also be tortious and give rise to an action for damages, for example for assault, wrongful interference with property and, in the case of economic duress, intimidation.[6]

Unlawful and illegitimate pressure

Unlawful pressure occurs where the coercive party threatens to do something that is a breach of a common law or statutory duty. The act may be a crime, a tort, or, subject to the qualifications set out below, a breach of contract. Where an unlawful act is threatened, provided it induces the contract, in principle the contract may be set aside by the other party. No distinction is drawn, as it was until recently, between the effect of different categories of duress. In the words of Lord Devlin, '[a]ll that matters to the plaintiff is that, metaphorically speaking, a club has been used. It does not matter to the plaintiff what the club is made of—whether it is a physical club or an economic club or an otherwise illegal club'.[7]

The position is different where what is threatened is not an unlawful act. Ordinarily it is not duress to threaten to do that which one has a legal right to do, for instance to refuse to enter into a contract or to terminate a contract lawfully. But exceptionally such a threat may constitute duress when coupled with a demand. Although such pressure is not unlawful, it is 'illegitimate'.

(b) Unlawful Pressure

Duress of the person

Until 1976, despite some authority to the contrary,[8] the received view was that the only form of duress that could vitiate a contract was actual or threatened

[3] *National Westminster Bank plc* v. *Morgan* [1985] A.C. 686, *per* Lord Scarman at p. 708. On statutory intervention, see *post*, p. 290.

[4] Beatson, *The Use and Abuse of Unjust Enrichment* (1991) ch. 5, [1974] C.L.J. 94; Cartwright, *Unequal Bargaining* (1991), ch. 7; Dawson (1947) 45 Mich. L.Rev. 253; Hale (1943) 43 Col. L.Rev. 603; Halson (1991) 107 L.Q.R. 649; Smith [1997] C.L.J. 343.

[5] Coke 2 Inst. 483; *Whelpdale's Case* (1605) 5 Co. Rep. 119a; *North Ocean Shipping Co. Ltd.* v. *Hyundai Construction Co. Ltd.* [1979] Q.B. 705; *Pao On* v. *Lau Yiu Long* [1980] A.C. 614; *Universe Tankships Inc. of Monrovia* v. *International Transport Workers Federation* [1983] 1 A.C. 366. Cf. *Barton* v. *Armstrong* [1976] A.C. 104, at p. 120. Contrast Lanham (1966) 29 M.L.R. 615, who contends that duress renders the contract void.

[6] *Universe Tankships Inc. of Monrovia* v. *International Transport Workers Federation* (*supra*, n. 5) at pp. 385, 400; *Rookes* v. *Barnard* [1964] A.C. 1129.

[7] *Rookes* v. *Barnard* [1964] A.C. 1129, at p. 1209.

[8] *Tamvaco* v. *Simpson* (1866) L.R. 1 C.P. 363; *Government of Spain* v. *North of England S.S. Co. Ltd.* (1938) 54 T.L.R 852, 61 Ll.L.Rep. 44.

violence to the person,[9] for example threats to kill the party to the contract or perhaps a close relative.[10] How serious the action threatened must be in order to render the contract voidable will depend upon the ability of the person threatened to resist the pressure improperly brought to bear.[11] But once it is established that the threats contributed to the decision of the person threatened to enter into the contract, that person is entitled to relief, even though the contract might well have been entered into it all the same if no threats had been made.[12]

At common law, a threat of *lawful* imprisonment, e.g. a criminal prosecution, would not ordinarily amount to duress, but in equity a threat by one party to prosecute the other for a criminal offence could constitute a ground on which the contract would be set aside,[13] and today the equitable rule prevails.[14]

Duress of goods

The former narrowness of duress as a vitiating factor in contract was in contrast to the position in the law of restitution where money paid under protest for the release of goods from unlawful detention could be recovered by virtue of an action for money had and received.[15] But it is now clear that a contract entered into as the result of actual or threatened violence to or the illegal seizure of goods or other property can be set aside on the ground of duress.[16] The authority to the contrary can possibly be explained as a case of the voluntary compromise of a claim,[17] or as involving facts in which the degree of coercion applied was in fact insufficient to constitute duress.[18]

Economic duress

It is also now established that, in certain circumstances, a contract can be set aside for economic duress.[19] So it has been held that an unlawful threat by a trade union to continue the 'blacking' of a ship[20] and a threat to break an existing contract[21] can be a sufficient ground to render voidable a contract, supported by consideration, entered into as a result of its pressure. In particular, one party may threaten to break an existing contract unless the contract is re-negotiated in its favour, and the other party accedes to this demand in order to avoid the adverse

[9] Co. 2 Inst. 483; Co. Litt. 253b; 1 Roll. Abr. 687, pl. 5,6; *Skeate* v. *Beale* (1841) 11 A. & E. 983.
[10] *Barton* v. *Armstrong* [1976] A.C. 104.
[11] *Scott* v. *Sebright* (1886) 12 P.D. 21, at p.24.
[12] *Barton* v. *Armstrong* [1976] A.C. 104.
[13] *Williams* v. *Bayley* (1886) L.R. 1 H.L. 200.
[14] *Mutual Finance Co. Ltd.* v. *John Wetton & Sons Ltd.* [1937] 2 K.B. 389.
[15] *Astley* v. *Reynolds* (1731) 2 Str. 915; *Maskell* v. *Horner* [1915] 3 K.B. 106.
[16] *Vantage Navigation Cpn.* v. *Suhail & Saud Bahwan Building Materials Llc. (The Alev)* [1989] 1 Lloyd's Rep. 138. See also *Lloyds Bank Ltd.* v. *Bundy* [1975] Q.B. 326, at p. 337; *Occidental Worldwide Investment Cpn.* v. *Skibs A/S Avanti* [1976] 1 Lloyd's Rep. 293, at pp. 335–6; *North Ocean Shipping Co. Ltd.* v. *Hyundai Construction Co. Ltd.* [1979] Q.B. 705, at p. 715; *Pao On* v. *Lau Yiu Long* [1980] A.C. 614, at p. 635.
[17] *Occidental Worldwide Investment Cpn.* v. *Skibs A/S Avanti* (*supra*, n. 16); Beatson, *The Use and Abuse of Unjust Enrichment* (1991), pp. 105–6. On compromises, see *ante*, p. 100.
[18] *Skeate* v. *Beale* (1840) 11 A. & E. 983, at p. 990.
[19] *Occidental Worldwide Investment Cpn* v. *Skibs A/S Avanti* (*supra*, n. 16), at p.336; *North Ocean Shipping Co. Ltd.* v. *Hyundai Construction Co. Ltd.* (*supra*, n. 16); *Pao On* v. *Lau Yiu Long* (*supra*, n. 16), at p.635; *Universe Tankships Inc. of Monrovia* v. *International Transport Workers Federation* [1983] 1 A.C. 366, at pp. 383, 391, 397, 400; *Alec Lobb (Garages) Ltd.* v. *Total Oil Great Britain Ltd.* [1983] 1 W.L.R. 87, at p. 93.
[20] *Universe Tankships Inc. of Monrovia* v. *International Transport Workers Federation* (*supra*, n. 19).
[21] *North Ocean Shipping Co. Ltd.* v. *Hyundai Construction Co. Ltd.* (*supra*, n. 16); *Pao On* v. *Lau Yiu Long* (*supra*, n. 16). See also *Occidental Worldwide Investment Cpn* v. *Skibs A/S Avanti* (*supra*n. 16) (threat to put company into liquidaton).

financial consequences which would ensue from the threatened breach.[22] In *Atlas Express Ltd.* v. *Kafco (Importers and Distributors) Ltd.*:[23]

> The defendant had agreed to supply basketware to a chain of retail shops and made a contract for its delivery with the plaintiff, a carrier. The plaintiff had erroneously estimated that each load would contain over four hundered cartons and, on this basis, had agreed a price of £1.10 per carton. The first load was for a smaller number of cartons, and the plaintiff, believing that carrying such a load at the agreed rate was not financially viable, said that it would not perform unless the defendant agreed to pay a minimum of £440 a load. Because the defendant's commercial survival depended on the contract with the retail chain and it could not find an alternative carrier, it agreed to the plaintiff's demand but then refused to pay.

It was held that the new terms were agreed under economic duress. In that case there was a direct threat to repudiate the contract, but the threat may be indirect. Thus, an indication by a party to a contract that it was prepared to allow its workers to strike unless the other party agreed to make a payment in addition to the contract price has been held to be a veiled threat and to constitute duress where the other party had no other practical choice open to it but to agree to pay.[24]

Causation

Not every threat to break a contract unless its terms are renegotiated will amount to duress. It is also necessary for the threat to induce the renegotiation, and in this context a number of factors will be taken into account. These include the availability of an adequate alternative remedy, whether there has been a compromise or a submission to a claim made in good faith, and whether the victim has protested or taken independent advice. Thus, in *Pao On* v. *Lau Yiu Long*,[25] where one party was coerced into accepting the renegotiation of a business transaction by a threat by the other party to break an existing contract, but did so with legal advice and without protest, and after a considered appraisal of the risk involved, it was held by the Privy Council that the renegotiated agreement would not be set aside on the ground of economic duress.

(c) Juridical Basis

Juridical basis

It was originally stated that a contract could only be set aside for duress if the will of the victim was coerced so as to vitiate consent.[26] But the fallacy of this approach was exposed in *Universe Tankships Inc. of Monrovia* v. *International Transport Workers Federation*.[27] A person subjected to duress is fully aware of the nature and

[22] On the distinction between a 'threat' and a 'warning' which will not suffice, see *post*, p. 275.

[23] [1989] Q.B. 833.

[24] *B. & S. Contracts and Design Ltd.* v. *Victor Green Publications Ltd* [1984] I.C.R. 419, at pp. 426, 428.

[25] [1980] A.C. 614, *ante*, pp. 103–4. See also *Alec Lobb (Garages) Ltd.* v. *Total Oil Great Britain Ltd.* (*supra*, n. 19).

[26] *Occidental Worldwide Investment Cpn* v. *Skibs A/S Avanti* (*supra*, n. 16), at p. 336; *North Ocean Shipping* Co. *Ltd.* v. *Hyundai Construction* Co. *Ltd.* (*supra*, n. 16) at pp. 717, 719; *Pao On* v. *Lau Yiu Long* (*supra*, n. 25), at p. 635. See also *Barton* v. *Armstrong* (*supra*, n. 12) at p. 121; *Alec Lobb (Garages) Ltd.* v. *Total Oil Great Britain Ltd* (*supra*, n. 19), at p. 93.

[27] [1983] 1 A.C. 366. See also *Lynch* v. *D.P.P. of Northern Ireland* [1975] A.C. 653, at pp. 670, 675, 680, 690–1, 695, 703, 709; Atiyah (1982) 98 L.Q.R. 197, (1983) 99 L.Q.R. 353; Beatson (1976) 92 L.Q.R. 496, *The Use and Abuse of Unjust Enrichment* (1991), pp. 113–17.

terms of the contract which is thus entered. The victim still intends to contract, though the contract is made unwillingly. 'The classic case of duress is . . . not the lack of will to submit but the victim's intentional submission arising from the realisation that there is no other practical choice open to him'.[28] The rationale of duress is thus not lack of knowledge or consent but illegitimate pressure which means that the victim's apparent consent is treated in law as revocable, unless approbated expressly or by implication after the pressure has ceased to operate on the victim's mind.[29]

(d) Alternative Remedies

Alternative remedies

A person threatened with duress of goods or a breach of contract can stand up to the threat and, if the other party breaches the contract, sue for damages. In the context of duress of goods the presence of an alternative remedy, such as an action in tort for wrongful interference with goods, is not necessarily a bar to relief; the threatened party might have had 'such an immediate want of his goods that [such an action] would not do'[30] and in any event there is no *right* to recover the goods themselves as opposed to damages in an action in tort.[31]

In the case of duress by threatened breach of contract, although damages and, where available, specific relief may be adequate, there will be situations in which such remedies do not adequately protect the victim, for example where it is imperative that there be no interruption in performance or where, as in *Atlas Express Ltd.* v. *Kafco (Importers and Distributors) Ltd.*, it is not possible to obtain the contractual services from another source. The existence and adequacy of an alternative remedy is taken into account in such cases. There is some support for treating this as purely evidential and not conclusive, i.e. one of the factors (with protest and independent advice) which the court takes into account in determining whether the victim was in fact coerced by the threat.[32] But it is submitted that, since the basis of the doctrine of duress is the absence of a practical alternative on the part of the victim to submission to the threat, the better view is that the existence of an adequate alternative remedy goes to the essence of and precludes a finding of duress.[33]

(e) Duress Distinguished from Legitimate Renegotiation

Permissible conduct in renegotiations

We noted in Chapter 3 of this book that it may well be reasonable for a party to seek to renegotiate a contract and that one of the functions of promissory estop-

[28] [1983] 1 AC 366, *per* Lord Scarman at p. 400. See also Lord Diplock at p. 384.

[29] See *post*, p. 285.

[30] *Astley* v. *Reynolds* (1731) 2 Str. 915, at p. 916; *Maskell* v. *Horner* [1915] 3 K.B. 106, at p. 122. See also *Kanhaya Lal* v. *National Bank of India* (1913) 29 T.L.R. 314. Cf. *Vantage Navigation Cpn.* v. *Suhail & Saud Bahwan Building Materials Llc. (The Alev)* (*supra*, n. 16) at pp. 146–7.

[31] By the Torts (Interference with Goods) Act 1977, ss. 3(2)(a), 3(3)(b) an order for delivery of the goods may be made at the discretion of the court.

[32] *Pao On* v. *Lau Yiu Long* (*supra*, n. 19), *per* Lord Scarman at pp. 635, 640.

[33] *Vantage Navigation Cpn.* v. *Suhail & Saud Bahwan Building Materials Llc. (The Alev)* (*supra*, n. 16); *Hennessy* v. *Craigmyle & Co. Ltd.* [1986] I.C.R. 461.

pel is to protect reasonable renegotiations. Where the party seeking to renegotiate honestly believes that in the circumstances it is entitled not to perform, we have seen that the result will generally be a binding compromise.[34] But where it does not, the development of duress makes it important that parties who genuinely face difficulties if they complete performance on the contract terms and wish to renegotiate know what is and what is not permissible conduct.

In *Williams* v. *Roffey Bros. & Nicholls (Contractors) Ltd.*[35] the defendant, noticing its carpentry sub-contractor's difficulties, offered an additional payment which, as we have seen, was held binding. But surely the renegotiation would not automatically have been vitiated by duress if it was the sub-contractor who had taken the initiative. It should not necessarily be seen as a threat to point out that without renegotiation it will not be possible to continue performance,[36] provided that this is so in fact. This is particularly so where, as in the *High Trees* case,[37] changes of circumstances have affected the risks originally undertaken.[38] It must be recalled that, save for specifically enforceable contracts, it is open for a party to a contract to be in deliberate breach of contract in order to cut its losses commercially.[39] We have seen that the bona fides of the person making a demand are relevant in determining whether there is a compromise or whether the doctrine of promissory estoppel applies.[40] They should also be relevant in determining whether there is duress.[41]

Is it commercially reasonable to renegotiate?

One way to determine what is permissible is by a test, similar to that in paragraph 176(2) of the *Restatement of Contracts 2d*, which would ask whether it was commercially reasonable to seek to renegotiate and whether, as in the case of promissory estoppel, the renegotiated terms are 'fair and equitable'.[42] But it is difficult to see how the courts could do this without becoming more involved in an examination of the fairness of both the original contract and the renegotiation than they have hitherto been.[43] It is, however, equally difficult to see any way of distinguishing permissible and impermissible conduct during renegotiations that does not ultimately involve some monitoring of the substantive fairness of the contract,

[34] *Ante*, p. 100.

[35] [1991] 1 Q.B. 1, *ante*, p. 105.

[36] See, on the difference between a 'threat' and a 'warning' in the context of economic torts, *Conway* v. *Wade* [1909] A.C. 506, at p. 510; *Rookes* v. *Barnard* [1964] A.C. 1129, at p. 1166; *Camilla Tanker Ltd.* v. *International Transport Workers Federation.* [1976] I.C.R. 274, at pp. 284, 296. See also *Hodges* v. *Webb* [1920] 2 Ch. 70; Beatson, *The Use and Abuse of Unjust Enrichment* (1991), pp. 118–20; Smith [1997] C.L.J. 343, 346–50.

[37] [1947] K.B. 130, *ante*, p. 111.

[38] *B. & S. Contracts and Design Ltd.* v. *Victor Green Publications Ltd* (*supra*, n. 24) (actions of third parties insufficient, possibly because contractor had not made reasonable efforts to avoid strike). See also *Watkins & Sons Inc.* v. *Carrig* 21 A. 2d. 591 (1941) (hard rock unexpectedly struck during excavations) but cf. *North Ocean Shipping* Co. *Ltd.* v. *Hyundai Construction* Co. *Ltd.* (*supra*, n. 16) at p. 714; *Williams* v. *Roffey Bros. & Nicholls (Contractors) Ltd.* (*supra*, n. 35) at p. 20.

[39] *Williams* v. *Roffey Bros. & Nicholls (Contractors) Ltd.* (*supra*, n. 35) *per* Purchas L.J. at p. 23.

[40] *D. & C. Builders* v. *Rees* [1966] 2 Q.B. 617, *ante*, p. 113.

[41] *CTN Cash and Carry Ltd.* v. *Gallagher Ltd.* [1994] 4 All E.R. 714 (lawful act duress, see *post*, p. 276).

[42] *D. & C. Builders* v. *Rees* (*supra*, n. 40), *ante*, p. 113.

[43] Beatson, *The Use and Abuse of Unjust Enrichment* (1991), pp. 126–9, 135; Goff and Jones, *The Law of Restitution*, 4th edn. (1993), p. 251.

although this should be kept to the absolute minimum by emphasizing that duress is primarily a doctrine of *procedural* impropriety focusing on conduct.

(f) Threats of Lawful Action

Ordinarily not duress

We have noted that it is not ordinarily duress to threaten to do that which one has a right to do, for instance to refuse to enter into a contract or to terminate a contract lawfully.[44] In the cut-and-thrust of business relationships various types of pressure may be brought to bear in differing situations. Where there are shortages in goods or services the person who wishes to acquire them has little choice. Thus, a private person or undertaking is generally permitted to refuse to deal with another at all or except on specified terms,[45] and the poor person who has to agree to pay a high rent to get a roof over his head is nevertheless bound. 'No bargain will be upset which is the result of the ordinary interplay of [market] forces'[46] and a contracting party will not be permitted to escape from its contractual obligations merely because it was coerced into making a contract by fear of the financial consequences of refusing to do so.[47] So, it has been held that a wholesale buyer of cigarettes who, following an honest but mistaken demand by the seller, paid a sum not due because the seller had threatened, as it was entitled to do, to withdraw credit facilities from the buyer, could not recover it on the ground of duress.[48] It was said that this enables people to know where they stand, avoids the reopening of settled accounts, and provides certainty as to what is acceptable conduct in the bargaining process.[49] Although this approach leaves many forms of socially objectionable conduct unchecked, as a general rule the determination of when socially objectionable conduct which is not in itself unlawful should be penalized is for the legislature rather than the judiciary.[50]

Exceptional cases: 'illegitimate' pressure

Exceptionally, however, a threat of lawful action may constitute duress and render a contract voidable. We have seen that a threat by one party to prosecute the other for a criminal offence could constitute a ground on which the contract would be set aside.[51] Similarly, in the context of salvage, a refusal to rescue a vessel in distress or those on board save on extortionate terms has led to the resulting contract being set aside.[52] Again, it is inconceivable that the Courts would give effect to an agreement obtained by threats amounting to blackmail, although in

[44] *Leyland Daf Ltd.* v. *Automotive Products plc* [1994] 1 B.C.L.R. 244, at pp. 249–50, 257; *Smith* v. *Charlick Ltd.* (1923) 34 C.L.R. 38, at pp. 56, 64–5 (High Court of Australia).

[45] For the position of a public body see *R.* v. *Lewisham L.B.C., ex parte Shell U.K. Ltd.* [1988] 1 All E.R. 938 and the statutory controls discussed *ante*, pp. 6, 210.

[46] *Lloyds Bank Ltd.* v. *Bundy* [1975] Q.B. 326, at p. 336.

[47] *Hardie and Lane Ltd.* v. *Chilton* [1928] 2 K.B. 306: *Eric Gnapp Ltd.* v. *Petroleum Board* [1949] 1 All E.R. 980.

[48] *CTN Cash and Carry Ltd.* v. *Gallagher Ltd.* [1994] 4 All E.R. 714. See also *Leyland Daf Ltd.* v. *Automotive Products plc* [1994] 1 B.C.L.R. 244.

[49] *Ibid.*, at p. 719.

[50] *CTN Cash and Carry Ltd.* v. *Gallagher Ltd.* (*supra*, n. 48), *per* Steyn L.J. at pp. 718–19, and see Birks, *An Introduction to the Law of Restitution* (1985) p. 177.

[51] *Mutual Finance Co. Ltd.* v. *John Wetton & Sons Ltd.* [1937] 2 K.B. 389, *ante*, p. 272.

[52] *The Port Caledonia* [1903] P. 184 ('£1,000 or no rope'). See also *The Rialto* [1891] P. 175 (agreement to pay £6,000 when proper sum was £3,000).

one sense the blackmailer may only be threatening to do some act which he is lawfully entitled to do, e.g. to tell a wife of her husband's adultery. Lord Scarman has stated that:[53]

> [d]uress can, of course, exist even if the threat is one of lawful action: whether it does so depends upon the nature of the demand. Blackmail is often a demand supported by a threat to do what is lawful, e.g. to report criminal conduct to the police.

In the typical case of blackmail, the blackmailer has no economic interest in the outcome apart from getting what has been demanded, and it is for this reason that the threat is regarded as illegitimate. Where the person making the threat has some economic or other interest in the outcome apart from getting what has been demanded, the question will be whether the demand is 'unwarranted' in the sense of being unrelated to any 'legitimate' interest of the party making the demand. It is submitted that, as in the criminal law, a demand will not be unwarranted where the person making it believes that there are reasonable grounds for making it and the use of the menaces is a proper means of reinforcing the demand.[54] Since in the typical case of coercion by the threat of a lawful act concerning an existing or future contractual relationship, the threatener will have a direct economic interest, the demand will, in the majority of cases, be 'legitimate'.[55] The tort of conspiracy to injure, which also does not involve unlawful means, provides a useful guide. In that context the pursuit of more profit, of a larger share of the market, price stability, and of higher wages have all been held to be legitimate purposes.[56] For these reasons, while in principle a threat to do what is lawful can constitute duress, this form of pressure is unlikely to have much practical impact save where the relationship between the parties is one accorded special protection by the law.[57]

III. Undue Influence

WE have already seen that the term 'fraud' was used in a sense wider and less precise in the Court of Chancery than in the common law courts.[58] This followed naturally from the remedies which they respectively administered. The common

[53] *Universe Tankships Inc. of Monrovia* v. *International Transport Workers Federation* [1983] 1 A.C. 366, at p. 401. See also Lord Diplock, *ibid.*, at p. 385. See further *Thorne* v. *Motor Trade Association* [1937] AC. 797, at p. 822; *Dimskal Shipping Co. S.A.* v. *International Transport Workers Federation (The Evia Luck)* [1992] 2 A.C. 152. Cf. *Royal Boskalis Westminster N.V.* v. *Mountain* [1997] 2 All E.R. 929, at p. 981.

[54] Theft Act 1968, s. 2(1); Criminal Law Revision Committee, Eighth Report (Cmnd. 2977); *R.* v. *Hervey* (1980) 72 Cr. App. R. 139.

[55] For a possible example of an unwarranted demand see *Norreys* v. *Zeffert* [1939] 2 All E.R. 186.

[56] *Mogul Steamship Co.* v. *McGregor* [1892] A.C. 25; *Thorne* v. *Motor Trade Association* [1937] A.C. 797; *Crofter Hand Woven Harris Tweed Co. Ltd.* v. *Veitch* [1942] A.C. 435.

[57] See *post*, pp. 279 (presumed undue influence) and 287 (unconscionability) for consideration of such relationships.

[58] *Ante*, p. 261.

law gave damages for a wrong, and was compelled to define with care the wrong which furnished a cause of action. Equity refused specific performance of a contract or set aside the transaction, with or without compensation, where one party had acted unfairly by the other. Fraud in equity was often used in the sense of unconscientious dealing—'although, I think, unfortunately', to use the words of a great equity lawyer, Lord Haldane.[59] One such form of dealing is commonly described as 'undue influence'.

(a) Nature of Undue Influence

The nature of undue influence

The term 'undue influence' has sometimes been used by the Courts to describe the equitable doctrine of coercion which has just been referred to,[60] but it also includes, and it would perhaps be convenient to confine it to, forms of pressure much less direct or substantial than those already discussed. It may arise where the parties stand to one another in a relation of confidence or dependence which puts one of them in a position to exercise over the other an influence which may be perfectly natural and proper in itself, but is capable of being unfairly used.[61] In dealing with such cases the Courts have been careful not to fetter their jurisdiction by defining the exact limits of its exercise,[62] but there seem to be two situations in which it will be held to be present, which have been classified as follows.[63]

First, class 1, the direct analogue of common law duress, where the party charged has in fact exercised undue influence, in the sense of domination, over the other party. This has been termed 'actual' undue influence.

Secondly, class 2, where the parties are in a relationship which is either in law (class 2(A)) or in the special circumstances of the parties' association (class 2(B)), one in which duties of care and confidence are imposed on one party towards the other.

It is often said that, in cases within class 1, evidence of express influence must be adduced by the party seeking to impeach the transaction, whereas, in cases within class 2, undue influence is presumed by the law in the absence of evidence to the contrary.[64] Although this is undoubtedly true, it tends to be rather misleading, as once it is established that one person is in a position to exercise undue influence over the other, it is presumed that such influence has been exercised until the contrary is proved.[65]

[59] *Nocton* v. *Lord Ashburton* [1914] A.C. 932, at p. 953.
[60] *Mutual Finance Co. Ltd.* v. *John Wetton & Sons Ltd.* [1937] 2 K.B. 389.
[61] Winder (1939) 3 M.L.R. 97. See also Cartwright, *Unequal Bargaining* (1991), ch. X. Cf. Birks and Chin in Beatson and Friedmann (eds.), *Good Faith and Fault in Contract Law* (1995), ch. 3 (undue influence is about impaired consent, not exploitation).
[62] *National Westminster Bank plc* v. *Morgan* [1985] A.C. 686, at p. 709.
[63] *Barclays Bank plc* v. *O'Brien* [1994] 1 A.C. 180. See also *Tufton* v. *Sperni* [1952] 2 T.L.R. 516, at p. 520.
[64] *Allcard* v. *Skinner* (1887) 36 Ch. D. 145, *per* Lindley L.J. at p. 181.
[65] *Ibid.*, at p. 183. See also *Goldsworthy* v. *Brickell* [1987] 1 Ch. 378, at p. 401.

(b) Actual Undue Influence

Class 1 'actual' undue influence: domination

If it can be shown that one party exercised such domination over the mind and will of the other that the latter's independence of decision was substantially undermined, and this domination brought about the transaction, the victim will be entitled to relief on the ground of undue influence.

There is no need for any special relationship (of the type mentioned below) to exist between the parties, although, of course, it may do so. The mere fact that domination was exercised is sufficient; no abuse of confidence need be proved. In *Smith* v. *Kay*,[66] for example, a young man, only just of age, incurred liabilities to the appellant by the contrivance of an older man who had acquired a strong influence over him, and who professed to assist him in a career of extravagance and dissipation. It was held that influence of this nature, though in no way 'fiduciary', entitled the young man to the protection of the Court. Similarly, in *Morley* v. *Loughnan*[67] executors sued to recover £140,000 paid by the deceased to a member of the 'Exclusive Brethren' in whose house he had lived for some years, and under whose religious influence he had been. Wright J., in giving judgment for the plaintiffs, said that it was unnecessary to decide whether or not any special relationship existed between the deceased and the defendant, for he 'took possession, so to speak, of the whole life of the deceased, and the gifts were not the result of the deceased's own free will, but the effect of that influence and domination'.[68]

Many other cases on this point have unfortunately concerned spiritual 'advisers' who have used their expert knowledge of the next world to obtain advantages in this.[69] In more recent times the cases have often concerned men who have put pressure on their wives or partners to secure business debts by mortgaging the family home.[70] While heavy family pressure will not in itself suffice to constitute domination, in one case wounding and insulting language and demeaning comparisons between what a husband characterized as his wife's disloyalty and his relations' loyalty amounted to moral blackmail and coecion.[71]

Actual undue influence itself suffices for relief, and it is not necessary that the transaction induced by it be manifestly disadvantageous to the victim.[72] In this it differs from presumed undue influence, where, as we shall see, it is necessary to show such a disadvantage.

(c) Presumed Undue Influence

Relationship of confidence

Even if it cannot be proved that the plaintiff's mind was a 'mere channel through which the will of the defendant operated',[73] relief may be given if there existed

[66] (1859) 7 H.L.C. 750. [67] [1893] 1 Ch. 736. [68] At p. 756.

[69] 'Totius autem injustitiae nulla capitalior est quam eorum qui, cum maxime fallunt, id agunt, ut boni viri esse videantur': Cicero, *De Off.* lib. i, s.13.

[70] *C.I.B.C. Mortgages Ltd.* v. *Pitt* [1994] 1 A.C. 200; *B.C.C.I.* v. *Aboody* [1990] 1 Q.B. 923.

[71] *Bank of Scotland* v. *Bennett* [1997] 1 F.L.R. 801, at pp. 822–7.

[72] *C.I.B.C. Mortgages Ltd.* v. *Pitt* (*supra*, n. 70) overruling *B.C.C.I.* v. *Aboody* (*supra*, n. 70).

[73] *Tufton* v. *Sperni* [1952] 2 T.L.R. 516, at p. 530.

between the parties some special relationship of confidence which the defendant has abused:

> Wherever two persons stand in such a relation that, while it continues, confidence is necessarily reposed by one, and the influence which naturally grows out of that confidence is possessed by the other, and this confidence is abused, or the influence is exerted to obtain an advantage at the expense of the confiding party, the person so availing himself of his position will not be permitted to retain the advantage, although the transaction could not have been impeached if no such confidential relation had existed.[74]

In the present state of the law, there are thus two components in the establishment of a situation in which undue influence will be presumed. The first is the nature of the relationship, and the second, which has been criticized, is the nature of the transaction, which must be 'manifestly disadvantageous' to the victim.

(i) The nature of the relationship

As is shown in the classification of types of undue influence set out above,[75] there are two forms of 'class 2' situations; those in which the presumption is made as a matter of law, and those in which it arises by virtue of the particular circumstances of the parties' relationship.

Presumption raised as a matter of law

It is not every fiduciary relationship that as a matter of law raises a presumption of undue influence.[76] It must be one of a limited class which the Courts regard as suggesting undue influence. The relations which fall into this category are those between parent (or person *in loco parentis)* and child,[77] solicitor and client,[78] doctor and patient,[79] trustee and cestui que trust,[80] spiritual adviser and any person to whom that person stands in that relationship,[81] and, in certain circumstances, fiancé and fiancée.[82] But the relationship of husband and wife is not one to which this presumption applies as a matter of law.[83]

Presumption raised on the facts of the particular case

Where, as in the case of husband and wife, the presumption does not apply as a matter of law, one of the parties may nevertheless be able to demonstrate that on the facts of the particular case he or she placed such trust and confidence in the other that a presumption of undue influence is raised. In the case of wives, it has been stated that 'this special tenderness of treatment' is attributable to the fact that in many cases a wife is able to demonstrate that she placed trust and confidence in her husband in relation to her financial affairs and because 'the sexual and emotional ties between the parties provide a ready weapon for undue influence: a wife's true wishes can easily be overborne because of her fear of destroying or damaging the wider relationship between her and her husband if she opposes his

[74] *Tate* v. *Williamson* (1866) L.R. 2 Ch. App. 55, *per* Lord Chelmsford at p. 61.
[75] *Ante*, p. 278.
[76] *Re Coombe* [1911] 1 Ch. 723, at p. 728 (principal and agent will not suffice).
[77] *Bainbrigge* v. *Browne* (1881) 18 Ch. D. 188.
[78] *Wright* v. *Carter* [1980] 1 Ch. 27.
[79] *Mitchell* v. *Homfray* (1881) 8 Q.B.D. 587.
[80] *Beningfield* v. *Baxter* (1886) 12 App. Cas. 167.
[81] *Huguenin* v. *Baseley* (1807) 14 Ves. Jun. 273; *Allcard* v. *Skinner* (1887) 36 Ch. D. 145.
[82] *Re Lloyds Bank Ltd.* [1931] 1 Ch. 289. Cf. *Zamet* v. *Hyman* [1961] 1 W.L.R. 1442.
[83] *Barclays Bank plc* v. *O'Brien* [1994] 1 A.C. 180. See also *Bank of Montreal* v. *Stuart* [1911] 1 A.C. 120. Cf. *Backhouse* v. *Backhouse* [1978] 1 W.L.R. 243, at p. 251.

wishes'.[84] Similar principles apply to all other cases where there is an emotional relationship between unmarried cohabitees.[85]

Domination not necessary: trust and confidence suffice

The list of situations in which such a relationship exists on the facts of the particular case is not a closed one; the principle applies to every case where influence is acquired and abused, where confidence is reposed and betrayed.[86] All the circumstances have to be considered to determine whether such a relationship does exist,[87] and it is not necessary to show that it is one of domination. It suffices that the party in whom trust and confidence is reposed is in a position to exert influence over the party who reposes it. Thus in *Tate* v. *Williamson*:[88]

An undergraduate, T, aged 23 years, was being pressed to pay his college debts, which amounted to some £1,000. Being estranged from his father, he asked his great-uncle to advise him how he should find the means to pay. The great-uncle was unable to advise in person owing to ill health, but he deputed the defendant, his nephew, to do so. Conversations took place between T and the defendant in which T expressed the desire to sell part of his estate, upon which the defendant offered to buy it for £7,000. Before the sale was completed, the defendant obtained a report from a surveyor on the property, and this valued it at £20,000. The defendant did not disclose this fact to T, but proceeded with the purchase. Excessive drinking led to T's death one year later. It was held that the purchase must be set aside. The defendant, having been asked to give advice, stood in a confidential relationship to T, and this prevented him from becoming a purchaser of the property without the fullest communication of all material information which he had obtained as to its value.

Similarly, in *Tufton* v. *Sperni*,[89] the situation was such that a confidential relationship arose:

The plaintiff and defendant were fellow members of a committee formed to establish a Moslem cultural centre in London, it being understood that the plaintiff would provide the funds for the centre. The defendant induced the plaintiff to buy his (the defendant's) own house for the purpose at a price which grossly exceeded its market value.

The Court of Appeal set the contract aside. The situation was not one which was comprehended by the established categories, nor was there any domination of the plaintiff by the defendant; yet, as Evershed M.R. pointed out:[90]

[84] *Barclays Bank plc* v. *O'Brien* (*supra*, n. 83) *per* Lord Browne-Wilkinson at pp. 190–1, 196. For a sociological analysis of the law and practice relating to surety wives and partners, see Fehlberg, *Sexually Transmitted Debt* (1997).

[85] *Ibid.*, at p. 198.

[86] *Smith* v. *Kay* (1859) 7 H.L.C. 750, *per* Lord Kingsdown at p.779.

[87] *Lloyds Bank Ltd.* v. *Bundy* [1975] Q.B. 326, at p. 342.

[88] (1866) L.R. 2 Ch. App. 55. See also *Cheese* v. *Thomas* [1994] 1 W.L.R. 129 (great nephew and aged great-uncle); *Grosvenor* v. *Sherratt* (1860) 28 Beav. 659 (executor and young woman); *Re Craig* [1971] Ch. 95 (secretary-companion and man of 84 years); *Goldsworthy* v. *Brickell* (*supra*, n. 65) (85-year-old farmer and farm manager); *Lloyds Bank, Ltd.* v. *Bundy* (*supra*, n. 87) (banker and customer) but cf. *National Westminster Bank plc* v. *Morgan* [1985] 1 A.C. 686; *Horry* v. *Tate & Lyle Refineries Ltd.* [1982] 2 Lloyd's Rep. 416 (injured employee and employer's insurers); *O'Sullivan* v. *Management Agency and Music Ltd.* [1985] Q.B. 428 (unknown pop musician and internationally recognized manager). Perhaps the high watermark is *Credit Lyonnais Bank Nederland N.V.* v. *Burch* [1997] 1 All E.R. 144 (employer and employee) which is perhaps better regarded, see Chen-Wishart [1997] C.L.J. 60, as a case of unconscionability, on which see *post*, p. 287.

[89] [1952] 2 T.L.R. 516. See also *Roche* v. *Sherrington* [1982] 1 W.L.R. 599.

[90] At p. 523. See also *Goldsworthy* v. *Brickell* (*supra*, n. 65).

If a number of persons join together for the purpose of furthering some charitable or altruistic objective, it would seem not unreasonable to conclude that in regard to all matters related to that objective, each 'necessarily reposes confidence' in the others and each possesses accordingly that 'influence which naturally grows out of confidence'.

(ii) The nature of the transaction

Manifest disadvantage

The second and more problematic requirement is that, as a result of the decision of the House of Lords in *National Westminster Bank plc* v. *Morgan*[91] in 1985, a claim to set aside a transaction on the ground of presumed undue influence cannot succeed unless the impugned transaction is manifestly disadvantageous to the claimant. In *Goldsworthy* v. *Brickell* Nourse L.J. stated:[92]

> the presumption is not perfected and remains inoperative until the party who has ceded the trust and confidence makes a gift so large, or enters a transaction so improvident, as not to be reasonably accounted for on the ground of friendship, relationship, charity or other ordinary motives on which men act. Although influence might have been presumed beforehand, it is only then that it is presumed to have been undue.

An undertaking to guarantee the debts of another satisfies this requirement and it is, of course, an inherent feature of gifts, which have been the subject of many cases of undue influence.[93] It was held to have been satisfied where an elderly man parted with all his capital as a contribution to a joint purchase of a house with his great-nephew which he was to occupy for the rest of his life because in the future he might wish or need to live elsewhere, for example in sheltered accommodation, and because he would be in jeopardy if the great nephew failed to pay the payments due under the mortgage.[94] But where a debtor refinances or remortgages an existing loan[95] the transaction will not generally be 'manifestly disadvantageous'. And where a guarantor has an interest in the business, the debts of which are being guaranteed, the guarantee will not be 'manifestly disadvantageous' unless the security given is out of all proportion to the benefit conferred by the transaction.[96] Although the primary focus of the test of 'manifest disadvantage' appears to be financial, i.e. the adequacy of the consideration given in exchange for the money paid or property transferred, it is submitted that Nourse L.J.'s formulation, quoted above, which asks whether the transaction can be 'reasonably accounted for on the ground of friendship, relationship, charity or other ordinary motives' as well as whether it is 'improvident' allows other factors to be taken into account. So, where the requisite relationship of trust and confidence exists between two persons, the fact that an offer by one to buy land or a valuable oil painting from the other is for the full or even an enhanced market price should not necessarily prevent the transaction being presumed to be vitiated by undue

[91] [1985] A.C. 686.
[92] [1987] Ch. 378, at p. 401. This requirement does not apply to cases of 'actual' undue influence, *ante*, p. 279.
[93] e.g. *Allcard* v. *Skinner* (1887) 36 Ch. D. 145, *post*, p. 285.
[94] *Cheese* v. *Thomas* [1994] 1 W.L.R. 129, at p. 133.
[95] *National Westminster Bank plc* v. *Morgan* [1985] A.C. 686.
[96] *Bank of Scotland* v. *Bennett* [1997] 1 F.L.R. 801; *Credit Lyonnais Bank Nederland N.V.* v. *Burch* [1997] 1 All E.R. 144. Cf. *Brittania Building Society* v. *Pugh* [1997] 2 F.L.R. 7.

influence. The person subjected to the influence should not be presumed to wish to sell a family home or business, or an item of particular sentimental value, even for the full market price.

The requirement of 'manifest disadvantage' was not a feature of the reasoning in the judgments of the older cases on undue influence although, as indicated, it is almost inevitably satisfied in such cases. The attempt to apply it to cases of 'actual' undue influence has been rejected. There are also difficulties in applying it in cases of presumed undue influence, particularly class 2(a) cases where the presumption arises as a matter of law from the relationship. In *C.I.B.C. Mortgages Plc* v. *Pitt*[97] the House of Lords indicated that it might be willing to reconsider the matter. This is because the requirement is difficult to reconcile with cases in which those in a fiduciary position who enter into transactions with those to whom the fiduciary duties are owed are required to establish affirmatively that the transaction is a fair one. Lord Browne-Wilkinson stated that in those cases, which were not considered in *Morgan's* case, the policy of the law is to protect those in the relationship *as a class*.[98] It is submitted that it is difficult to see why this should not be so in the case of presumed undue influence.

(iii) Rebutting the presumption

Rebutting the presumption

Where undue influence is shown to exist, the presumption of its exercise can only be rebutted by proof that the party reposing the confidence has been 'placed in such a position as will enable him to form an entirely free and unfettered judgment, independent altogether of any sort of control'.[99] The most obvious way of establishing this is to show that the party reposing the confidence received independent legal advice and took it. In some (possibly extreme) cases, very cogent evidence has been required to be adduced by the defendant to prove that the significance of the advice was brought home to the other party. In *Powell* v. *Powell*:[100]

A settlement was executed by a young woman, under the influence of her stepmother, by which she shared her property with the children of the stepmother's second marriage. She received some independent advice from a solicitor, but he was acting for some of the other parties to the settlement as well as for the plaintiff. It appeared that, although he had expressed disapproval of the transaction, he had not carried his disapproval to the point of withdrawing his services.

It was held that the settlement should be rescinded. And in *Huguenin* v. *Baseley*, where a woman made over her property to a clergyman in whom she reposed confidence, Lord Eldon said:[101]

[97] [1994] 1 A.C. 200, at p. 209.

[98] *Ibid.* See also Birks and Chin in Beatson and Friedmann (eds.), *Good Faith and Fault in Contract Law* (1995), pp. 81–4.

[99] *Archer* v. *Hudson* (1844) 7 Beav. 551, *per* Lord Langdale M.R. at p. 560. See also *Zamet* v. *Hyman* [1961] 1 Ch. 1442, at p. 1446; *Re Craig* [1971] Ch. 95, at p. 105; *Goldsworthy* v. *Brickell* [1987] 1 Ch. 378, at pp. 408–9.

[100] [1900] 1 Ch. 243.

[101] (1807) 14 Ves. Jun. 273, at p. 300. See also *Credit Lyonnais Bank Nederland N.V.* v. *Burch* [1997] 1 All E.R. 144, *per* Millett L.J. at pp. 155–6.

The question is, not, whether she knew what she was doing, had done, or proposed to do, but how the intention was produced: whether all that care and providence was placed round her, as against those, who advised her, which, from their situation and relation with respect to her, they were bound to exert on her behalf.

But this is not the only way of rebutting the presumption. The essential thing is to show that the transaction was 'the result of the free exercise of independent will'.[102] If this is established, the transaction will be upheld despite the absence of independent advice.[103] On the other hand, such advice will not necessarily rebut the presumption. There must he a full appreciation of the facts. In *Tate* v. *Williamson*, for example, the young man, T, was referred to independent solicitors, but such fair dealing in other respects was, said Lord Chelmsford, 'of no consequence, when once it is established that there was a concealment of a material fact, which the defendant was bound to disclose'.[104]

(d) Rescission

Rescission: the need for restitution

The right to rescind contracts and to revoke gifts made under undue influence is similar to the right of rescinding contracts induced by fraud and misrepresentation. The conditions for and bars to rescission considered in Chapter 6 above in principle apply here. So, if the transaction is to be set aside, the parties must be restored to their original positions.[105] Each must give back what has been received, although here too the flexibility of equity means that the impossibility of restoring the parties precisely to their original position will not bar the remedy.[106] The court will grant relief whenever, by directing accounts and making allowances, it can do what is practically just. Moreover, since it is restitution that has to be made, not damages paid,[107] when reversing a transaction under which both parties had made a financial contribution to the acquisition of an asset from which they were both to benefit but the value of which has fallen, if the conduct of the party presumed to have exercised influence was not morally reprehensible, the Court may order the loss in the value of the asset to be borne by the parties in proportion to their contributions to the purchase price.[108]

Another example of equity's flexibility where complete restitution is impossible is provided by *O'Sullivan* v. *Management Agency and Music Ltd.*[109] In that case a management agreement between an inexperienced pop musician and an internationally known firm of managers presumed to have been entered as a result of undue influence was set aside athough the parties could not be restored to their original position, *inter alia*, because the plaintiff had since achieved considerable fame. The defendant was ordered to account for the profit it had made from the

[102] *Inche Noriah* v. *Shaik Allie Bin Omar* [1929] AC. 127, at p. 135.
[103] *Re Brocklehurst* [1978] Ch. 14.
[104] (1866) L.R. 2 Ch. App. 55, at p. 65.
[105] *Dunbar Bank plc* v. *Nadeem* [1997] 2 All E.R. 253 (party setting aside transaction required to account to lender for lender's money used to purchase house).
[106] *Cheese* v. *Thomas* [1994] 1 W.L.R. 129. See *ante*, p. 250.
[107] *Ibid.*, *per* Nicholls V.-C. at p. 135.
[108] *Ibid.* See Chen-Wishart (1994) 110 L.Q.R. 173.
[109] [1985] 1 Q.B. 428.

agreement, but was also held to be entitled to reasonable remuneration for its skill and work in promoting the plaintiff and making a significant contribution to his success. Where taking an account of profits will not do justice, the defendant may be ordered to pay equitable compensation to the plaintiff.[110]

Severance

A finding of undue influence normally vitiates effective consent, so that it will rarely be possible to sever the objectional parts of the transaction leaving the parts uncontaminated by undue influence enforceable. But, where a person's consent can be regarded as having been freely given in relation to part of the transaction and it is possible to sever that part without rewriting the contract, this will be possible.[111]

Affirmation of transaction

The right to rescind may be lost by affirmation, and so soon as the undue influence is withdrawn, the action or inaction of the party influenced becomes liable to the construction that he or she intended to affirm the transaction. Thus in *Mitchell* v. *Homfray*[112] a jury found as a fact that a patient who had made a gift to her physician determined to abide by her gift after the confidential relationship of physician and patient ceased, and the Court of Appeal held that the gift could not be impeached. Also in *Allcard* v. *Skinner*:[113]

> The plaintiff was introduced by her spiritual adviser and confessor to the defendant who was the lady superior of a Protestant community called 'The Sisters of the Poor'. The plaintiff subsequently became a professed member of the community and bound herself to observe rules of poverty, chastity, and obedience. The rule of poverty bound her to relinquish all earthly possessions, and the rule of obedience not to seek the advice of anyone outside the community without permission. In 1872 she came into possession of certain stocks, which she transferred to the defendant as superior of the community; she also made a will in the defendant's favour. In 1879, she left the sisterhood. She immediately revoked the will, but took no steps to retrieve the property which she had conveyed to the defendant until some 6 years had elapsed.
>
> It was held that, by her inactivity after she had been freed from the spiritual influence of the defendant, she had acquiesced in the gift, and her claim was barred by this acquiescence.

depends on cessation of influence

An affirmation will not be valid unless there is an entire cessation of the undue influence which had brought about the contract or gift. The necessity for such a complete relief of the will of the injured party from the dominant influence under which it has acted is thus set forth in *Moxon* v. *Payne*:[114]

> Frauds or impositions of the type practised in this case cannot be condoned; the right to property acquired by such means cannot be confirmed in this Court unless there be full knowledge of all the facts, full knowledge of the equitable rights arising out of those facts, and an absolute release from the undue influence by means of which the frauds were practised.

[110] *Mahoney* v. *Purnell* [1996] 3 All E.R. 61. See Heydon (1997) 113 L.Q.R. 8.
[111] *Barclays Bank plc* v. *Caplan*, *The Times*, 12 December 1997. Cf. *Allied Irish Bank plc* v. *Byrne* [1995] 2 F.L.R. 325 and the position concerning rescission for misrepresentation, *ante*, p. 248.
[112] (1881) 8 Q.B.D. 587. [113] (1887) 36 Ch. D. 145.
[114] (1873) L.R. 8 Ch. App. 881, *per* James L.J. at p. 885. See also *Re Pauling's Settlement Trusts* [1964] Ch. 303; *Goldsworthy* v. *Brickell* [1987] 1 Ch. 378, at pp. 410, 417 (*quaere* whether knowledge of the right to rescission is needed, *post*, p. 500).

The same principle is applied where someone parts with a valuable interest under pressure of poverty and without proper advice. Acquiescence is not presumed from delay alone; on the contrary, 'it has always been presumed, that the same distress, which pressed him to enter into the contract, prevented him from coming to set it aside'.[115]

Third parties without notice

As transactions affected by undue influence are voidable, not void, third parties who acquire some interest in the subject-matter of the contract in good faith and for value cannot be displaced by the person seeking rescission.[116]

Third parties with notice & volunteers

But a transaction into which a person has been induced to enter by the exercise of duress or undue influence may be set aside, not only as against the person exercising compulsion or influence, but also as against a party having notice of the fact that the compulsion or influence was used.[117] Money or property transferred can be recovered from such a person, and from a person who, even though ignorant of the undue influence, has furnished no consideration: 'Let the hand receiving it be ever so chaste, yet, if it comes through a polluted channel, the obligation of restitution will follow it'.[118]

Constructive notice

In this context notice includes constructive as well as actual notice. This can be illustrated from the cases in which a wife has guaranteed a loan made by a bank to her husband, although it is not confined to such cases.[119] Where the bank knows of facts which put it on inquiry that the wife may have the right, as against the husband, to avoid the transaction, it will be held to have constructive notice of her right unless it has taken reasonable steps to ensure that her agreement had been properly obtained.[120] A bank will be put on inquiry where the transaction is on its face not to the financial advantage of the wife, as where she guarantees his business debts,[121] but not where there was nothing to indicate to the bank that the transaction was anything other than a normal advance of funds to the husband and wife for their joint benefit.[122] In the case of a family company where the wife who is a guarantor has an interest in the business, the lender will be put on notice where the security given is out of all proportion to the interest in the company.[123]

[115] *Fry* v. *Lane* (1888) 40 Ch. D. 312, *per* Kay J. at p. 324.
[116] *Bainbrigge* v. *Browne* (1881) 18 Ch. D. 188.
[117] *Lancashire Loans Ltd.* v. *Black* [1934] 1 K.B. 380; *Kesarmel s/o Letchman Das* v. *Valliappa Chettiar (N.K.V.) s/o Nagappa Chettiar* [1954] 1 W.L.R. 380. Cf. Bills of Exchange Act 1882, s. 30(2); *Talbot* v. *Von Boris* [1911] 1 K.B. 854.
[118] *Bridgeman* v. *Green* (1757) Wilmot 58, *per* Wilmot J. at p. 65.
[119] Guarantors in other relationships include employees (*Credit Lyonnais Bank Nederland N.V.* v. *Burch* [1997] 1 All E.R. 144) and friends (*Banco Exterior Internacionale S.A.* v. *Thomas* [1997] 1 W.L.R. 221). See also *O'Sullivan* v. *Management Agency and Music Ltd.* [1985] Q.B. 428 (companies controlled by person with undue influence affected by it).
[120] *Barclays Bank plc* v. *O'Brien* [1994] 1 A.C. 180, at p. 195 ff. See also *Allied Irish Bank plc* v. *Byrne* [1995] 2 F.L.R. 325 (no such steps taken).
[121] *Ibid.*
[122] *C.I.B.C. Mortgages Ltd.* v. *Pitt* [1994] 1 A.C. 200, at p. 211 (advance to enable parties to purchase shares). The facts of *National Westminster Bank plc* v. *Morgan* [1985] A.C. 686 (refinancing of existing debt) may be another example.
[123] *Bank of Scotland* v. *Bennett* [1997] 1 F.L.R. 801; *Credit Lyonnais Bank Nederland N.V.* v. *Burch* [1997] 1 All E.R. 144. Cf. *Brittania Building Society* v. *Pugh* [1997] 2 F.L.R. 7.

Where the lender is put on inquiry, it has no duty to ask about the guarantor's motives. Normally it will be able to show[124] that it has taken reasonable steps by warning the person entering the transaction, in our example the wife, at a meeting not attended by the principal debtor, of the amount of the potential liability and of the risks involved, and advising her to take independent legal advice.[125] The lender will not, however, have to take these steps where it knows that legal advice has been given to the guarantor; it is entitled to assume that a legal adviser has carried out its professional duty to advise the guarantor.[126] This is so even where the legal adviser is the debtor's lawyer,[127] but not where the legal advice is given by a lawyer who is acting on behalf of and as agent of the lending bank; in such cases the bank is responsible for the discharge of the lawyer's duty.[128]

IV. Unconscionable Bargains[129]

(a) Unconscientious Dealing

Unconscientious dealing

There is another class of cases analogous to those of undue influence, but with the element of personal influence wanting, in which equity also throws the burden of justifying the righteousness of a bargain on the party who claims the benefit of it. Lord Selborne describes these cases in *Earl of Aylesford* v. *Morris*[130] as cases:

> which, according to the language of Lord Hardwicke,[131] raise, 'from the circumstances or conditions of the parties contracting—weakness on one side, usury on the other. or extortion, or advantage taken of that weakness'—a presumption of fraud. Fraud does not here mean deceit or circumvention, it means an unconscientious use of the power arising out of these circumstances and conditions; and when the relative position of the parties is such as *prima facie* to raise this presumption, the transaction cannot stand unless the person claiming the benefit of it is able to repel the presumption by contrary evidence, proving it to have been in point of fact fair, just, and reasonable.

Thus although equity will not normally intervene to protect a contracting party against the consequences of his or her own folly, some protection is offered to poor and ignorant persons who are overreached in the absence of independent advice.

[124] The burden is on the lender: *Barclays Bank plc* v. *Boulter* [1998] 1 W.L.R. 1.
[125] *Barclays Bank plc* v. *O'Brien* (*supra*, n. 120) at p. 196. See also *Credit Lyonnais Bank Nederland N.V.* v. *Burch* (*supra*, n. 123).
[126] *Banco Exterior Internacionale S.A.* v. *Mann* [1995] 1 All E.R. 936; *Massey* v. *Midland Bank plc* [1995] 1 All E.R. 929; *Bank of Baroda* v. *Rayarel* [1995] 2 F.L.R. 376. See Hooley [1995] L.M.C.L.Q. 346.
[127] See the cases referred to in the previous footnote.
[128] *Midland Bank plc* v. *Serter* [1995] 1 F.L.R. 1034; *Royal Bank of Scotland plc* v. *Ettridge* [1997] 3 All E.R. 628. Cf. *Halifax Mortgage Services Ltd.* v. *Stepsky* [1996] Ch. 207 (knowledge acquired by solicitors acting for both lender and borrower only imputed to lender if it came to them while acting for the lender).
[129] Waddams (1976) 39 M.L.R. 369; Bamforth [1995] L.M.C.L.Q. 538.
[130] (1873) L.R. 8 Ch. App. 484, at p. 490. See also *Hart* v. *O'Connor* [1985] A.C. 1000, at p. 1024.
[131] *Earl of Chesterfield* v. *Janssen* (1751) 2 Ves. Sen. 125, at p. 157.

A particular case of the application of this principle was the protection given by equity to 'expectant heirs', that is, to those persons who have expectations (in the popular sense) of succeeding to property on another's decease.[132] But this is but one illustration, and the principle also applies generally to what have been called 'catching bargains', that is to say, whenever the parties 'meet under such circumstances as, in the particular transaction, to give the stronger party dominion over the weaker'.[133]

> In ordinary cases each party to a bargain must take care of his own interest, and it will not be presumed that undue advantage or contrivance has been resorted to on either side; but in the case of the 'expectant heir', or of persons under pressure without adequate protection, and in the case of dealings with uneducated ignorant persons, the burden of shewing the fairness of the transaction is thrown on the person who seeks to obtain the benefit of the contract.[134]

Thus in *Fry* v. *Lane*[135] it was held that when a purchase had been made from a poor and ignorant man at a considerable undervalue, the vendor having had no independent advice, equity would set aside the transaction. At common law, the nearest analogue is to be found in the cases on salvage, mentioned above,[136] in which extortionate bargains made to rescue ships in distress have been set aside.

The cases suggest that three elements are necessary if the Court is to intervene.[137] First, one party must be at a serious disadvantage to the other through, for example poverty, ignorance or lack of advice. Secondly, this weakness must be exploited by the other party in some morally culpable manner; and thirdly, the resulting transaction must be, not merely harsh or improvident, but overreaching and oppressive. The last requirement means that, in the case of a sale by the disadvantaged party, the sale must not merely be at an undervalue, but at a *substantial* undervalue which 'shocks the conscience of the court'.[138] And the second requirement means that a gross disparity in the price does not suffice, however serious the disadvantage of the weaker party. In *Hart* v. *O'Connor*[139] it was held by the Judicial Committee of the Privy Council that a contract made with a person who, although apparently of full capacity was mentally disordered, could not be set aside as unconscionable unless the other party was aware of the mental disorder at the time the contract was made. So, for relief to be granted, both procedural and substantive unconscionability must be shown.

[132] By the Law of Property Act 1925, s. 174, a bargain with an expectant heir, made in good faith, and without unfair dealing, is not to be set aside merely on the ground of undervalue. But the jurisdiction of the Court to set aside or modify unconscionable bargains is not affected in other respects.
[133] *Earl of Aylesford* v. *Morris* (1873) L.R. 8 Ch. App. 484, *per* Lord Selborne L.C. at p. 491.
[134] *O'Rorke* v. *Bolingbroke* (1877) 2 App. Cas 814, *per* Lord Hatherley at p. 823.
[135] (1888) 40 Ch. D. 312. See also *Cresswell* v. *Potter* [1978] 1 W.L.R. 255n; *Watkin* v. *Watson-Smith*, *The Times*, 3 July 1986; *Boustany* v. *Pigott* (1993) 69 P. & C.R. 298.
[136] *Ante*, p. 276.
[137] *Alec Lobb (Garages) Ltd.* v. *Total Oil (Great Britain) Ltd* [1983] 1 W.L.R. 87, *per* Peter Millett Q.C. at pp. 94–5. This aspect of his judgment was not varied by the Court of Appeal: see [1985] 1 W.L.R. 173, at pp. 182–3.
[138] *Ibid.*
[139] [1985] A.C. 1000.

Although there have been expressions of support for a wider role for this doctrine,[140] particularly by giving a broad meaning to the concept of 'serious disadvantage',[141] there has been no fundamental change. The fact that procedural unconscionability must be present means that there will often be an overlap with the doctrines of duress and undue influence, and some cases which would perhaps have been best regarded as cases of unconscionability have been treated as cases of duress or undue influence.[142] This is in sharp contrast to the position in other common law jurisdictions, particularly Australia and the USA, where a general doctrine of unconscionability has been developed.[143]

Inequality of bargaining power

The intervention of equity in all these cases of coercion, undue influence, and unconscionable bargains, and also in certain other cases such as penalties[144] and forfeiture, has been stated by Lord Denning M.R.[145] to be grounded upon the same general principle: that of 'inequality of bargaining power'. In *Lloyds Bank Ltd.* v. *Bundy*:[146]

> The defendant, an elderly farmer, and his only son, had been customers of the plaintiff bank for many years. The son founded a company which banked at the same bank. In 1966, the defendant guaranteed the company's overdraft for £1,500 and charged his farm to the bank to secure that sum. Subsequently the overdraft was increased and the bank sought further security. In May 1969, the defendant, having taken legal advice, signed a further guarantee in favour of the bank for £5,000 and a further charge for £6,000. In December 1969, the bank manager visited the defendant and indicated to him that continuance of the company's overdraft facility was dependent upon the defendant executing in favour of the bank a further guarantee for £11,000 and a further charge for £3,500. The bank manager did not advise the defendant to seek independent advice, and the defendant signed the required guarantee and charge without such advice.
>
> The Court of Appeal held that this last guarantee and charge should be set aside for undue influence, since a special relationship of confidence existed between the defendant and the bank in the particular circumstances of the case. But Lord Denning M.R. also considered that the guarantee and charge were voidable on the larger ground of inequality of bargaining power:[147]

[140] See e.g. *A. Schroeder Music Publishing Ltd.* v. *Macaulay* [1974] 1 W.L.R. 1308, *per* Lord Diplock at p. 1315, *post*, p. 377; *Alec Lobb (Garages) Ltd.* v. *Total Oil (Great Britain) Ltd.* [1985] 1 W.L.R. 173. See also the cases on penalties and forfeiture, *post*, p. 594. For criticism, see Trebilcock (1976) 26 U. of Tor. L.J. 359.

[141] *Cresswell.* v. *Potter* [1978] 1 W.L.R. 255n; *Backhouse* v. *Backhouse* [1978] 1 W.L.R. 243; *Watkin* v. *Watson-Smith*, *The Times*, 3 July 1986.

[142] *Credit Lyonnais Bank Nederland N.V.* v. *Burch* [1997] 1 All E.R. 144 (undue influence, but see Chen-Wishart [1997] C.L.J. 60); *CTN Cash and Carry Ltd.* v. *Gallagher Ltd.* [1994] 4 All E.R. 714, *per* Sir Donald Nicholls V.-C., at p. 720 (and see Carter and Tolhurst [1996] 9 J.C.L. 220).

[143] *Commercial Bank of Australia Ltd.* v. *Amadio* (1983) 151 C.L.R. 447; *Louth* v. *Diprose* (1992) 175 C.L.R. 621 (Australia); Uniform Commercial Code §2–302 (USA) *Paris* v. *Machnik* (1972) 32 D.L.R. (3d) 723 (Canada).

[144] See *post*, pp. 594, 607.

[145] *Lloyds Bank Ltd.* v. *Bundy*, [1975] Q.B. 326, at p. 339.

[146] [1975] Q.B. 326.

[147] At p. 336. See also *Clifford Davis Management Ltd.* v. *W.E.A. Records Ltd.* [1975] 1 W.L.R. 61; *Arrale* v. *Costain Civil Engineering Ltd.* [1976] 1 Lloyd's Rep. 98; *Cresswell* v. *Potter* [1978] 1 W.L.R. 255n.; *Backhouse* v. *Backhouse* [1978] 1 W.L.R. 243, at p. 252; *A. Schroeder Music Publishing Ltd.* v. *Macaulay* [1974] 1 W.L.R. 1308. Cf. *Alec Lobb (Garages) Ltd.* v. *Total Oil Great Britain Ltd.* [1985] 1 W.L.R. 173.

There are cases in our books in which the courts will set aside a contract, or a transfer of property, where the parties have not met on equal terms—when the one is so strong in bargaining power and the other so weak that, as a matter of common fairness, it is not right that the strong should be allowed to push the weak to the wall.

His Lordship nevertheless pointed out that no bargain should be upset which was the result of the ordinary interplay of economic forces, but only 'where there has been inequality of bargaining power such as to merit the intervention of the court'. But such a general principle has not yet been accepted in English law, and in *National Westminster Bank plc* v. *Morgan*[148] the need for it was questioned. First, it was said that the development of the doctrine of undue influence was a preferable technique. Secondly, it was said that the task of restricting freedom of contract was essentially a legislative rather than a judicial task, and one that Parliament has undertaken in legislation protecting, for example, consumers, employees, and investors.[149] We now turn to two examples of such statutory intervention.

(b) Credit Agreements

Certain types of contract which may give rise to the kind of oppressive dealing which equity discourages have been dealt with by statute in the Consumer Credit Act 1974.[150] These are credit agreements: for example, a moneylending contract or a contract of hire-purchase. The Act enables a Court, if it finds a credit transaction to be extortionate, to reopen the agreement so as to do justice between the parties.[151] A credit agreement may be held to be extortionate if it requires the debtor to make payments which are grossly exorbitant having regard, not only to objective factors such as prevailing interest rates and the degree of risk accepted by the creditor, but also to subjective factors such as the debtor's age, experience, business capacity and state of health, and the degree to which, at the time of entering into the transaction, the debtor was under financial pressure. In one case an interest rate of 48 per cent was held not to be extortionate since little security was offered for the loan.[152] Although there is no specific requirement that the subjective factors should have been known to the lender, some cases have required that the lender 'take advantage' of the borrower.[153] A credit agreement may also be reopened on the ground that it is extortionate because it 'grossly contravenes ordinary principles of fair dealing'.[154]

[148] [1985] A.C. 686, at p. 708. See also *Pao On* v. *Lau Yiu Long* [1980] A.C. 614, at p. 634; *Horry* v. *Tate & Lyle Refineries Ltd.* [1982] 2 Lloyd's Rep. 416, at p. 423.

[149] *Ante*, pp. 4–5.

[150] Repealing the Moneylenders Act 1900, s. 1, and the Moneylenders Act 1927, s. 10.

[151] Consumer Credit Act 1974, ss. 137–40.

[152] *A. Ketley Ltd.* v. *Scott* [1982] I.C.R. 241.

[153] *Davies* v. *Directloans Ltd.* [1986] 1 W.L.R. 823; *Coldunell Ltd.* v. *Gallon* [1986] Q.B. 1184.

[154] Consumer Credit Act 1974, s.138 (1).

(c) Unfair Terms in Consumer Contracts

By the Unfair Terms in Consumer Contracts Regulations 1994[155] which implemented E.E.C. Council Directive 93/13,[156] a term in a contract between a seller or supplier of goods or services and a consumer which has not been 'individually negotiated'[157] is subjected to a requirement of 'fairness'. Regulation 4(1) provides that a term will be 'unfair' where, 'contrary to the requirement of good faith', it 'causes a significant imbalance in the parties' rights and obligations under the contract to the detriment of the consumer'. The scope of the Regulations and their relationship to the Unfair Contract Terms Act 1977 have been considered in Chapter 4 above.[158] Here we consider the requirements of 'good faith' and 'significant imbalance'.

The test of unfairness

Regulation 4(2) provides:

> An assessment of the unfair nature of a term shall be made taking account the nature of the goods or services for which the contract was concluded and referring, at the time of the conclusion of the contract to all circumstances attending the conclusion of the contract and to all the other terms of the contract or of another contract on which it is dependent.

We noted in Chapter 4 above that it is clear that in certain respects the 1994 Regulations permit a broader approach than the 1977 Act. We shall see that the test has substantive aspects and the Regulations apply to all terms, not just to exemption and limitation clauses. Moreover, they expressly require regard to be had to 'all the other terms of the contract'[159] so that the determination of fairness will take account of the entire contractual package. A term which, in isolation, might appear to be unfair, might not be when looked at in the light of the contract as a whole. Thus while a term may create an imbalance between the parties' rights and obligations, it might be one that is justified as fair (or reasonable) say in a high risk or speculative contract or where a seller is dependent on a third party who may (because of market strength) supply only on very restrictive terms. Again, the Regulations probably permit a broader approach to severance since they provide that 'the contract shall continue to bind the parties if it is capable of continuing in existence without the unfair term'.[160]

Good faith

Recital 16 of the Preamble to Directive 93/13 and Schedule 2 to the 1994 Regulations, state that in making an assessment of good faith account should be taken of the strength of bargaining positions of the parties, whether the consumer had an inducement to agree to the term, and whether the goods were sold or supplied to the consumer's special order. These look much like some of the guidelines to the reasonableness test in the 1977 Act.[161] But recital 16 also states that the requirement of 'good faith' is satisfied where the seller or supplier 'deals fairly and equitably with the other party *whose legitimate interests he also takes into*

[155] S.I. 1994 No. 3159. See generally *ante*, p. 196; Beale in Beatson and Friedmann (eds.), *Good Faith and Fault in Contract Law* (1995), ch. 9; Collins (1994) 14 O.J.L.S. 229; Dean (1993) 56 M.L.R. 581; MacNeil (1995) 40 Jur. Rev. 147; Macdonald [1994] J.B.L. 441.

[156] OJ L. 95, 21 April 1993, p. 29.

[157] 1994 Regulations, reg. 3(1).

[158] *Ante*, p. 196.

[159] 1994 Regulations, reg. 4(2).

[160] *Ibid.*, reg. 5(2).

[161] *Ante*, p. 191.

account'. The implication is that where the other party's legitimate interests are not taken into account, the requirement will not be satisfied. This may pose a puzzle for English law which, as Lord Ackner's speech in *Walford* v. *Miles*[162] shows, considers parties to a contractual negotiation to be in an adversarial relationship in which they are entitled to pursue their own interests so long as they avoid making misrepresentations.

Different approaches to good faith

The question is how the common lawyer should proceed to put flesh on the bare bones of the requirements of 'good faith' and 'significant imbalance'. There are a number of possibilities. First, one of the civil law systems might be used, although, as their concepts of good faith differ radically, English courts have a wide choice. The meaning of 'good faith' ranges from French law's use of the concept to avoid unreasonable and onerous conditions, which has a substantive edge, to the notions of unfair surprise and absence of real choice which characterize Dutch and German law.[163] Alternatively, an autonomous European Community concept of 'good faith' could be developed.[164] Finally, the statutory concept of 'reasonableness' in the 1977 Act might be adapted, perhaps reinforced by support from the equitable concepts of unconscionability and undue influence considered earlier in this chapter and the rules on penalty and forfeiture clauses considered in Chapter 17 below.[165] This is supported by the similarity of three of the guidelines in Schedule 2 to the 1994 Regulations to those in the 1977 Act[166] and the requirement in the fourth that 'the extent to which the seller or supplier has dealt fairly and equitably with the consumer' be taken into account in making an assessment of good faith.

Primarily a procedural test, but with a substantive component

So far we have little guidance. Despite the primarily substantive nature of the controlling concept of 'significant imbalance', and the fact that some clauses may cause such a serious imbalance that they should always be treated as being contrary to good faith,[167] it is submitted that most commentators are correct to consider the test as a whole to be primarily concerned with procedural fairness.[168]

The requirement that terms concerning the price and defining the main subject-matter of the contract are left out of account (provided they are in plain intelligible language) makes it difficult to regard the test as primarily substantive, because those, particularly 'price' are central to substantial fairness.[169] In this respect the 1994 Regulations are probably narrower than the 1977 Act because, as

[162] [1992] 2 A.C. 128, at p. 138, *ante*, p. 65.

[163] Beale, (*supra*, n. 155), pp. 243–5 cites *inter alia*, on French law, Ghestin, *Le Contrat: Formation*, 2nd edn. (1988) para. 608-2; on Dutch law, Storme, *La bonne foi dans la formation des contrats en droit neerlandais* (1992); decision of the Hoge Raad H.R. 15–11–1957; Article 6.233 of the New Netherlands Civil Code; on German law B.G.B. para. 242; Micklitz (1989) 41 Rev. Int droit compare 101, 109.

[164] See MacNeil (1995) 40 Jur. Rev. 146, 148, citing *Fiddelaar* v. *Commission* (Case 44/59) [1960] E.C.R. 535, at p. 547.

[165] *Post*, pp. 587–92.

[166] Unfair Contract Terms Act 1977, s. 11 and Sched. 2.

[167] Beale, (*supra*, n. 155), at p. 245. Some of the terms contained in the indicative list of terms which might be regarded as unfair may fall into this category, e.g. excluding or limiting liability for death or personal injury, making the seller or supplier's duty to perform a matter for its discretion, or giving it the right to determine whether the goods or services are in conformity with the contract or the exclusive right to interpret any term: see Schedule 3 to the 1994 Regulations.

[168] *Supra*, n. 155. Cf. Smith (1994) 47 C.L.P. 5, 8.

[169] Collins (1994) 14 O.J.L.S. 229, 249.

we have noted,[170] under section 3(2)(b) of the 1977 Act, exemption clauses shrinking the contractual obligation are subject to control and the reasonableness test if they permit a contractor to perform in a way that is 'substantially different from that which was reasonably expected'. Under the Regulations, it is possible that a term permitting such performance would escape the control of the 'fairness' test if it was in 'plain intelligible language'. Furthermore, although the statement in recital 16 of the preamble to the Directive concerning taking the legitimate interests of the other party into account smacks of substantive fairness, this requirement has not been carried over into paragraph (d) of Schedule 2 to the United Kingdom's Regulations.[171] Finally, although the list of terms which may be regarded as unfair in Schedule 3 contains some substantive restrictions,[172] it is only an indicative and non-binding list, and regulation 4(1) contains the overriding test.

The 'good faith' part of the test under the 1994 Regulations seeks to promote fair and open dealing, and to prevent unfair surprise and the absence of real choice. To this extent, despite taking a different approach to that taken by the common law, the result achieved is, as Bingham L.J. acknowledged in *Interfoto Picture Library Ltd.* v. *Stiletto Visual Programmes Ltd.*[173] and as the similarity of three of the guidelines in the Regulations to those in the 1977 Act suggests, not likely to be very different to that under the 1977 Act in relation to terms excluding or limiting liability.[174] But it is clear from the above discussion that in certain respects the Regulations permit a broader approach than the 1977 Act. Notwithstanding this, the experience of administrative enforcement by the Office of Fair Trading suggests that there will not be a sharp difference from that previously taken in English law under the 1977 Act. In part this is because of the similarity of the problems, but in part it is because of an understandable tendency to retreat to familiar ground when confronted by unfamiliar concepts on which there is little guidance. In the long term, however, it is submitted that English contract lawyers will be forced to become comparative lawyers so that they can properly and sensitively transpose the concept of good faith into English law in this context when putting flesh on the concept of 'significant imbalance'. Whether this spills over into other contractual contexts as some commentators have suggested,[175] is, of course another matter, but the experience of the impact of European law in other contexts, notably public law,[176] suggests that it might.

[170] *Ante*, p. 189.

[171] It is possible that the *Marleasing* principle (see *Marleasing S.A.* v. *La Commercial* (Case C-106/89) [1992] 1 C.M.L.R. 305) which permits reference to be made to the Directive and probably also to the preamble in interpreting the Regulations, will assist in preserving the substantive element.

[172] *Supra*, n. 167.

[173] [1989] Q.B. 433. See also *Balfour Beatty Civil Engineering* v. *Docklands Light Railway* [1996] C.L.C. 1435, at p. 1442.

[174] Dean (1994) 56 M.L.R. 581, 585.

[175] Clarke (1996) 81 Svensk Jurist Tidning 145.

[176] *M.* v. *Home Office* [1994] A.C. 377 (spilling over from *Brasserie du Pecheur* v. *Germany* (Case C-43/93) and *R.* v. *Secretary of State for Transport, ex parte Factortame Ltd.* (Case C-48/93) [1996] E.C.R. I-1029) and *Woolwich Building Society* v. *Inland Revenue Commissioners* [1993] A.C. 70 (spilling over *inter alia* from *Amministrazione della Finanze dello Stato* v. *San Giorgio* (Case 199/82) [1983] E.C.R. 3595).

8

Mistake

Introduction

MISTAKE is one of the most difficult topics for the student in the English law of contract.[1] The principles upon which and the circumstances in which a contract will be held to be defective if one, or both, of the parties enter into it under some misapprehension or misunderstanding but would not have done so had they known the true facts, have never been precisely settled, the decided cases are open to a number of varying interpretations and the position is further complicated by two factors.

First, there has been a distinct change in the attitude of the judges towards the question of mistake during the last hundred years. During the nineteenth century, in reliance on the *consensus* theory of contract, the Courts were more readily disposed to hold that, where there was no 'true, full and free'[2] consent, there was no valid contract. At the present time, however, the Courts are very reluctant to intervene in this manner.

The reasons for this change are first that, at common law, if a contract is entered into under a legally operative mistake, it is void *ab initio*; it has no legal effect whatever. Consequently, if the subject-matter of the contract consists of goods, no property in the goods will pass under the contract. A third party who takes the goods in good faith and for value will nevertheless acquire no title to them, and will have to deliver them up to the true owner.[3] Secondly, there is a feeling that, once the parties are ostensibly in agreement in the same terms and upon the same subject-matter, they ought to be held to their bargain; they must rely on the stipulations of the contract for protection from the effect of facts unknown to them.[4] This has led to increased reliance on objectivity where matters are judged by the external standard of the reasonable person.[5] Thirdly, there is a fear that parties to a contract will plead mistake to get out of a bad bargain or to reallocate the risks and consequently undermine the sanctity of contract.[6] This

[1] The periodical literature on this subject is voluminous. In addition to the articles cited in relation to particular categories of mistake, see generally: Stoljar, *Mistake and Misrepresentation* (1968); Cheshire (1944) 60 L.Q.R. 175; Tylor (1948) 11 M.L.R. 257; Slade (1954) 70 L.Q.R. 385; Stoljar (1965) 28 M.L.R. 265; Goldberg and Thomson [1978] J.B.L. 30, 147; Cartwright (1987) 103 L.Q.R. 594; Smith [1994] C.L.J. 400.

[2] Pollock, *Principles of Contract*, 13th edn. (1950), p. 364.

[3] *Cundy* v. *Lindsay* (1878) 3 App.Cas. 459; *post*, p. 312.

[4] *Bell* v. *Lever Brothers Ltd.* [1932] A.C. 161, *per* Lord Atkin at p. 224.

[5] *Smith* v. *Hughes* (1871) L.R. 6 Q.B. 597, *ante*, p. 31, *post*, p. 310.

[6] e.g. *Amalgamated Investment & Property Co. Ltd.* v. *Walker & Sons Ltd.* [1977] 1 W.L.R. 164, at p. 172; *Riverlate Properties Ltd.* v. *Paul* [1975] Ch. 133, at pp 140–1; *Associated Japanese Bank (International) Ltd.* v. *Crédit du Nord* [1989] 1 W.L.R. 255, at p. 264.

is coupled with a perception that a person who has acquired an expertise in the subject-matter of the contract, for instance antique Chinese porcelain, could not be deprived of the benefit of a bargain made with an uninformed counter-party without imperilling the market system.[7]

Nevertheless, cases will undoubtedly arise in which it would be unjust to hold the parties strictly to their agreement. Such cases will occur quite independently of any express warranty, or misrepresentation, or fraud, and relief must be sought, if at all, on the ground of mistake. To meet this difficulty the Courts have, side by side with their general refusal to apply the doctrine of common law mistake, developed the use of certain equitable remedies which are, in some ways, more satisfactory as they are discretionary and, further, do not render the contract void *ab initio*. Thus, as in the position of a contract vitiated by fraud, misrepresentation, or duress, the position of third parties who take goods in good faith is protected.

It is this separate development of common law and equitable doctrine before the Judicature Act 1873 that is the second complicating factor in this topic. Although, in principle, the state of the law with a narrow doctrine of common law mistake supplemented by the more flexible doctrine of mistake in equity is 'entirely sensible and satisfactory',[8] it is not easy to state the precise relationship of the equitable remedies with the common law doctrine of mistake and there appear to be differences, not easy to justify, between the operation at law and in equity of the policies against the use of mistake to get out of a bad bargain or to reallocate the risks of the contract. There are some indications of a more integrated approach, but the present state of the law requires us first to discuss the effect of mistake, at common law, and then in equity, remembering that the principles here laid down should in no way be regarded as definitive, but rather as an attempt to extract a *rationale* from cases decided on a more empirical basis.

I. Mistake at Common Law

Common law

THIS section is concerned with that form of mistake which invalidates a contract,[9] and there are certain topics, superficially connected with the subject, which it will be well to eliminate at the outset.

Mistake of expression

We are not here concerned with cases where the parties are genuinely agreed, although the terms employed in making their agreement do not convey their true meaning. In such cases the Courts may be willing to correct their error; but this

[7] *Smith* v. *Hughes* (1871) L.R. 6 Q.B. 597, at pp. 604, 606. See generally Kronman (1978) 7 J.L.S. 1. Where there is no contractual bargain to set aside or avoid, the common law recognizes a broader role for mistake. Thus, a payment caused by a mistake of fact is recoverable: *Barclay's Bank Ltd.* v. *W.J. Simms Son & Cooke (Southern) Ltd.* [1980] Q.B. 677.

[8] *Associated Japanese Bank (International) Ltd.* v. *Crédit du Nord S.A.*, (*supra*, n. 6) at pp. 267–8. See *post*, p. 298.

[9] 'If mistake operates at all it operates so as to negative or in some cases to nullify consent': *Bell* v. *Lever Brothers Ltd.* (*supra*, n. 4), at p. 217.

is a question which concerns the rectification, and not the formation, of a contract.[10]

Want of mutuality

Nor are we concerned with cases in which there is not even the outward semblance of agreement, because offer and acceptance never coincided in their respective terms.[11]

Failure of expression

Nor, lastly, are we concerned with cases in which one party finds the obligation of a contract more onerous than he intended, or is disappointed in the performance received from the other party. If the terms of a contract do not express what one party intended them to express, that party's failure to find words appropriate to the intended meaning does not invalidate the contract.

Cases of operative mistake

The cases with which we have to deal fall into two main classes:

(i) cases in which the parties, though genuinely agreed, have both contracted in the mistaken belief that some fact which lies at the root of the contract is true. This type of mistake is generally known as *mutual* mistake, as it is shared by both parties;

(ii) cases where, although to all outward appearances the parties are agreed, there is in fact no genuine agreement between them, and the law therefore does not regard a contract as having come into existence. This type of mistake is sometimes known as *unilateral* mistake,[12] as the mistake is on one side only.

It should be noted, however, that for a mistake to be operative at common law, and to invalidate a contract, it must be one of fact. A mistake of law will be ineffective.[13]

(a) Mistakes going to the Root of the Contract

Mutual mistake

In this type of mistake, the parties, though genuinely *ad idem*, contract on the basis of an assumption which subsequently proves to be false.

Bell v. *Lever Brothers*

The leading case is that of *Bell* v. *Lever Brothers Ltd.*[14] The facts of the case are fairly simple, but the judgments are difficult of interpretation, so that it is advisable to discuss the case at some length.

Lever Brothers, entered into two agreements with Bell and Snelling. The first was a service contract by which Bell and Snelling were appointed to the Board of the Niger Company, a subsidiary of Lever Brothers, for a period of five years at salaries of £8,000 and £6,000 p.a. respectively. The second was a compensation contract by which Lever Brothers, in consideration of their retiring within the service period, promised to pay Bell £30,000 and Snelling £20,000.

[10] *Post*, p. 324.

[11] *Ante*, p. 38.

[12] e.g. by Lord Atkin in *Bell* v. *Lever Brothers Ltd.* [1932] A.C. 161, at p. 217.

[13] For the different position in equity, see *post*, p. 322. Note that, in the different context of restitution, the rule precluding the recovery of money paid under a mistake of law (see *National Parl-Mutuel Assoc. Ltd.* v. *The King* (1930) 47 T.L.R. 110; *Sawyer and Vincent* v. *Window Brace Ltd.* [1943] K.B. 32) has been said to be 'on the turn': *Friends Provident Life Office* v. *Hillier Parker* [1997] Q.B. 85, *per* Auld L.J. at p. 97. See also *Woolwich Equitable B.S.* v. *I.R.C.* [1993] A.C. 70, at pp. 177, 192.

[14] [1932] A.C. 161.

While they were acting under their appointments, both Bell and Snelling had secretly entered on their own account into speculative transactions in cocoa, a course of conduct which would have given Lever Brothers the right to dismiss them summarily and without compensation. Lever Brothers had entered into the compensation contract, and paid the sums therein promised in ignorance of this fact. They now sought rescission of this contract and recovery of the money on the ground that it had been paid under a mistake of fact.

The jury found that Bell and Snelling had been guilty of no fraud and that, at the time they entered into the compensation contract, they did not have in mind their breaches of duty. The case must therefore be considered as one of *mutual* mistake, that is, one where the parties had both contracted under the same mistaken assumption. Lever Brothers would nevertheless never have entered into the contract had they known the true state of affairs, and they therefore alleged that the contract was a nullity from the beginning. The Court of Appeal[15] upheld this contention; but the House of Lords, by a bare majority, held that the contract was valid and binding.

Conflicting interpretations

There has been considerable discussion as to what this case in fact decides. One member of the House, Lord Blanesburgh, while stating that he was in accord with the other majority opinions, based his own decision mainly on a point of pleading.[16] The other two majority members, Lord Atkin and Lord Thankerton, in the course of their speeches, formulated a number of propositions which, although directed to the same end, tend not to be easily reconcilable one with the other. The speeches therefore provide support for a variety of conflicting interpretations of the doctrine of mutual mistake.[17]

(i) no doctrine of mistake

First it is said that the case establishes that there is no doctrine of mistake, rendering the contract void *ab initio*, in English law.[18] In *Solle* v. *Butcher*, for example, Denning L.J. said:[19]

> The correct interpretation of [*Bell* v. *Lever Brothers Ltd.*], to my mind, is that, once a contract has been made, that is to say, once the parties, whatever their inmost states of mind, 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. Neither party can rely upon his own mistake to say that it was a nullity from the beginning, no matter that it was a mistake which to his mind was fundamental, and no matter that the other party knew that he was under a mistake. A fortiori, if the other party did not know of the mistake but shared it.

[15] [1931] 1 K.B. 557.

[16] He also pointed out (pp. 180–1, 183, 197) that the payments made to Bell and Snelling were, at any rate in part, voluntary payments because their agreement was with the Niger Company not Lever Brothers, and so could not be recovered as money paid under a mistake: see *Morgan* v. *Ashcroft* [1938] 1 K.B. 49, at pp 66, 71, 77.

[17] Cheshire (1944) 60 L.Q.R. 175, at p. 177; Tylor (1948) 11 M.L.R. 257, at p. 262; Slade (1954) 70 L.Q.R. 385, at p. 396; Shatwell (1955) 33 Can. Bar Rev. 164; Bamford (1955) 32 S.A.L.J. 166; Atiyah (1957) 73 L.Q.R. 340; Atiyah and Bennion (1961) 24 M.L.R. 421; McTurnan (1963) 41 Can. Bar Rev. 1; Stoljar (1965) 28 M.L.R. 265, at p. 275; Smith [1994] C.L.J 400.

[18] Slade (1954) 70 L.Q.R. 385; Shatwell (1955) 33 Can. Bar Rev. 164; Smith [1994] C.L.J. 400.

[19] [1950] 1 K.B. 671, at p. 691, *post*, p. 328. Bucknill and Jenkins L.JJ. did not mention *Bell* v. *Lever Brothers Ltd.*

Some support for this contention can be found in the speech of Lord Atkin,[20] but both he and other members of the House of Lords assume throughout that certain types of mistake will avoid a contract, although they differ as to the circumstances in which it will do so and it has been stated that Denning L.J.'s view does not do justice to the speeches of the majority.[21] Nevertheless, it is clear that the effect of the decision in *Bell* v. *Lever Brothers* is to confine the doctrine of mutual mistake within the most narrow limits; it is only in the most extreme cases that the Court will intervene.

(ii) contract invalid only if term can be implied to that effect

Secondly, it is said that the case establishes that a contract is void at law only if some term can be implied in both offer and acceptance which prevents the contract from coming into operation.[22] Lord Atkin expressly states that this is a proposition to which few would demur,[23] but cogently goes on to point out that it does not take us very far in the inquiry how to ascertain whether the contract does contain such a term.

An example is provided by *Associated Japanese Bank (International) Ltd.* v. *Crédit du Nord S.A.*[24]

A fraudulent party purported to sell to the plaintiff and lease-back from it certain machines which in fact did not exist. The defendant guaranteed the fraudulent party's obligations under the sale and lease-back. When the fraudulent party was adjudged bankrupt, the plaintiff sued on the guarantee.

It was held that as the guarantee provided that substitution of the subject of the contract, i.e. the machines, could only be made with the guarantor's consent, it was subject to an express condition precedent that the lease related to existing machines. Alternatively, it was stated that the contextual background and the fact that both parties were informed that the machines existed meant that such a condition could be implied.[25]

(iii) Construction of the contract

Thirdly, it is suggested that the application of the doctrine of mutual mistake depends upon the true construction of the contract made between the parties. As a general rule, one or other of them will be considered to have assumed the risk of the ordinary uncertainties which exist when an agreement is concluded. Normally, because of the principle *caveat emptor*, the buyer is held to have taken the risk that property sold might prove defective or might be in some way different from that which the parties believed it to be. Alternatively, this risk will have been assumed by the seller if there was an express or implied warranty as to quality of description in the contract. A mutual misunderstanding will not therefore normally nullify the contract.

It is only where the terms of the contract, construed in the light of the nature of the contract and of the circumstances believed to exist at the time it was

[20] *Bell* v. *Lever Brothers Ltd.* [1932] A.C. 161, at p. 224.

[21] *Associated Japanese Bank (International) Ltd.* v. *Crédit du Nord S.A.* [1989] 1 W.L.R. 255, at p. 267. But cf. Smith [1994] C.L.J. 400, at pp. 412–13.

[22] This, as in the case of frustration, may be a fiction: see *post*, p. 514.

[23] [1932] A.C. 161, at p. 225. See also *Whittaker* v. *Campbell* [1984] Q.B. 318, at p. 327; Goldberg and Thomson [1978] J.B.L. 150.

[24] [1989] 1 W.L.R. 255, at p. 263.

[25] *Ibid.* See also *Financings Ltd.* v. *Stimson* [1962] 1 W.L.R. 1184.

made,[26] show that it was never intended to apply to the situation which in reality existed at that time, and the risk of the relevant mistake has not been allocated to one of the parties, that the contract will be held void.[27] In *Bell* v. *Lever Brothers Ltd.*, for example, since the appellants were under no duty to disclose their breaches of the service agreement to their employers,[28] the risk that such breaches might have taken place was one which was assumed by the respondents when they entered into the contract to pay compensation. In the view of the majority of the House of Lords, the terms of this contract were still applicable notwithstanding the fact that the respondents would have been entitled, had they known the true position, to treat the contract of service as at an end: an agreement to terminate a broken contract was not radically different from an agreement to terminate an unbroken contract since the party paying for the release got exactly what he bargained for.[29]

Instances of mistake

No systematic test can be laid down to determine whether the obligations envisaged by the parties extend to cover the situation which has unexpectedly emerged; but a number of factual situations have been considered by the Courts, and these may be conveniently marshalled into four categories:

(i) mistake as to the existence of the subject-matter of the contract;
(ii) mistake as to title;
(iii) mistake as to the quality of the thing contracted for;
(iv) a false and fundamental assumption going to the root of the contract.

(i) Mistake as to the existence of the subject-matter of the contract

Non-existence of subject matter

If the subject-matter of the contract is a *res extincta*, that is it has, at the time of the contract, and unknown to the parties, ceased to exist, or if it has never been in existence, then the contract may be void for mutual mistake.

In a contract for the sale of goods, for example, where the terms of the contract indicate that the parties intended it to take effect only if the goods were in existence, the non-existence of the goods will produce a situation not contemplated by the contract and to which it cannot apply.[30] It is also enacted in section 6 of the Sale of Goods Act 1979[31] that, where there is a contract for the sale of specific goods, and the goods without the knowledge of the seller have perished at the time when the contract is made, the contract is void.

[26] Extrinsic evidence is admissible to assist in the construction of the contract: *Pritchard* v. *Merchants' and Tradesmen's Life Assurance Society* (1858) 3 C.B. (N.S.) 622.

[27] Mistake can be regarded as a type of 'pre-contractual frustration': see *Associated Japanese Bank (International) Ltd.* v. *Crédit du Nord S.A.* [1989] 1 W.L.R. 255, at p. 268; *William Sindall Plc* v. *Cambridgeshire C.C.* [1994] 1 W.L.R. 1016, at pp. 1035, at p. 1039; Smith [1994] C.L.J. 400. But it is doubtful whether the *application* of the two doctrines is identical: see *Amalgamated Investment & Property Co. Ltd.* v. *John Walker & Sons Ltd.*, [1977] 1 W.L.R. 164, and *post*, p. 526 and cf. *Gamerco S.A.* v. *I.C.M./Fair Warning (Agency) Ltd.* [1995] 1 W.L.R. 1226.

[28] See *ante*, p. 262.

[29] *Bell* v. *Lever Brothers Ltd.* [1932] A.C. 161, at pp. 223–4. See *post*, p. 329.

[30] *Ibid.*, *per* Lord Atkin at p. 217.

[31] See *Barrow, Lane, and Ballard Ltd.* v. *Phillip Phillips & Co.* [1929] 1 K.B. 574 (subject-matter of sale stolen prior to it). But contrast s. 55(1) of the Act which, it has been argued, enables contractual variation of this rule: Atiyah (1957) 73 L.Q.R. 340, at pp. 348–9; *Sale of Goods*, 8th edn. (1990), p. 77.

The leading case is that of *Couturier* v. *Hastie*:[32]

A contract was made for the sale of a cargo of corn, which the parties believed was being shipped from Salonica to England. The corn had, in fact, before the date of sale, deteriorated and had been unloaded at Tunis and sold. The buyer contended that, since the cargo of corn was not in existence, he was not bound to pay the price. But the seller argued that, on the true construction of the contract, 'this was not a mere contract for the sale of an ascertained cargo, but that the purchaser bought the adventure, and took upon himself all risks from the shipment of the cargo'.

The House of Lords held that the purchaser was not liable to pay for the corn. The contract contemplated a sale of existing goods. Neither Coleridge J., who delivered the judgment of seven judges in the Exchequer Chambers,[33] nor Lord Chancellor Cranworth in the House of Lords, actually mentioned the word 'mistake', for they considered the case purely as one of the construction of the contract; but they intimated that the contract would be void, inasmuch as 'it plainly imports that there was something which was to be sold at the time of the contract, and something to be purchased', whereas the object of the sale had ceased to exist.[34]

Similarly, in *Strickland* v. *Turner*,[35] the plaintiff bought and paid for an annuity on the life of a man who was, unknown to both parties, already dead. He was able to recover the purchase money as the annuity had ceased to exist at the time of sale.

Failure of consideration

In these cases it is not difficult to see that the non-existence of the subject-matter of the contract gave rise to a total failure of consideration. If a cargo does not exist, it cannot be delivered; if an annuity is purchased on the life of a dead person, the purchaser gets nothing for his money. It does not matter whether the contract is valid or void. In neither case can the seller claim to recover, or retain, the purchase money. The consideration for the contract has totally failed. It is only when the buyer brings an action for *damages* for non-delivery that the crucial question of the validity of the contract will arise. So in *McRae* v. *Commonwealth Disposals Commission*:[36]

The Commonwealth Disposals Commission invited tenders for the purchase of a wrecked vessel described as 'an oil tanker on Jourmaund Reef approximately 100 miles north of Samarai' in New Guinea. The plaintiff's tender was accepted, and he thereupon fitted out a salvage expedition at considerable expense. In fact there was no oil tanker in the locality indicated, nor was there even such a reef as Jourmaund Reef. The plaintiff claimed damages against the Commission for the loss sustained by him in the expedition.

The Commission, whose conduct was described by the High Court of Australia as 'reckless and irresponsible', resisted the claim to damages on the ground that the contract was void *ab initio*. It relied on *Couturier* v. *Hastie* for the proposition

[32] (1856) 5 H.L.C. 673. See also Atiyah (1957) 73 L.Q.R. 340.
[33] (1853) 9 Exch. 102, reversing the Court of Exchequer at (1852) 8 Exch. 40.
[34] (1856) 5 H.L.C. 673, at p. 681.
[35] (1852) 7 Exch. 208. See also *Hitchcock* v. *Giddings* (1817) 4 Price 135.
[36] (1951) 84 C.L.R. 377 (noted (1952) 15 M.L.R. 229).

that mutual mistake as to the existence of the subject-matter of a contract nullifies consent and avoids the contract. The Court did not, however, accept this argument, considering that the question of the validity of the contract had never arisen in that case; it was merely concerned with the failure of the consideration. If it had arisen, the decision would have depended upon whether the contract was subject to an implied condition precedent that the cargo existed at the time of the contract. No such condition could, in any event, be implied in the case before the Court, for the Commission had clearly contracted that there was a tanker in the position specified, and they must be held liable for breach.

It has been argued that the reasoning of the High Court of Australia in *McRae's* case negatives the existence of any doctrine of mutual mistake; indeed, it is said that a contract concerning subject-matter which is non-existent is always valid and binding, unless a term can be implied to the contrary.[37] It is submitted, however, that this is not the case. The merit of the decision in *McRae* v. *Commonwealth Disposals Commission* is that it shows that, save where section 6 of the Sale of Goods Act applies,[38] invalidity is not an invariable consequence of such a contract. The question is one of the construction of the agreement.

Possible constructions

When properly construed, the contract may indicate that the seller assumed responsibility for the non-existence of the subject-matter. This was so in *McRae's* case, where the seller was held to have guaranteed the existence of the tanker.[39] Alternatively the contract may indicate that the buyer took the risk that the subject-matter might not exist and undertook to pay in any event. This was the point at issue in *Couturier* v. *Hastie*, where the House of Lords was called upon to decide whether or not the buyer had purchased merely the expectation that the cargo would arrive, and the securities (i.e. the shipping documents) against the contingency of its loss. There is therefore no absolute rule that a contract for the sale of a *res extincta* is necessarily void in English law. But if the true construction of the contract is that the parties entered into it on the footing that the subject-matter was in existence, and that neither of them should bear the responsibility if this was not so, then the contract is void for mutual mistake.

This would seem to be the most satisfactory approach to the question of mistake as to the existence of the subject-matter of the contract.

(ii) Mistake as to title

Property already owned by purchaser

Where a person agrees to purchase property which, unknown to itself and the seller, is the buyer's already, i.e. a *res sua*, the contract may be void.

In *Bell* v. *Lever Brothers*, Lord Atkin said:[40]

> Corresponding to mistake as to the existence of the subject-matter is mistake as to title in cases where, unknown to the parties, the buyer is already the owner of that which the seller

[37] Slade (1954) 70 L.Q.R. 385. See also Smith [1994] C.L.J. 400, at p. 402.

[38] It did not apply in *McRae*'s case because the goods had not perished, but never been in existence. But cf. *ante*, p. 299, n. 31.

[39] At p. 407. See also *Barr* v. *Gibson* (1838) 3 M. & W. 390; *Tommey* v. *Finextra* (1962) 106 S.J. 1012.

[40] [1932] A.C. 161, at p. 218.

purports to sell to him. The parties intended to effectuate a transfer of ownership: such a transfer is impossible: the stipulation is *naturali ratione inutilis.*

So if A agrees to take from B a lease of land of which, contrary to the belief of both parties at the time of the contract, A is already tenant for life, the contract is void at common law.[41] But this principle must not be applied too widely. Normally a seller is taken to warrant title to the property sold; even though the parties both contract under a mistaken belief as to the title of the seller, there is a valid contract, and the seller may be made liable in damages. It is only where the buyer happens to purchase his own property, and where no warranty can be implied, that the contract is a nullity from the beginning. For both parties must necessarily have accepted in their minds as an essential and integral element of the subject-matter of the transaction that the seller was, and that the buyer was not, entitled to the property.[42]

(iii) Mistake as to the quality of the thing contracted for

Quality & substance

This has proved to be one of the most contentious categories in the law of mutual mistake. In *Bell* v. *Lever Brothers*, Lord Atkin said:

> Mistake as to quality . . . will not affect assent unless it is the mistake of both parties, and is as to the existence of some quality which makes the thing without the quality *essentially different* from the thing as it was believed to be.

In reliance on this statement, it has been suggested that while a mistake as to *substance* (or essence) will avoid the contract, a mistake as to *quality* (or attributes) will not.[43]

Some support for this distinction may be gained from *Kennedy* v. *Panama, New Zealand, and Australian Royal Mail Co. Ltd.*:[44]

> The plaintiff was induced to take shares in a further issue of capital by the defendant company by a statement in the prospectus that the new capital was required to carry out a contract recently entered into with the New Zealand government for the carriage of mails. The contract, which the company believed to be valid, had been made with an unauthorized agent of the New Zealand government and the government refused to ratify it. The shares fell greatly in value and the plaintiff claimed to return the shares and recover back the purchase price.

The Court of Queen's Bench refused to allow the plaintiff to do so. It held that the shares which had been received were not, because of the difference in value, different in substance from those which the company had contracted to deliver. Blackburn J., delivering the judgment of the Court, referred to the Digest of Civil Law[45] which distinguished substance and quality. He considered that the prin-

[41] *Cooper* v. *Phibbs* (1867) L.R. 2 H.L. 149—a case in equity where the contract was rescinded for mistake; but see the view of Lord Atkin at p. 218 and Lord Thankerton at p. 236 of *Bell* v. *Lever Brothers Ltd.* on its validity at common law. Cf. Matthews (1989) 105 L.Q.R. 599.

[42] [1932] A.C. 161, *per* Lord Thankerton at pp. 235, 236. [43] Tylor (1948) 11 M.L.R. 257.

[44] (1867) L.R. 2 Q.B. 580 (a common law case), expressly approved in *Bell* v. *Lever Brothers Ltd.*, *passim*. Cf. *Emmerson's Case* (1866) L.R. 1 Ch. App. 433 (company in liquidation).

[45] At p. 588. Digest, 18.1.9, 10, 11.

ciple of English law was the same as that of Roman law,[46] and that, at common law, if the mistake was as to quality, there was no remedy in the absence of fraud, or of a definite warranty.

Mistake as to quality usually not operative

That a mistake as to quality will not generally avoid the contract can scarcely be doubted. We may give some examples, both actual and hypothetical:

A agrees to buy from B a certain parcel of oats which both believe to be old oats. They are in fact new oats, and unsuitable for the purpose for which A wants them. There is a valid contract despite the mistake.[47]

C buys from D a picture which both believe to have been painted by Constable. Several years later, when C tries to sell the picture, he finds that it was not painted by Constable at all. The mistake, though 'fundamental', does not avoid the contract.[48]

E agrees to buy from F '100 bales of Calcutta kapok, Sree brand'. The sale is by sample, but both parties believe that this particular brand of kapok is pure kapok, consisting of tree cotton, whereas it in fact contains an admixture of bush cotton and is a commercially inferior product. The contract is valid.[49]

G buys from H a car which both believe to be a 1948 model. It is actually a 1939 model, and worth very much less. There is no mistake at common law.[50]

Mistake as to substance: (i) contract not avoided

When, however, we come to consider the effect of a mistake as to substance, we find that this type of mistake does not necessarily avoid the contract. In *Solle* v. *Butcher*:[51]

The defendant made structural alterations to a flat and let it to the plaintiff for seven years at a rent of £250 per year, both parties mistaken in believing that it was a 'new' dwelling-house and not subject to a controlled rent of £140.

The Court of Appeal held that, although there was a mistake as to the identity of the flat, and this was, in the social context, a mistake on a matter of considerable importance, nevertheless the lease was not void at common law. The mistake would afford grounds for relief in equity, but the lease was not a nullity from the beginning. Similarly in another case, where the parties contracted to buy and sell 'horsebeans', in the belief that they were the same as 'feveroles', an entirely different sort of bean, the contract was not avoided.[52]

Mistake as to substance: (ii) contract avoided

It is evident then that there is no clear rule which states that a mistake as to the substance of the thing contracted for will avoid the contract although there are possibly circumstances in which it will do so. Where the mistake is as to 'an essential and integral element in the subject-matter of the bargain'[53] so that it renders the subject-matter 'essentially and radically different from the subject matter

[46] Cf. Lawson (1936) 52 L.Q.R. 79.
[47] *Smith* v. *Hughes* (1871) L.R. 6 Q.B. 597; *post*, p. 310.
[48] *Leaf* v. *International Galleries* [1950] 2 K.B. 86; *ante*, p. 250; *Harlingdon & Leinster Enterprises Ltd.* v. *Christopher Hull Fine Art Ltd.* [1991] 1 Q.B. 564, at p. 576.
[49] *Harrison & Jones Ltd.* v. *Bunten and Lancaster Ltd.* [1953] 1 Q.B. 646.
[50] *Oscar Chess, Ltd.* v. *Williams* [1957] 1 W.L.R. 370, *ante*, p. 127.
[51] [1959] 1 K.B. 671, followed in *Grist* v. *Bailey* [1967] Ch. 532.
[52] *Frederick E. Rose (London) Ltd.* v. *William H. Pim Junior & Co. Ltd.* [1953] 2 Q.B. 450; *post*, p. 326.
[53] *Bell* v. *Lever Brothers Ltd.* [1932] A.C. 161, *per* Lord Thankerton, at p. 236.

which the parties believed to exist'[54] the contract will be void. Accordingly, the following contracts of sale have been held to be void: of an unstamped and invalid inland bill of exchange which was thought to be a foreign bill and so valid without a stamp;[55] of a quantity of Georgian table linen erroneously described in the particulars of sale as 'the authentic property of Charles I' and as bearing the arms of that unhappy monarch;[56] of a breeding cow which was mistakenly believed to be a sterile cow and sold by the pound for beef;[57] of a prefabricated 'cottage' which could never be erected as a building as it did not conform to building regulations;[58] and of a plot of land, zoned as building land, for which, however, due to the absence of sewage facilities, it was impossible to obtain a building permit.[59]

Unsatisfactory nature of substance–quality distinction

The distinction between substance and quality is nevertheless, at the best, an arbitrary one, for there is no metaphysical 'substance' independent of qualities.[60] Moreover, 'the principle enunciated in *Bell* v. *Lever Brothers Ltd.* is markedly narrower in scope than the civilian doctrine' and 'it is therefore no longer useful to invoke the civilian distinction'.[61] It is better to enquire what exactly the parties intended in their contract, i.e. whether the risk has been assigned to one of the parties or whether to enforce the contract would compel one or other of them to assume a risk which it was never intended should be undertaken.[62] The contract is then void because on its true construction it does not apply.

(iv) A false and fundamental assumption

Mistaken assumption going to root of contract

Where the parties contract under a false and fundamental assumption, going to the root of the contract, and which both of them must be taken to have had in mind at the time they entered into it as the basis of their agreement, the contract may be void.

This category is not separate and distinct from those categories of mistake already mentioned, but rather a more compendious statement of the type of error required. It received the approval of both Lord Atkin[63] and Lord Thankerton[64] in *Bell* v. *Lever Brothers Ltd.*, although some doubts were expressed as to its value owing to the necessary vagueness of its formulation. One thing, however, is certain. It is not sufficient for one party to establish that, had the true facts been known, that party would never have entered into the bargain. Indeed, there may be assumptions which may be regarded by one, or both, of the parties as, in one sense, 'fundamental'—for example, that a picture is the work of an old master, or

[54] *Associated Japanese Bank (International) Ltd.* v. *Crédit du Nord S.A.* [1989] 1 W.L.R. 255, at p. 263.
[55] *Gompertz* v. *Bartlett* (1853) 2 E. & B. 849.
[56] *Nicholson and Venn* v. *Smith Marriott* (1947) 177 L.T. 189.
[57] *Sherwood* v. *Walker* 33 N.W. 919 (1887), (Michigan).
[58] *Frazer* v. *Dalgety & Co. Ltd.* [1953] N.Z.L.R. 126 (New Zealand).
[59] *Alessio* v. *Jovica* (1974) 42 D.L.R. (3d) 242 (Canada). Cf. *Amalgamated Investment & Property Co. Ltd.* v. *John Walker & Sons Ltd.* [1977] 1 W.L.R. 164.
[60] Glanville Williams (1945) 61 L.Q.R. 293. Cf. Tylor (1948) 11 M.L.R. 257.
[61] *Associated Japanese Bank (International) Ltd.* v. *Crédit du Nord S.A.* [1989] 1 W.L.R. 255, *per* Steyn J., at p. 268.
[62] *Ante*, p. 299.
[63] [1932] A.C. 161, at p. 225.
[64] *Ibid.*, at p. 236.

that a flat is free from rent control. Yet the contract will still bind. As Lord Thankerton points out:[65]

> The phrase 'underlying assumption by the parties', as applied to the subject-matter of a contract . . . can only properly relate to something which both must have necessarily accepted in their minds as an essential and integral element of the subject-matter.

In *Bell* v. *Lever Brothers Ltd.* itself, this requirement was not fulfilled. On its true construction, the agreement to pay compensation applied notwithstanding the fact that the contract of service had been broken:

> The contract released is the identical contract in both cases, and the party paying for release gets exactly what he bargains for. It seems immaterial that he could have got the same result in aother way, or that if he had known the true facts he would not have entered into the bargain.[66]

The discovery of the new facts must, it was said, destroy the identity of the contract.

Examples from cases

It is not surprising that the strictness of this test has resulted in a dearth of cases on the subject of fundamental mistake. In *Scott* v. *Couslon*,[67] however, a contract for the assignment of a policy of life insurance was made upon the basis of an erroneous belief, shared by both parties, that the assured was still alive. It was held that the vendor was entitled to the return of the policy and also the moneys payable under it. Similarly the following have been held to be void: a separation deed entered into by a husband and wife on the erroneous assumption that their marriage was valid;[68] a contract for the hire of rooms to watch a coronation procession made in ignorance that the procession had already been cancelled;[69] an agreement to compromise an insurance claim arising under a policy which in fact was voidable for misrepresentation,[70] and an agreement as to the amount due under two contracts of sale entered into in the erroneous belief that the results in the two certificates of analysis had been transposed.[71]

The operation of this principle can also be illustrated by *Sheikh Brothers Ltd.* v. *Ochsner*,[72] a case from Kenya, decided by the Judicial Committee of the Privy Council under section 20 of the Indian Contract Act 1872. Section 20 provides: 'Where both the parties to an agreement are under a mistake as to a matter of fact essential to the agreement, the agreement is void'.

> The appellants granted the respondent a licence to cut and manufacture all sisal grown on a particular estate. As well as paying for the licence, the respondent undertook to deliver

[65] *Ibid.*, at p. 235.
[66] *Ibid.*, *per* Lord Atkin at p. 223. Cf. *Horcal* v. *Gartland* [1983] I.R.L.R. 459.
[67] [1903] 2 Ch. 249.
[68] *Galloway* v. *Galloway* (1914) 30 T.L.R. 531.
[69] *Griffith* v. *Brymer* (1903) 19 T.L.R. 434.
[70] *Magee* v. *Penine Insurance Co. Ltd.* [1969] 2 Q.B. 507 *per* Fenton Atkinson L.J. at p. 517 (Winn L.J. dissenting). But cf. *post*, p. 330 n. 215.
[71] *Grains & Fourrages S.A.* v. *Huyton* [1997] 1 Lloyd's Rep. 628.
[72] [1957] A.C. 136. See also *Clifford* v. *Watts* (1870) L.R. 5 C.P. 577; *Associated Japanese Bank (International) Ltd.* v. *Crédit du Nord S.A.* [1989] 1 W.L.R. 255, at p. 269, *ante*, p. 298 (guarantee of machine lease agreement said to be void because machines did not exist).

to the appellants 50 tons of sisal each month. The estate was, in fact, not capable of producing such a quantity of sisal as would meet this requirement.

The Judicial Committee held, following the statements in *Bell* v. *Lever Brothers Ltd.*, that the contract was void. In this case, however, there was nothing in the contract to indicate that one or other of the parties took the risk that the estate would not produce so much sisal. The decision would have been otherwise if, on a true construction of the contract, the appellants had guaranteed the yield of the estate or the respondent had agreed to pay in any event.[73]

(v) Effect of negligence

Effect of negligence

A party wishing to rely on an operative mutual mistake must have had reasonable grounds for entertaining the belief on which the mistake was made. Such a party who does not and is at fault, is not allowed to rely on the mistake. In *McRae* v. *Commonwealth Disposals Commission*, it was said:[74]

> At least it must be true to say that a party cannot rely on a mutual mistake where the mistake consists of a belief which is, on the one hand entertained by him without any reasonable ground, and, on the other hand, deliberately induced by him in the mind of the other party.

In *Associated Japanese (International) Bank Ltd.* v. *Crédit du Nord S.A.* this qualification of the positive rules regarding mistake was said to preclude a person who makes a contract with a minimal knowledge of the facts to which the mistake relates but is content that it is a good speculative risk, from relying on a mutual mistake which consists of a belief entertained without any reasonable grounds for such belief.[75] The qualification rested on policy and good sense rather than principles such as estoppel or negligence.

(b) Absence of a Genuine Agreement

It follows from the essential nature of a contract that if there is no genuine agreement between the parties, or, as is commonly said, if the parties are not *ad idem*, there is no contract. This is only another way of saying that offer and acceptance must correspond exactly, or no contract will ensue. Therefore, if the offeree thinks that the offeror is some person other than he really is, or that the thing offered is something different, or that the terms proposed by the offeror are other than those actually proposed, and if she accepts on that mistaken assumption, it is clear that there is no genuine agreement, for the offer which she has accepted is not the offer made by the other party.

Objective test often excludes mistake

But the offeree may nevertheless be held to have accepted the real offer, and not that which exists merely in her mind, if an agreement can reasonably be inferred from objective facts. For it is a rule of our law that the intention of the

[73] *Bute (Marquis of)* v. *Thompson* (1844) 13 M. & W. 487; *Jeffries* v. *Fairs* (1876) 4 Ch. D. 448.
[74] (1950) 84 C.L.R. 377, *per* Dixon and Fullagar JJ. at p. 408; see *ante*, p. 300.
[75] [1989] 1 W.L.R. 255, at p. 268. See also the requirement of absence of fault in equity: *Solle* v. *Butcher* [1950] 1 K.B. 671, at p. 693; *post*, p. 329.

parties must be inferred from their words and conduct as interpreted by a reasonable person:

> If, whatever a man's real intention may be, he so conducts himself that a reasonable man would believe that he was assenting to the terms proposed by the other party, and that other party upon that belief enters into the contract with him, the man thus conducting himself would be equally bound as if he had intended to agree to the other party's terms.[76]

It is evident that in the vast majority of cases the operation of this objective test will exclude the plea that the parties were not in agreement. It will be remembered that in Chapter 2, The Agreement[77] and Chapter 4, The Terms of the Contract,[78] it was stated that, as a general rule, the intention of the parties must be construed objectively. So it is clear that the cases in which mistake affects a contract must be considered to be the rare exceptions to this general rule. Parties are bound by agreements to which they have expressed a clear assent. If they exhibit all the outward signs of agreement the law will hold that they have agreed.

Contracts void for mistake

Nevertheless it may happen that the law regards a contract as void though at first sight it appears perfectly valid. This may occur in one of four situations:

(i) where, despite outward appearances, there is no real coincidence between the terms of the offer and those of the acceptance;
(ii) where there is a mistake as to the promise known to the other party;
(iii) where there is a mistake as to the identity of the person with whom the contract is made;
(iv) where there is a mistake in relation to a written document.

(i) Offer and acceptance not coincident

Parties at cross-purposes

It may happen that, owing to a mistake on the part of one party, an offer may be innocently accepted in a different sense from that in which it was intended by the offeror, and the terms in which the contract is expressed may suffer from such latent ambiguity that it is impossible to say that the conduct of the parties points to one solution rather than another. In such a case one party may say that she did not attach the same meaning to the terms as the other party, and it will be impossible to say that her conduct would have induced a reasonable person to make one deduction rather than the other. The contract will be void because the terms of the offer and the acceptance did not coincide.[79]

Examples

If, for example, two things have the same name, and A makes an offer to B referring to one of them, which offer B accepts thinking that A is referring to the other, then provided there is nothing in the terms of the contract to identify one or other as its subject-matter, evidence may be given to show that the mind of each party was in fact (and subjectively) directed to a different object: that A offered one thing and B accepted another. So in *Raffles* v. *Wichelhaus*:[80]

[76] *Smith* v. *Hughes* (1871) L.R. 6 Q.B. 597, *per* Blackburn J. at p. 607. See also *Centrovincial Estates PLC* v. *Merchant Investors Assurance Co. Ltd.* [1983] Com. L.R. 158; *O.T. Africa Line Ltd.* v. *Vickers plc* [1996] 1 Lloyd's Rep. 700.

[77] *Ante*, p. 29.

[78] *Ante*, p. 156.

[79] Cited with approval in *Alampi* v. *Swartz* (1963) 38 D.L.R. (2d) 300 (Canada).

[80] (1864) 2 H. & C. 906. See Simpson (1975) 91 L.Q.R. 247, at p. 268 n. 99.

The defendant agreed to buy from the plaintiff a cargo of cotton 'to arrive *ex Peerless* from Bombay'. There were two ships called *Peerless*, and both sailed from Bombay, but the defendant meant a *Peerless* which sailed in October, and the plaintiff a *Peerless* which sailed in December.

It was held that there was no contract. There was nothing in the agreement which would point to one or other of the vessels as being the one identified in the contract; the offer and acceptance did not coincide.

Similarly, if A makes to B an offer which is ambiguous in its terms, or is rendered ambiguous by the circumstances surrounding it, and B accepts the offer in a different sense from that in which it is meant, then unless an objective construction requires otherwise, B may effectively maintain that there is no binding contract. In *Scriven Bros. & Co.* v. *Hindley & Co.*:[81]

The plaintiffs instructed an auctioneer to sell certain bales of hemp and tow. These bore the same shipping mark and were described in the auction catalogue as so many bales in different lots with no indication of the difference in their contents. The defendants examined samples of the hemp before the sale intending to bid for the hemp alone. At the auction, the tow was put up for sale, and the defendants' buyer, believing it to be hemp, made a bid which was a reasonable one if it had been intended for hemp, but an excessive one for tow. This bid was accepted by the auctioneer, who did not realize the buyer's mistake, but merely thought the bid an extravagant one for tow. The plaintiffs sought to enforce the contract by suing for the price.

It was clear that offer and acceptance did not coincide. The plaintiffs intended to sell tow, the defendants' buyer, misled by the auction catalogue, to buy hemp. The court held that there was nothing in the defendants' conduct which would estop them from pleading that the parties were not in agreement as to the subject-matter of the sale. Accordingly no contract had come into existence, and the defendants were not liable.

It has been said that these are not truly cases of mistake, but rather cases where there is merely no concurrence between the terms of the offer and those of the acceptance. This is true, but it is convenient to deal with them here as proof of a mistake must be adduced before a flaw can be found in the ostensible agreement.

(ii) Mistake as to the promise known to the other party

No duty to disillusion

In entering into contracts people must use their own judgment or, if they cannot rely upon their judgment, must take care that the terms of the contract secure to them what they want. *Caveat emptor* is a general rule of the law of contracts. One party is not bound to disclose to the other all material circumstances which might affect the bargain and which are known to that party alone. Even if it is known that the other party is contracting under a misapprehension, the general rule is that there is no duty to disillusion the mistaken party.[82] The position is different

[81] [1913] 3 K.B. 564. See also *Thornton* v. *Kempster* (1814) 5 Taunt. 786; *Henkel* v. *Pape* (1870) L.R. 6 Ex. 7; *Falck* v. *Williams* [1900] A.C. 176; *Lloyds Bank plc* v. *Waterhouse* (1991) 10 Tr. L.R. 161, at pp. 185, 191.

[82] *Bell* v. *Lever Brothers Ltd.* [1932] A.C. 161; *ante*, p. 296. See also *G.S. Fashions Ltd.* v. *B. & Q. plc* [1995] 1 W.L.R. 1088.

if the contract contains statutory implied terms;[83] or is *uberrimae fidei*;[84] or there has been some active fraudulent concealment.[85] Save in these cases mere silence will not constitute a misrepresentation, and each party must protect itself from the consequences of its own mistake.

Mistake as to the promise

Nevertheless the law will not recognize that a contract has come into existence when one party makes or accepts an offer which that party knows that the other understands in a fundamentally different sense from that in which the offer was made or accepted. So we find that a mistake by one party as to the *promise*, if known to the other party, will avoid the contract. Only a mistake as to the promise is sufficient; any other mistake, for example, as to the quality or the substance of the thing contracted for, will not affect consent in this way.[86] Moreover, although, in the current state of the authorities, the mistake must be known to the other party, and, if it is not, the party mistaken will be prevented from denying the ostensible agreement, *dicta* suggest that a mistake by one party of which the other ought reasonably to have known will suffice, at least where there was something in the conduct of the other party making it inequitable for that party to insist on the apparent bargain, including wilfully shutting her eyes to the obvious.[87]

Illustrations

We can best illustrate these propositions by an imaginary sale:

A sells *X* a piece of china.

Mistake as to thing sold (i) unknown to other party

(1) X thinks that it is Dresden china. A thinks it is not. Each takes a chance. X may get a better thing than A intended to sell, or a worse thing than X intended to buy; in neither case is the validity of the contract affected.

(ii) known to other party

(2) X thinks that it is Dresden china. A knows that X thinks so, and knows that it is not. The contract holds. A must do nothing to deceive X, but she is not bound to prevent X from deceiving himself as to the quality of the thing sold. X's error is one of motive alone, and although it is known to A, it is insufficient.

Mistake as to offer (i) unknown to other party

(3) X thinks that it is Dresden china and thinks that A intends to contract to sell it as Dresden china; and A knows that it is not Dresden china, but does not know that X thinks that A is contracting to sell it as Dresden china. A reasonably believes that X is assenting to a sale of china in general terms. The contract holds. The misapprehension by X of the extent of A's promise, *if unknown to* A, has no effect, unless, as in *Scriven Brothers & Co.* v. *Hindley & Co.*,[88] A has caused or contributed to X's misapprehension.

(ii) known to other party

(4) X thinks it is Dresden china, and thinks that A intends to contract to sell it as Dresden china. A knows that X *thinks A is contracting to sell it as Dresden china*, but does not mean to, and in fact does not, offer more than china in general terms. The contract is void. X's error was not one of judgement as to the quality of the china, as in (2), but was an error as to the nature of A's promise, and A, knowing that her promise was misunderstood, nevertheless allowed the mistake to

[83] *Ante*, p. 150, 156. [84] *Ante*, p. 258. [85] *Ante*, p. 235.

[86] *Bell* v. *Lever Brothers Ltd.* (*supra*, n. 82), at p. 218.

[87] *Centrovincial Estates PLC* v. *Merchant Investors Assurance Co. Ltd.* [1983] Com. L.R. 158; *O.T. Africa Line Ltd.* v. *Vickers plc* [1996] 1 Lloyd's Rep. 700. See also *Mannai Investment Co. Ltd.* v. *Eagle Star Life Assurance Co. Ltd.* [1997] 2 W.L.R. 945 *Clinton* v. *Windsor Life Ass. Co. Ltd* [1998] 2 C.L. 120. Cf. the test for rectification in cases of unilateral mistake, *post*, p. 326.

[88] [1913] 3 K.B. 564; see *ante*, p. 308.

continue. There can be no contract if A knows that X has accepted her offer in terms different from those in which it was in fact made.

Rule in *Smith* v. *Hughes*

This rule is sometimes known as the rule in *Smith* v. *Hughes*:[89]

The plaintiff sued the defendant for the price of oats sold and delivered, and for damages for not accepting the oats. The plaintiff had offered to sell to the defendant, by sample, a parcel of oats at 35s. a quarter. According to the defendant, the plaintiff described the oats as 'good *old* oats', but the plaintiff denied that the word 'old' had been used. This offer was rejected by the defendant's counter-offer of 34s. a quarter, which in turn was accepted by the plaintiff's delivery of the oats. When they were delivered, they were found to be new oats, and unsuitable for the defendant's purpose.

The trial judge directed the jury to consider:

(i) whether the word 'old' had been used by the plaintiff or the defendant in making the contract. If so, they were to give a verdict for the defendant;
(ii) if the word 'old' had not been used, whether they were of the opinion that the plaintiff believed the defendant to believe, or to be under the impression, that he was contracting for the purchase of old oats. If so, they were to give a verdict for the defendant.

The jury found for the defendant without stating on which ground they had based their verdict. On a motion for a new trial, the majority of the Court of Queen's Bench were of the opinion that the second of these two directions would not sufficiently bring to the minds of the jury the distinction between agreeing to take the oats under the belief that they were old, and agreeing to take the oats under the belief that the plaintiff *contracted* that they were old.[90] Hannen J. said:[91]

If, therefore, in the present case, the plaintiff knew that the defendant, in dealing with him for oats, did so on the assumption that the plaintiff was contracting to sell him old oats, he was aware that the defendant apprehended the contract in a different sense to that in which he meant it, and he is thereby deprived of the right to insist that the defendant shall be bound by that which was only the apparent, and not the real bargain.

But this was not necessarily so. The defendant might merely have been mistaken as to the age of the oats, and not as to the plaintiff's promise. If such were the case, the contract would be valid, and a verdict should have been given for the plaintiff:[92]

In order to relieve the defendant, it was necessary that the jury should find not merely that the plaintiff believed the defendant to believe that he was buying old oats, but that he believed the defendant to believe that he, the plaintiff, was contracting to sell old oats.

Accordingly a new trial was ordered.

The same rule was applied in slightly different circumstances in *Hartog* v. *Colin & Shields*:[93]

[89] (1871) L.R. 6 Q.B. 597.
[90] (1871) L.R. 6 Q.B. 597, *per* Blackburn J. at p. 608.
[91] At p. 610.
[92] *Ibid.*, *per* Hannen J. at p. 611.
[93] [1939] 3 All E.R. 566, followed in *McMaster University* v. *Wilchar Construction, Ltd.* (1971) 22 D.L.R. (3d) 9 (Canada) aff'd (1973) 69 DLR 3d 410.

The defendants offered to sell to the plaintiff 3,000 Argentine hare skins, but by a mistake they offered them at so much per *pound* instead of so much per *piece*. The plaintiff accepted the offer. It was shown that it was the usual practice of the trade to charge on a per piece basis and that the written and oral negotiations leading up to the sale had proceeded throughout on a price per piece. As a pound contained on average three pieces the price under the agreement was roughly one-third of what it would have been on a per piece basis. The plaintiff sought to enforce the sale in the terms of the offer, and sued for non-delivery.

Singleton J. held that the plaintiff must have known and did in fact know that, when he accepted the defendants' offer, they were under a mistake, and that this mistake amounted to a stipulation of the contract.[94] The *apparent* agreement (i.e. so much per pound) was therefore void. It has not been decided whether the defendant seller can enforce the *intended* contract (i.e. so much per piece) but both principle and the analogy of rectification in cases of unilateral mistake[95] suggests that the seller should be able to.

(iii) Mistake as to the identity of the person with whom the contract is made[96]

Mistake as to party

Mistake of this sort can only occur where A contracts with B, believing B to be C: that is, where a party has in contemplation a definite and identifiable person with whom he intends to contract. Further, the identity of the other party must be material: at the time when the contract is made, one party must regard the identity of the other party as a matter of vital importance.[97] One who, for example accepts a bid at a public auction cannot normally allege that he is concerned with the identity of the person who makes the bid.[98]

An offer can only be accepted by the person to whom it is addressed

We may start with the proposition that a person cannot constitute himself a contracting party with one whom he knows or ought to know has no intention of contracting with him. An offer can be accepted only by the person to whom it is addressed. In *Boulton* v. *Jones*:[99]

Boulton had taken over the business of one Brocklehurst, with whom the defendant, Jones, had been used to deal. Jones had a running account with Brocklehurst and was entitled to a set-off in respect of sums owed to him by Brocklehurst. Jones sent an order for goods to Brocklehurst, which Boulton supplied without informing him that the business had

[94] *Sed quaere* whether it is sufficient that a reasonable person would have known of the other's mistake (see *McMaster University* v. *Wilcher Construction Ltd.* (*supra*, n. 93), at p. 32; *Centrovincial Estates plc* v. *Merchant Investors Assurance Co. Ltd.* [1983] Com. L.R. 158, at p. 159; *O.T. Africa Line Ltd.* v. *Vickers plc* [1996] 1 Lloyd's Rep. 700) or whether, as the analogy with rectification suggests (*post*, p. 326), actual knowledge, as in *Hartog* v. *Colin & Shields*, is necessary.

[95] *Post*, p. 326. See also *Commission for the New Towns* v. *Cooper (Great Britain) Ltd.* [1995] Ch. 259 (false and misleading statements made to divert mistaken party's attention).

[96] See Goodhart (1941) 57 L.Q.R. 228; Cheshire (1944) 60 L.Q.R. 175, at p. 183; Glanville Williams (1945) 23 Can. Bar Rev. 271, at p. 380; Tylor (1948) 11 M.L.R. 257, at p. 259; Slade (1954) 70 L.Q.R. 385, at p. 390; Wilson (1954) 17 M.L.R. 515; Unger (1955) 18 M.L.R. 259; Smith and Thomas (1957) 20 M.L.R. 38; Samek (1960) 38 Can. Bar Rev. 479; Hall [1961] C.L.J. 86; Stoljar (1965) 28 M.L.R. 265, at p. 280.

[97] *Ingram* v. *Little* [1961] 1 Q.B. 31, at p. 57; *Lewis* v. *Averay* [1972] 1 Q.B. 198, at p. 209.

[98] *Dennant* v. *Skinner* [1948] 2 K.B. 164.

[99] (1857) 2 H. & N. 564. From the report of this case in (1857) 6 W.R. 107 it appears that Boulton knew of the existence of the set-off.

changed hands. When Jones learned that the goods had not come from Brocklehurst, he refused to pay for them, and was sued by Boulton for the price.

It was held that he was not liable to pay for the goods. Pollock C.B. said:[100]

It is a rule of law that if a person intends to contract with A, B cannot give himself any right under it. Here the order in writing was given to Brocklehurst. Possibly Brocklehurst might have adopted the act of the plaintiff in supplying goods and maintained an action for their price. But since the plaintiff had chosen to sue, the only course the defendants could take was to plead that there was no contract with him.

Nevertheless it must be remembered that offer and acceptance must here, as elsewhere, be understood in an objective sense. The test is not merely 'Did the offeror intend to contract with the person to whom the offer was made?' but also 'How would a reasonable person in the position of the offeree have interpreted the offer?'. So if A makes an offer to B in mistake for C, and B, reasonably believing the offer is intended for him, accepts, then A is bound even though he can prove that he had made a mistake. An extreme application of this principle can be seen in *Upton-on-Severn R.D.C.* v. *Powell.*[101]

The defendant sent for the Upton fire brigade in mistake for the Pershore fire brigade, in whose area he was, and the call was accepted in good faith by the Upton brigade.

It was held that the defendant was contractually bound to pay for their services despite his mistake and despite the fact that neither party thought they were entering a contract; the defendant thought he was calling the brigade the services of which he was entitled to without charge, and the fire brigade thought they were answering a call within their area for which there would be no charge.[102]

But no contract will be formed if a person accepting an offer believes on reasonable grounds that he is accepting an offer from someone other than the person by whom it has in fact been made, and this fact is known to the offeror. In *Cundy* v. *Lindsay*:[103]

The respondents received an order for goods from one Blenkarn, who gave as his address '37 Wood Street, Cheapside'. He imitated the signature of a respectable firm named Blenkiron & Co., who were known by reputation to the respondents and who carried on business at 123 Wood Street. The respondents were thus fraudulently induced to send the goods to Blenkarn's address, which goods he afterwards sold to innocent purchasers, the appellants. The respondents sued the appellants for the return of the goods.

If the contract between the respondents and Blenkarn was merely voidable for fraud, the appellants would be entitled to retain the goods as they had taken them in good faith and for value. If the contract was void for mistake, Blenkarn could pass no title to the goods to the appellants because as between him and the respond-

[100] At p. 565.

[101] [1942] 1 All E.R. 220.

[102] *Sed quaere* whether the plaintiff would have been contractually liable if he had cancelled the call before the services were rendered. It is preferable to regard the liability for the services rendered as based on restitution (reasonable recompense for services rendered) rather than on contract. See also *ante*, p. 31 n. 23.

[103] [1878] 3 App. Cas. 459.

ents there was no contract. The House of Lords held that the respondents were entitled to succeed. Lord Cairns said[104]:

> Of him [Blenkarn] they knew nothing, and of him they never thought. With him they never intended to deal. Their minds never, even for an instant of time rested upon him, and as between him and them there was no *consensus* of mind which could lead to any agreement or any contract whatever. As between him and them there was merely the one side to a contract, where, in order to produce a contract, two sides would be required.

When his offer was accepted, Blenkarn knew that the respondents thought they were entering into a contract with Blenkiron & Co. The contract was therefore void *ab initio*.

Mistake as to attributes ineffective

But if A's mistake does not go to the *identity* of the other party, if A does intend to make a contract with that particular person, then the fact that he would not have made it if he had not been labouring under some mistake regarding the personality of the other party will not prevent the formation of a contract. Mistake as to *attributes*, for example, as to the solvency or social position of that person or whether that person holds a driving licence,[105] is insufficient.[106] In *King's Norton Metal Co. Ltd.* v. *Edridge, Merrett & Co, Ltd.*:[107]

> The plaintiff, a metal manufacturer, received a letter purporting to come from 'Hallam & Co.' in Sheffield asking for quotations for metal wire. On the letterhead was a picture of a large factory and a list of overseas depots. The plaintiff replied, and Hallam & Co. ordered the wire. In fact, the firm of 'Hallam & Co.' consisted solely of a fraudulent person named Wallis. The letters had been written, and the writing paper prepared, by him. Wallis subsequently sold the wire so obtained to the defendant. The plaintiff sued the defendant, contending that the contract with Hallam & Co. was void, and that the wire was therefore still its property.

The Court of Appeal held that the plaintiff had intended to contract with the writer of the letter. Although it would not have done so if it had known what sort of a person the writer was, and that he was using an *alias*, a contract had been made which was not void on the ground of mistake, but only voidable for fraud. Consequently the property in the goods delivered had passed under it to Wallis, and an innocent purchaser from him acquired a good title to them. A.L. Smith L.J. put the question as follows:[108]

Need for identifiable third person

> With whom, upon this evidence, which was all one way, did the plaintiffs contract to sell the goods? Clearly with the writer of the letters. If it could have been shown that there was

[104] At p. 465.

[105] *Whittaker* v. *Campbell* [1984] Q.B. 318, at p. 329.

[106] There is nevertheless no more intrinsic validity in the distinction between *identity* and *attributes* than between *substance* and *qualities (supra)*; but the law does conveniently distinguish between cases where there are two individuals in the picture (i.e. A contracts with B in mistake for C) and cases where there is only one (i.e. A contracts with B in the belief that B is not B). In (1945) 23 Can. Bar Rev. 278, Glanville Williams says cogently 'The conclusion is that a so-called "error of identity" consists in misapprehending (the attributes of) two or more persons. An "error of attributes" consists in misapprehending (the attributes of) a single person'. Cf. Wilson (1954) 17 M.L.R. 515, and the reply by Unger (1955) 18 M.L.R. 259.

[107] (1897) 14 T.L.R. 98. Cf. *Newborne* v. *Sensolid (Great Britain) Ltd.* [1954] 1 Q.B. 45.

[108] At p. 99.

a separate entity called Hallam & Co. and another entity called Wallis then the case might have come within the decision in *Cundy* v. *Lindsay*.

Therefore, in order to establish mistake as to indentity, the party contracting must prove not merely that she did not intend to contract with the person with whom the apparent contract was concluded, but also that there was a third identifiable person with whom there was an intention to contract.[109]

Contracts concluded in the parties' presence

This question is most difficult to resolve where the transaction takes place not, as in the cases which we have so far considered, between parties at a distance from one another, but in each other's presence. In *Phillips* v. *Brooks Ltd.*:[110]

A man, North, called at the plaintiff's shop and selected some pearls and a ring. He wrote out a cheque for £3,000, saying 'I am Sir George Bullough' (a person of credit whose name was known to the plaintiff) and giving Sir George Bullough's address. The plaintiff, finding on reference to a directory that Sir George lived at that address, allowed North to take away the ring which North then pledged to the defendants for £350. The defendants had no notice of the fraud. The plaintiff sued for the return of the ring, alleging that he had never parted with the property in it.

Horridge J. held that, although the plaintiff believed the person to whom he was handing the ring was Sir George Bullough, he in fact contracted to sell and deliver it to the person who came into his shop. His intention was 'to sell to the person present and identified by sight and hearing'.[111] The contract, therefore, was not void on the ground of mistake, but only voidable on the ground of fraud, and the defendants had acquired a good title to the ring.

It does not follow from this decision that there can be no operative mistake as to identity where the parties are in each other's presence though obviously, when two parties contract with one another face to face, the proper inference will normally be that each intended to contract with the other and not with someone else. This inference is not, however, inevitable. In *Hardman* v. *Booth*:[112]

The plaintiff visited the place of business of a firm, Gandell & Co. The firm was run solely by Thomas Gandell, but employed a clerk named Edward Gandell. This clerk fraudulently persuaded the plaintiff that he (Edward Gandell) was a member of the firm. The plaintiff thereupon despatched goods to that address, but invoiced them to 'Edward Gandell & Co.'. Edward Gandell pledged the goods with the defendant, who took them *bona fide* and without notice of the fraud. The plaintiff sued the defendant for return of the goods.

It was held that the plaintiff was entitled to the goods. His intention had been to contract with Gandell & Co. and not with Edward Gandell. The contract was therefore void. Again, in *Lake* v. *Simmons*:[113]

[109] See also *Citibank N.F.* v. *Brown Shipley & Co. Ltd.* [1991] 2 All E.R. 690, at p. 702 (mistake as to identity of messenger insufficient). See generally Goodhart (1941) 57 L.Q.R. 228; Unger (1955) 18 M.L.R. 259. Cf. Wilson (1954) 17 M.L.R. 515.

[110] [1919] 2 K.B. 243, criticized by Goodhart (1941) 57 L.Q.R. 228, at p. 241.

[111] *Edmunds* v. *Merchant Despatch Co.* (1883) Mass. 283, *per* Morton C.J. at p. 286.

[112] (1863) 1 H. & C. 803.

[113] [1927] A.C. 487.

The appellant, a jeweller, was insured with a company against loss by theft, with the exception of jewellery 'entrusted to a customer'. A woman named Esme Ellison, posing as the wife of a wealthy customer, one Van der Borgh, made a few purchases from the appellant to inspire confidence, and then was allowed to take away two pearl necklets of considerable value 'on approval' for her supposed husband. She made away with the necklets, and the question arose whether the loss was covered by the insurance policy, or came within the exception clause.

The House of Lords held that the loss was covered by the insurance. Viscount Haldane considered that the answer to the question turned on whether there was a contract between the jeweller and Esme Ellison, and said:[114]

The appellant thought that he was dealing with a different person, the wife of Van der Borgh, and it was on that footing alone that he parted with the goods. He never intended to contract with the woman in question.

It could, of course, be argued that the jeweller intended to contract with the woman in the shop, merely investing her with attributes of Mrs. Van der Borgh,[115] but Viscount Haldane thought otherwise. He distinguished *Phillips* v. *Brooks Ltd.* by pointing out that, in the case 'the jeweller was prepared to sell to North individually as a casual customer who had entered the shop. All that remained to be subsequently arranged was the payment of the price'.[116] The mention of Sir George Bullough induced therefore, not the making of the contract, but only the delivery of the goods. This would seem to suggest that if North had introduced himself as Sir George Bullough on entering the shop, it might well have been that the proper conclusion to be drawn would have been that the plaintiff had intended to contract with Sir George Bullough and no one else, and this fact being known to North, the contract would not have been voidable but void.

Two more recent cases, the facts of which closely resemble those in *Phillips* v. *Brooks Ltd.*, illustrate the difficulty of deciding whether a contract is void for mistake as to identity, or merely voidable for fraud. In *Ingram* v. *Little*:[117]

Miss Elsie and Miss Hilda Ingram advertised their car for sale. A rogue who called himself Hutchinson visited them and offered to buy the car. When he made as if to pay them by cheque, they refused to accept it and insisted on payment in cash. He then gave his initials and an address, describing himself as a respectable business man living in Caterham. One of the Ingrams then went to the local post office and ascertained from the telephone directory that there was such a person living at that address. They then allowed the rogue to take away the car in return for a worthless cheque and the rogue sold the car to the defendants who took it in good faith.

The Court of Appeal held that the contract between the Ingrams and 'Hutchinson' was void for mistake as to identity and that the vehicle was still their

[114] At p. 500. Cf. *Citibank N.A* v. *Brown Shipley & Co. Ltd.* [1991] 2 All E.R. 690, at p. 700.

[115] She did not exist. Van der Borgh was a widower. Esme Ellison was his mistress.

[116] At p. 501 (no trace of this as a material distinction can be found in the judgment in *Phillips* v. *Brooks Ltd.*). See also *Ingram* v. *Little* (*infra*, n. 117), at pp. 51, 60; *Lewis* v. *Averay* [1972] 1 Q.B. 198, at pp. 206, 208.

[117] [1961] 1 Q.B. 31 (Devlin L.J. dissenting). Contrast *Fawcett* v. *Star Car Sales Ltd.* [1960] N.Z.L.R. 406.

property. The circumstances (particularly the investigation of the telephone directory) indicated that it was with Hutchinson that the plaintiffs intended to deal and not with the rogue who was physically present before them. On the other hand, in *Lewis* v. *Averay*:[118]

Lewis, a post-graduate chemistry student, advertised his car for sale. A rogue, posing as the well-known television actor Richard Greene, called on Lewis and offered to buy the car. Lewis accepted the offer, and the rogue wrote out a cheque, signing it 'R.A. Green'. The rogue wished to take away the car at once, but Lewis was not willing for him to have it until the cheque had been cleared. At Lewis's request the rogue produced 'proof' that he was Richard Greene in the form of a special pass of admission to Pinewood studios bearing the name 'Richard A. Green' and an address, a photograph of the rogue and an official stamp. Lewis was satisfied on seeing this pass and allowed the rogue to have the car. The cheque was worthless and the rogue sold the car to Averay, a music student, who bought it in good faith.

The Court of Appeal held that Lewis intended to contract with the person actually present before him. The contract was therefore merely voidable for fraud, and Averay in consequence acquired the property in the car as against Lewis.

It is by no means easy to draw any convincing distinction between these various cases, and it is doubtful whether the statements of principle contained in them can be reconciled. In any event, it would seem that *Ingram* v. *Little*, if rightly decided, depends on 'the very special and unusual facts of the case'[119] for its decision. There is, however, considerable merit in the suggestion made by Lord Denning M.R. in *Lewis* v. *Averay* that such fine distinctions as exist, for example, between mistake as to identity and mistake as to attributes, are a reproach to the law. It would be preferable if statutory effect were given to a recommendation made by the Law Reform Committee[120] that, where goods are sold under a mistake as to the buyer's identity, the contract should, so far as third parties are concerned, be considered voidable and not void.

No third party in existence

There is yet a further problem in this subject which is again one of considerable difficulty.[121] This is where A contracts with B in the belief that B is not B, and B knows of this error.

Suppose that B, knowing that A will refuse to contract with him, disguises himself so as to conceal his identity, and effects a purchase of goods from A.

It might be thought that this situation is no different from that where A contracts with B in mistake for C, and B realizes the mistake. There is in fact a considerable difference. In the latter situation the contract is void because B cannot accept an offer which he knows is not intended for himself but for C. In the former, there is no third person to whom the offer is really addressed: it is addressed to B, even though A mistakenly believes that he is not B. B is not, therefore, prevented from accepting an offer addressed to himself, and the contract will be valid and binding.

[118] [1972] 1 Q.B. 198.

[119] *Ibid.*, *per* Phillimore L.J. at p. 208.

[120] Twelfth Report of the Law Reform Committee (Cmd. 2958, 1969) 15.

[121] The subsequent paragraph relies heavily on the convincing argument of Professor Goodhart in (1941) 57 L.Q.R. 228, at pp. 241 ff.

In certain circumstances, however, the offer made by A may expressly or impliedly contain a stipulation that excludes B. These are the terms upon which A is prepared to contract, and, as we have seen,[122] it is not possible for an offeree to accept an offer which he knows is made to him in different terms from those in which he purports to accept it. B cannot, therefore, accept such an offer. For example, the offer may be made to a limited class of persons, such as the members of a club or college, of whom B is not one. B may know, by reason of a previous refusal, that he is a person with whom A is unwilling to contract: a dramatic critic who is refused a ticket for a theatre performance cannot conclude a contract by going to the box office in disguise, or by employing a friend to buy a ticket for him.[123]

The difficulty is to know in what circumstances such a term is to be *implied* into the offer. In *King's Norton Metal Co. Ltd.* v. *Edridge, Merrett & Co. Ltd.*,[124] the mistaken plaintiff was unable to satisfy the court that such an implication should be made. This decision does not appear to have been cited in the case of *Sowler* v. *Potter*:[125]

The defendant had, at an earlier date, been convicted in the name of Ann Robinson of allowing disorderly conduct in a cafe. She subsequently assumed the name of Ann Potter, and the plaintiff had granted her a lease of certain premises under that name. The plaintiff's agent gave evidence that, at the time that he entered into this contract, he knew of the record of Ann Robinson, and that he would have never granted the lease to the defendant had he known that Ann Potter and Ann Robinson were the same person. The plaintiff therefore contended that the lease was void for mistake and that the defendant was therefore a trespasser.

Pothier's test

Tucker J. upheld this contention. He relied on a passage from the work of the eighteenth-century French jurist, Pothier, which had been more than once cited with approval in English cases:[126]

Whenever the consideration of the person with whom I am willing to contract *enters as an element into the contract*[127] which I am willing to make, error in regard to the person

[122] *Ante*, p. 308.

[123] *Said* v. *Butt* [1920] 3 K.B. 497 (this case was primarily concerned with the question of an undisclosed principal and not with mistake).

[124] *Ante*, p. 313.

[125] [1940] 1 K.B. 271.

[126] Pothier, *Traité des Obligations*, P. I, c. 1, s. 1, Art. III, para. 1, as cited in *Smith* v. *Wheatcroft* (1878) 9 Ch. D. 223, *per* Fry J. at p. 230; *Gordon* v. *Street* [1899] 2 Q.B. 641, at p. 647; *Phillips* v. *Brooks* [1919] 2 K.B. 243, at p. 248; *Lake* v. *Simmons* [1927] A.C. 487, at p. 501; *Sowler* v. *Potter* [1940] 1 K.B. 271, at p. 274. See Smith and Thomas (1957) 20 M.L.R. 38. Contrast *Lewis* v. *Averay* [1972] 1 Q.B. 198, at p. 206.

[127] The French text reads: 'Toutes les fois que la considération de la personne avec qui je veux contracter, entre pour quelque chose dans le contrat que je veux faire, l'erreur sur la personne détruit mon consentement, et rend par conséquent la convention nulle'. *Example*: If, intending to have a picture painted by N., I make a contract to have this picture painted by J. whom I mistake for N., the contract is void for want of consent on my part, for I did not intend to have a picture painted by J. but by N. . . . The consideration of the person of N., and of his reputation, entered into the contract . . . 'Au contraire lorsque la considération de la personne avec qui je croyais contracter n'est entrée pour rien dans le contrat, et que j'aurais également voulu faire ce contrat avec quelque personne que ce fût, comme avec celui avec qui j'ai cru contracter, le contrat doit être valable.' *Example*: I buy from a bookseller an unbound book which he undertakes to deliver to me bound. Although the

destroys my consent and consequently annuls the contract . . . On the contrary, when the consideration of the person with whom I thought I was contracting does not enter at all into the contract, and I should have been equally willing to make the contract with any person whatever as with him with whom I thought I was contracting, the contract ought to stand.

'This case of landlord and tenant', said the learned judge, 'is clearly a case where the consideration of the person with whom the contract was made was a vital element in the contract, and that, therefore, if there was any mistake on the part of the plaintiff with regard to the identity of the person with whom she was contracting, the contract is void *ab initio*'. It is believed, however, that this statement of Pothier, even if it could be regarded as correct in requiring that the identity of the contracting party should be material to the contract, does not, as here translated, constitute a sound positive test of mistake in English law. The proper approach in such a case as *Somler* v. *Potter* would be to inquire whether a stipulation could be implied into the offer that the offer excluded Ann Robinson, and whether this stipulation was known to the offeree. The answer is clear: no such stipulation could possibly be implied, and the contract should not have been held to be void. The decision in this case has incurred almost unanimous disapproval, and must now be taken to have been overruled.[128]

(iv) Mistake in relation to a written document

Non est factum

We now deal with a class of mistake which is peculiar to the law of written contracts. This is due to the existence of the common law defence of *non est factum* which permits one who has signed a written document, which is essentially different from that which he intended to sign, to plead that, notwithstanding his signature, 'it is not his deed' in contemplation of law.[129] The term properly applies to a deed but is equally applicable to other written contracts.

The effect of a successful plea of *non est factum* is that the transaction contained in the document is not merely voidable against the person who procured its execution, but is entirely void into whosesoever hands the document may come.

It must, however, be emphasized that the defence of *non est factum* is a narrow one. Those too lazy or too busy to read through a document before signing it can-

bookseller, at the time of sale, supposes that he is contracting with Peter whom I resemble, and even calls me Peter without my disillusioning him, this error . . . does not avoid the contract, and he cannot refuse to deliver the book at the price agreed if it has appreciated in value since the sale. For, although he believed he was selling the book to Peter, nevertheless since it was a matter of indifference to him who purchased his goods, it was not precisely and personally to Peter that he intended to sell, but to any person who would pay him the price he asked—whoever he might be. And so it is correct to say that I was that person, that it was to me that he intended to sell the book, and to me that he must now deliver it.

It is submitted that this passage does not correctly represent the English law on the matter to which it relates. Unless the words 'entre pour quelque chose dans le contrat' can be taken to mean 'enters as a term into the contract', it is clear that the two systems approach the question of mistake as to the person from an entirely different standpoint.

[128] *Solle* v. *Butcher* [1950] 1 K.B. 671, at p. 691; *Gallie* v. *Lee* [1969] 2 Ch. 17, at pp. 33, 41, 45 aff'd [1971] A.C. 1004; *Lewis* v. *Averay* [1972] 1 Q.B. 198, at p. 206. Cf. *Gordon* v. *Street* [1899] 2 Q.B. 641.

not rely upon it. Neither can those who sign a document containing objectionable terms or terms the legal effect of which they are unaware. As Donovan L.J. explained in *Muskham Finance Ltd.* v. *Howard*:[130]

> Much confusion and uncertainty would result in the field of contract and elsewhere if a man were permitted to try to disown his signature simply by asserting that he did not understand that which he signed.

In *Blay* v. *Pollard & Morris*,[131] the defendant signed a document which he knew to relate to the dissolution of a partnership of which he was a member. Unknown to him, the document contained a term which had not been mentioned in a previous oral agreement, and which made him liable to indemnify his fellow partner in respect of certain partnership liabilities. It was held that he was bound by his signature.

The narrowness of *non est factum* is also explained by the fact that it can be invoked against third parties:

> Where a fraudster has tricked, first, the signer of the document, in order to induce the signature, and then some third party, who is induced to rely on the signed document, which of the two victims is the law to prefer. The authorities indicate that the answer is, almost invariably, the latter. The signer of the document has, by signing, enabled the fraud to be carried out, enabled the false document to go into circulation.[132]

Essentially different transaction

In order for the defence to succeed, the person executing the document must show that the transaction which the document purports to effect is essentially different in substance or in kind from the transaction intended. At one time it was thought that the plea of *non est factum* would not succeed if the mistake was as to the contents of a document, as opposed to its essential nature or character.[133] This distinction between contents and character is not an intelligible one,[134] for a document takes it character from its contents and in *Saunders* v. *Anglia Building Society*,[135] it was rejected by the House of Lords in favour of a more flexible test: that there must be a 'radical' or 'essential' or 'fundamental' or 'serious' or 'very substantial' difference between the document signed and that which the person signing intended to sign. If, for example, a person signs a guarantee for £10,000 believing it to be a guarantee of a lesser sum, it will depend on the amount of the lesser sum and the surrounding circumstances of the case whether or not the difference between the two transactions is sufficient to satisfy this test. The question is one of degree.

In *Saunders* v. *Anglia Building Society*,[136] the House of Lords held that the test had not been satisfied:

[129] *Scriptum predictum non est factum suum.* See *Thoroughgood's Case* (1582) 2 Co. Rep. 9a; Holdsworth, *H.E.L.* viii, p. 50; Simpson, *A History of the Common Law of Contract* (1975), 98.
[130] [1963] 1 Q.B. 904, at p. 914. [131] [1930] 1 K.B. 628.
[132] *Norwich and Peterborough B.S.* v. *Steed (No. 2)* [1993] Ch. 116 *per* Scott L.J., at p. 125.
[133] *Howatson* v. *Webb* [1907] 1 Ch. 537, affd., [1908] 1 Ch. 1.
[134] See Glanville Williams (1945) 61 L.Q.R., at p. 194; *Gallie* v. *Lee* [1969] 2 Ch. 17, at pp. 31, 41, 43; *Saunders* v. *Anglia Building Society* [1971] A.C. 1004, at pp. 1017, 1022, 1025, 1039.
[135] [1971] A.C. 1004, at pp. 1017, 1019, 1021, 1026, 1039.
[136] [1971] A.C. 1004.

The appellant, an elderly widow, gave the title deeds of her house to her nephew, intending to make a gift to him of the house in order that he could borrow money on the security of the property. It was a condition of the gift that he was to permit her to reside there for the rest of her life. She was subsequently requested by a friend of her nephew, whom she knew to be assisting him to obtain a loan, to sign a document. The friend told her that it was 'to do with the gift by deed to Wally (her nephew) for the house'. As she had broken her spectacles, she signed the document without reading it. The document was in fact a deed conveying the house on sale to the friend. The friend did not pay the appellant or her nephew, but subsequently mortgaged the house to the respondents.

The plea of *non est factum* failed. At first sight there might seem to be an essential difference between a gift of the house to the nephew and a sale of the house to his friend. But, as Russell L.J. pointed out in the Court of Appeal,[137] the appellant intended to transfer the house so that the transferee could raise money on it, and she knew that her nephew and his friend were engaged jointly on this project. The 'object of the exercise' might well have been achieved by means of a sale if the friend had been honest and paid the nephew. Although their Lordships were by no means unsympathetic to the appellant's situation,[138] they held that the document which she had executed was not of a fundamentally different nature from the document which she believed she was signing. The building society could therefore enforce the mortgage.

Examples of plea succeeding

We must now examine two cases in which the plea of *non est factum* was successful. The first is that of *Foster* v. *Mackinnon*:[139]

Mackinnon, 'a gentleman far advanced in years', was fraudulently induced to indorse a bill of exchange for £3,000 on the assurance that it was a guarantee of a similar nature to one which he had previously signed. Later the bill was indorsed for value to Foster, who took it in good faith.

It was held that the defence of *non est factum* was available to Mackinnon, as he never intended to make such a contract, and had been guilty of no negligence. 'It was', said Byles J.,[140] 'as if he had written his name . . . in a lady's album, or on an order for admission to the Temple Church, or in the fly-leaf of a book, and there had already been, without his knowledge, a bill of exchange . . . on the other side of the paper'.

The second is *Lewis* v. *Clay*:[141]

Lord William Nevill came to the defendant and asked him to witness some deeds for him. He produced a roll of papers covered by blotting paper, in which there were cut four openings, and explained that it was 'a private matter'. Believing that he was witnessing Lord Nevill's signature, the defendant signed in the spaces indicated. It turned out that the papers were promissory notes to the value of £11,000 made out in favour of the plaintiff who took them in good faith and for value.

The jury found that the defendant had signed in misplaced confidence, but without negligence; and Lord Russell C.J. held that he was not liable because 'his mind

[137] *Gallie* v. *Lee* [1969] 2 Ch. 17, at pp. 40–1.
[138] The building society, in fact, undertook not to evict the appellant during her lifetime.
[139] (1869) L.R. 4 C.P. 704. [140] At p. 712. [141] (1898) 67 L.J.Q.B. 224.

never went with the transaction', but was 'fraudulently directed into another channel by the statement that he was merely witnessing a deed or other document'.

Effect of negligence of party signing

In neither of these cases had the party deceived contributed to his deception by his own negligence. The question was, therefore, strictly left open whether the plea of *non est factum* would avail one who is in fact deceived as to the nature of the document which he signs, but who is negligent in not informing himself of it. Certainly it might be thought reasonable that if one of two innocent parties is to suffer for the fraud of a third, the sufferer should be the one whose negligence has contributed to the loss suffered.

In *Saunders* v. *Anglia Building Society*[142] this view prevailed and it was held that, even if the document signed is essentially different from that which the person signing it intended to sign, as against a third party[143] he will not be entitled to disown his signature unless he proves[144] that he exercised reasonable care. What is reasonable care will depend on the circumstances of the case and the nature of the document being signed.

As a normal rule, therefore, if a person of full understanding and capacity forbears, or carelessly omits, to read what he signs, the defence of *non est factum* will not be available.[145] However, as Lord Wilberforce pointed out in *Saunders*' case:[146]

> There still remains a residue of difficult cases. There are still illiterate or senile persons who cannot read, or apprehend, a legal document; there are still persons who may be tricked into putting their signature on a piece of paper which has legal consequences different from anything they intended . . . Accepting all that has been said by learned judges as to the necessity of confining the plea within narrow limits, to eliminate it altogether would, in my opinion, deprive the courts of what may be, doubtless on sufficiently rare occasions, an instrument of justice.

Documents signed in blank

Where a person signs a document in blank, leaving it to another to fill in the terms of the contract in accordance with an oral agreement reached between them, it would seem that he could in theory rely on the defence of *non est factum* if the terms inserted render the transaction essentially different in substance or in kind from the transaction intended. However, unless there are exceptional circumstances present, a person who signs a document in blank accepts responsibility for

[142] [1971] A.C. 1004, at pp. 1019, 1023, 1027, 1037–8. *Carlisle and Cumberland Banking Co.* v. *Bragg* [1911] 1 K.B. 489, criticized by Anson (1912) 28 L.Q.R. 190; Guest (1963) 79 L.Q.R. 346, was overruled.

[143] Cf. *Petelin* v. *Cullen* (1975) 132 C.L.R. 355, at p. 360 (Australia) for the view that where no third party is involved, negligence is irrelevant. See also *Bradley West Solicitors Nominee Co. Ltd.* v. *Keenan* [1994] 2 N.Z.L.R. 111, at p. 118. But cf. *Lloyds Bank plc* v. *Waterhouse* (1991) 10 Tr. L.R. 161, at pp. 185, 191 for the suggestion that in two party cases remedies for fraud, misrepresentation, or unilateral mistake should be used rather than *non est factum*.

[144] The burden of proof lies on the person wishing to establish the defence of *non est factum*: [1971] A.C. at pp. 1016, 1019, 1027, 1038; *Crédit Lyonnais* v. *P.T. Barnard & Associates Ltd.* [1976] 1 W.L.R. 557; *Norwich and Peterborough B.S.* v. *Steed (No. 2)* [1993] Ch. 116.

[145] Cf. Stone (1972) 88 L.Q.R. 190; Spencer [1973] C.L.J. 104.

[146] [1971] A.C. 1004, at p. 1025. See also *Petelin* v. *Cullen* (1975) 132 C.L.R. 355 (Australia); *Lloyds Bank plc* v. *Waterhouse* (1991) 10 Tr. L.R. 161.

it; and he takes the risk if, through fraud or error, the document is filled in in some different way.[147] He cannot therefore avoid his liability as against an innocent third party.

II. Mistake in Equity

Equitable mistake

THE effect of a mistake at common law, if it operates at all, is to render the contract void *ab initio*; but, as we have already seen in the case of innocent misrepresentation, equity may be prepared to grant relief where the common law refuses to intervene. One reason for a less restrictive approach is that equity acts *in personam* so that innocent third parties who have given value are protected. In the case of mistake three equitable remedies are relevant:

(1) specific performance, which may be refused where there has been a mistake;
(2) rectification of a written contract;
(3) rescission of the contract.

In no case, however, does equitable relief take the form of a decree that the contract is a nullity from the beginning; at the most, the contract is voidable, and not void.

The equitable remedies in respect of contracts are only one aspect of a much wider equitable jurisdiction to relieve from the consequences of mistake, a jurisdiction which extends to gifts and is less concerned with the nature of the mistake.[148] This, coupled with the fact that the jurisdiction has developed primarily by reference to the remedy sought, has meant that attention has not always been paid to the allocation of risks in the contract or the need to prevent a party pleading mistake to get out of a contract that has turned out to be a bad bargain.

Before turning to the equitable remedies something must be said about their relationship with the doctrine of mistake at common law.

(a) Equity and Common Law[149]

Relationship of equitable & common law mistake before the Judicature Act

Before the Judicature Act 1873, common law and equity were administered in separate jurisdictions. If a plaintiff applied to the Court of Chancery for equitable relief on the ground of contractual mistake, the Court had its own remedies and followed its own principles in granting or refusing relief.[150] It did not first have

[147] *United Dominions Trust Ltd.* v. *Western* [1976] Q.B. 513. Cf. *Mercantile Credit Co. Ltd.* v. *Hamblin* [1965] 2 Q.B. 242. See Allcock (1982) 45 M.L.R. 18.

[148] Consequently it seems that a mistake of law will sometimes be effective: *Stone* v. *Godfrey* (1854) 5 De G.M. & G. 76 at p. 90; *Rogers* v. *Ingham* (1876) 3 Ch.D. 351, at p. 357; *Allcard* v. *Walker* [1896] 2 Ch. 369, at p. 381; *Re Diplock* [1948] Ch. 465, affirmed *sub. nom. Ministry of Health* v. *Simpson* [1951] A.C. 251; *Whiteside* v. *Whiteside* [1950] Ch. 65, at p. 74; *Gibbon* v. *Mitchell* [1990] 1 W.L.R. 1304, at p. 1309.

[149] See Grunfeld (1952) 15 M.L.R. 297.

[150] See, for example, *Wood* v. *Scarth* (1855) 2 K. & J. 33 (equity); (1858) 1 F. & F. 293 (law).

to inquire whether or not the contract was void at common law and it is therefore misleading to suggest, as does Denning L.J. in *Solle* v. *Butcher*,[151] first, that the intervention of equity *presupposed* that the contract was good at law, or secondly (and somewhat inconsistently) that if the contract was void at law, equity would automatically have had to follow the law. The truth is that the Court of Chancery did not trouble itself about the position at law, unless, of course, there had been actual judgment. Even where a contract might have been void at common law,[152] the Court of Chancery decided the case on equitable principles alone.

Relationship since 1875

Since 1875 the rules of common law and equity have been applied in all divisions of the High Court of Justice, and the particular rule to be applied in the case of contractual mistake has depended upon the nature of the relief demanded. In *Cundy* v. *Lindsay*,[153] for example, the case was decided according to common law principles because the plaintiff pleaded that the contract was void. In *Paget* v. *Marshall*,[154] on the other hand, the plaintiff's claim to have the contract rescinded or rectified meant that the case was to be determined according to equitable rules. Until *Solle* v. *Butcher* there had been no real consideration of their relationship one with the other.

In that case, however, Denning L.J. put forward the opinion that equity has somehow superseded the common law where contractual mistake is concerned.[155] For instance, he considered that *Smith* v. *Hughes*[156] and *Cundy* v. *Lindsay*[157] would nowadays be cases where the contract would be voidable and not void. The authority for this view would presumably be that provision in the Judicature Act 1873,[158] which lays down that where there is any conflict or variance between the rules of equity and common law with reference to the same matter, the rules of equity are to prevail. It is doubtful, however, whether this is a proper case for the application of this provision. The better view[159] is that the Court must first consider, if so pleaded, the question of common law mistake. If the contract is pronounced void, as it would be on the facts of *Cundy* v. *Lindsay*, no question of equitable relief will arise. If, on the other hand, the contract is not void, the Court may then proceed to consider the possibility of any further relief in equity which may have been asked for by the parties. The mere fact that the contract is good at common law does not preclude rescission in equity on similar grounds[160] or other equitable relief.

[151] [1950] 1 K.B. 671, at pp. 692, 694.

[152] See, for example, *Cooper* v. *Phibbs* (1867) L.R. 2 H.L. 149, *ante*, p. 302, n. 41 (mistake as to title) and *Webster* v. *Cecil* (1861) 30 Beav. 62, *post*, p. 324 and *Garrard* v. *Frankel* (1862) 30 Beav. 445, *ante*, pp. 310–13 (snapping up).

[153] *Ante*, p. 312.

[154] (1884) 28 Ch. D. 255.

[155] [1950] 1 K.B. 671, at p. 693, *ante*, p. 303, *post*, p. 328. See also *Magee* v. *Pennine Insurance Co. Ltd.* [1969] 2 Q.B. 507, at p. 514. Elsewhere he seems to conceive of the role of equity as merely supplementary.

[156] *Ante*, p. 310.

[157] *Ante*, p. 312.

[158] s. 25(11), now the Supreme Court Act 1981, s. 49.

[159] *Grist* v. *Bailey* [1967] Ch. 532; *Associated Japanese Bank (International) Ltd.* v. *Crédit du Nord S.A.* [1989] 1 W.L.R. 255, at p. 270; *William Sindall plc* v. *Cambridgeshire C.C.* [1994] 1 W.L.R. 1016, at p. 1039.

[160] *Munro (Robert A.) & Co. Ltd.* v. *Meyer* [1930] 2 K.B. 312, at pp. 333–5; *Frederick E. Rose (London) Ltd.* v. *William H. Pim Jnr. & Co. Ltd.* [1953] 2 Q.B. 450, at p. 460; *Oscar Chess Ltd.* v. *Williams* [1957] 1 W.L.R. 370, at p. 373.

(b) Refusal of Specific Performance

Refusal of specific performance

In the case of breaches of contracts for the sale or transfer of property, the common law remedy is damages but equity would compel the transfer of the property involved by means of an order for specific performance. If, however, one of the parties contracted under a mistake which would render it inequitable for the other to enforce the contract, this would afford a good defence to an action for specific performance of the contract. In *Webster* v. *Cecil*:[161]

> The defendant offered to sell the plaintiff several plots of land. Immediately after he had despatched the offer he discovered that, by a mistake in adding up the prices of the plots, he had offered his land for sale at £1,250 instead of the £2,250 which he had intended. He informed the plaintiff of the mistake without delay, but not before the plaintiff had accepted the offer. The plaintiff must have been taken to have known of the mistake as the defendant had previously refused an offer of £2,000. The plaintiff now sought specific performance of the contract.

This was refused. The plaintiff was left to such action at law as might be available.[162]

Specific performance is a discretionary remedy[163] and the Court will not order it where it would cause undue hardship in the circumstances of the case. Mistake of a type which is insufficient to render the contract void at law may thus be a ground for resisting specific performance, as it would be harsh to enforce performance of a contract against one who has entered into it under a mistake. In *Malins* v. *Freeman*[164] where a purchaser bid for and bought one lot of land at an auction in the belief that he was buying a wholly different lot, the Court refused to order specific performance of the contract. The defendant's mistake was due to his own carelessness and to no fault of the plaintiff, but the Court was prepared to exercise its discretion in his favour, leaving the plaintiff to claim damages at law. On the other hand, in *Tamplin* v. *James*,[165] the defendant bid for and bought an inn and outbuildings in the mistaken belief that the lot also included two pieces of garden attached thereto. There was little excuse for this misapprehension as the plans of the property to be sold were exhibited at the sale. The Court made an order for specific performance of the agreement.

(c) Rectification of Written Contracts

Rectification: (i) mutual mistake

Where a contract has been reduced to writing, or a deed executed, and the writing or deed, owing to mutual mistake, fails to express the concurrent intentions of the parties at the time of its execution, the Court will rectify the document in accordance with their true intent.

[161] (1861) 30 Beav. 62. See also *Wood* v. *Scarth* (1855) 2 K. & J. 33.
[162] In fact there would be no action for the contract would be void: see *Hartog* v. *Colin and Shields* [1939] 3 All E.R. 566; *ante*, p. 310.
[163] See *post*, p. 597 ff.
[164] (1837) 2 Keen 25. See also *Baskcomb* v. *Beckwith* (1869) L.R. 8 Eq. 100; *Denny* v. *Hancock* (1870) L.R. 6 Ch. App. 1; *Burrow* v. *Scammell* (1881) 19 Ch. D. 175, at p. 182.
[165] (1880) 15 Ch.D. 215.

In *Craddock Brothers* v. *Hunt*,[166] for example:

A vendor agreed orally to sell to a purchaser a certain piece of property. By a mistake, the written contract embodying this agreement included an adjoining yard which the parties had excluded from the sale and the subsequent conveyance actually conveyed this land to the purchaser.

The Court ordered that the conveyance should be rectified to bring it into line with the parties' oral agreement.

Requirements:

Before the remedy of rectification is made available certain conditions must be satisfied.

(a) full and final agreement

In the first place, the document which it is sought to rectify must fail to express the common intentions and common outward accord of the parties. Such accord cannot be shown where there is confusion as to what has been agreed[167] or where a matter is omitted from a document as a result of forgetfulness; an absence of intention does not suffice.[168] The accord does not, however, as some cases suggested, have to amount to a complete concluded contract.[169] It is now clearly established that there is jurisdiction to rectify where the parties have made a mistake in their attempt to embody in the document their concurrent intentions existing at the time it was put into writing or executed.[170] A concluded contract need not be shown.

(b) clear evidence of mistake

Secondly, the party seeking to have a document rectified must adduce convincing evidence that its terms do not accurately record the common intention of the parties at the time.[171] Unless the court is sure of the mistake and of the existence of a prior agreement, '[c]ertainty and ready enforceability would be hindered by constant attempts to cloud the issue by reference to pre-contractual negotiations'.[172] Parol evidence is, however, admissible even where the contract is one which is required to be in writing.[173]

(c) continuing intention

Thirdly, the intention of the parties as expressed in the prior accord must have continued unchanged up to the time of the execution of the written instrument.[174]

(d) literal disparity

Fourthly, rescission is not an appropriate remedy where the mistake relates to the transaction itself rather than to the document which purports to record it. Accordingly, there must be a literal disparity between the terms of the agreement

[166] [1923] 2 Ch. 136. See also *U.S.A.* v. *Motor Trucks, Ltd.* [1924] A.C. 196, at p. 200.
[167] *Cambro Contractors Ltd.* v. *John Kennelly Sales Ltd.*, *The Times*, 14 April 1994 (C.A.).
[168] *Olympia Sanna Shipping Co. S.A.* v. *Shinwa Kaiun Kaisha* [1985] 2 Lloyd's Rep. 364, at p. 370; *Kemp* v. *Neptune Concrete* (1989) 57 P & C.R. 369, at pp. 377, 379–80.
[169] *Mackenzie* v. *Coulson* (1869) L.R. 8 Eq. 368, at p. 375; *Faraday* v. *Tamworth Union* (1916) 86 L.J. Ch. 436, at p. 438; *Higgins (W.) Ltd.* v. *Northampton Cpn.* [1927] 1 Ch. 128, at p. 136; *U.S.A.* v. *Motor Trucks, Ltd.* [1924] A.C. 196, at p. 200.
[170] *Shipley U.D.C.* v. *Bradford Cpn.* [1936] Ch. 375; *Crane* v. *Hegemann-Harris Co., Inc.* [1939] 1 All E.R. 662, aff'd [1939] 4 All E.R. 68; *Joscelyne* v. *Nissen* [1970] 2 Q.B. 86. See also Bromley (1971) 87 L.Q.R. 532.
[171] *Joscelyne* v. *Nissen* (*supra*, n. 170), at p. 98.
[172] *Ets George et Paul Levy* v. *Adderley Nav. Co. Panama S.A.* [1980] 2 Lloyd's Rep. 67, at p. 73. See also *Thomas Bates & Son* v. *Wyndhams Ltd.* [1981] 1 W.L.R. 505. Cf. *Atlantic Marine Transport Corp.* v. *Coscol Petroleum Corp.* [1991] 1 Lloyd's Rep. 246, at p. 250.
[173] *Craddock Bros.* v. *Hunt* [1923] 2 Ch 136; *U.S.A.* v. *Motor Trucks Ltd.* [1924] A.C. 196.
[174] *Fowler* v. *Fowler* (1859) 4 De G. & J. 250.

and the document. Proof of an inner misapprehension is insufficient. In *Frederick E. Rose (London) Ltd.* v. *William H. Pim Jnr. & Co. Ltd.*:[175]

> The plaintiffs received from their Middle East associates an order for up to five hundred tons of 'Moroccan horsebeans described here as feveroles'. The plaintiffs did not know what feveroles were, and asked the defendants. The defendants replied that they were simply horsebeans, and so the plaintiffs orally contracted to buy from the defendants a quantity of horsebeans to meet this order. A subsequent written agreement embodied the same terms. In fact, however, feveroles were quite another type of bean, and the plaintiffs claimed to have the written agreement rectified to read 'feveroles', intending to claim damages on the agreement if so rectified.

The Court of Appeal refused rectification. Both the oral and the written contracts were for horsebeans. There was no literal disparity between them. The only mistake was in the minds of the parties at the time. As Denning L.J. put it:[176]

> Rectification is concerned with contracts and documents, not with intentions. In order to get rectification it is necessary to show that the parties were in complete agreement on the terms of their contract, but by an error wrote them down wrongly; and in this regard, in order to ascertain the terms of their contract, you do not look into the inner minds of the parties—into their intentions—any more than you do in the formation of any other contract.

It has, however, been held that, where the parties have expressly agreed what is the meaning of particular words used in a written contract, the contract can be rectified to make it clear that the words bear the meaning agreed.[177]

(ii) Unilateral mistake

The remedy of rectification was originally granted only in cases of mutual mistake, to correct the erroneous expression of the common intentions of *both* parties. But it has been extended to cases of unilateral mistake, where, due to a mistake of one party alone, the document fails to reflect that party's intentions at the time of its execution.[178] If, however, the mistake is unilateral, the knowledge or conduct of the party who was not mistaken must be such as to make it inequitable for that party to object to rectification. The Court will not order rectification unless three conditions are satisfied.[179] First, the other party must have actual knowledge of the mistaken party's intentions and of the mistake.[180] In this context the knowledge of an agent will not suffice[181] but a party who has wilfully shut its eyes to the obvious or wilfully and recklessly failed to make such inquiries as an honest and reasonable person would have made will be taken to have actual

[175] [1953] 2 Q.B. 450. See also *Agip s.p.A.* v. *Nav. Alta Italia s.p.A.* [1984] 1 Lloyd's Rep. 353, at p. 359; *Ets George et Paul Levy* v. *Adderley Nav. Co. Panama S.A.* [1980] 1 Lloyd's Rep. 67, at p. 72.
[176] At p. 461.
[177] *London Weekend Television Ltd.* v. *Paris & Griffith* (1969) 113 S.J. 222; *Joscelyne* v. *Nissen* [1970] 2 Q.B. 86, at p. 98; *Re Butlin's Settlement* [1976] Ch. 251; *Partenreederei M.S. Karen Oltmann* v. *Scarsdale Shipping Co. Ltd.* [1976] 2 Lloyd's Rep. 708.
[178] *Roberts & Co. Ltd.* v. *Leicestershire C.C.* [1961] Ch. 555; *Riverlate Properties Ltd.* v. *Paul* [1975] Ch. 133, at p. 140; *Thomas Bates & Son Ltd.* v. *Wyndham's (Lingerie) Ltd.* [1981] 1 W.L.R. 505.
[179] *Thomas Bates and Son Ltd.* v. *Wyndham's (Lingerie) Ltd.* (*supra*, n. 178), at pp. 515–16, 520–1.
[180] *Riverlate Properties Ltd.* v. *Paul* (*supra*, n. 178), at p. 140.
[181] *Kemp* v. *Neptune Concrete* (1989) 57 P. & C.R. 369.

knowledge.[182] Secondly, the party not under a mistake must have failed to draw the mistaken party's attention to the mistake; thirdly, the mistake must be such that the party not under a mistake would derive a benefit,[183] or the mistaken party would suffer a detriment,[184] if the inaccuracy in the document were to remain uncorrected. Previously there was some authority for the view that the conduct of the party who was not mistaken had to amount to fraud,[185] or at least involve a degree of sharp practice on his part;[186] but this is no longer required.[187] Nevertheless, it is clear that if a party executes a document in ignorance that the other party is under a mistake, the remedy of rectification will be denied.[188]

(d) Rescission[189]

Rescission

We have already seen that a party to a contract may obtain the right to rescind the contract where he has been induced to enter into it by a material misrepresentation,[190] or by fraud, whether actual or constructive,[191] or by non-disclosure of a material fact where the transaction is one which is *uberrimae fidei*.[192]

(i) Mutual mistake

Rescission is also available in certain circumstances where both parties have contracted under a *mutual* mistake. Thus in *Laurence* v. *Lexcourt Holdings, Ltd.*,[193] tenants of office premises obtained an order that the lease of the premises to them should be rescinded on the ground that, at the time of the letting, both parties to the lease had assumed that there was planning permission for the whole of the premises to be used as offices, whereas the permission related to part only of the premises.

Earlier authority for the proposition that a contract may be rescinded for mutual mistake is provided by *Huddersfield Banking Co., Ltd.* v. *Henry Lister & Son, Ltd.*:[194]

A company went into liquidation. In the company's factory were 33 looms. If these were attached to the realty, they would be fixtures and belong to the plaintiff bank as mortgagees; if not, they would pass to the Official Receiver and be sold for the benefit of the company's creditors. Representatives of the bank and the Receiver inspected the factory and found that they were not attached. In reliance upon this assumption, the bank concurred in a consent order for their sale. It later appeared that the looms had been wrongfully loosened. The bank successfully sought to have the consent order set aside.

[182] *Commission for the New Towns* v. *Cooper (G.B.) Ltd.* [1995] Ch. 259.
[183] *Ibid.*, at p. 516.
[184] *Ibid.*, at p. 521.
[185] *May* v. *Platt* [1900] 1 Ch. 616, at p. 623.
[186] *Riverlate Properties Ltd.* v. *Paul* (*supra*, n. 178), at p. 140.
[187] *Thomas Bates and Son Ltd.* v. *Wyndham's (Lingerie) Ltd.* (*supra*, n. 178).
[188] *Riverlate Properties Ltd.* v. *Paul* (*supra*, n. 178); *Agip s.p.A* v. *Nav. Alta Italia s.p.A.* [1984] 1 Lloyd's Rep. 353, at p. 362.
[189] On loss of the right to rescind, see *ante*, pp. 249–51.
[190] *Ante*, p. 248.
[191] *Ante*, pp. 239, 261.
[192] *Ante*, p. 258.
[193] [1978] 1 W.L.R. 1128, following *Solle* v. *Butcher* [1950] 1 K.B. 671, *post*, p. 328 but cf. *William Sindall plc* v. *Cambridgeshire C.C.* [1994] 1 W.L.R. 1016, at p. 1035.
[194] [1895] 2 Ch. 273. See also *Wilding* v. *Sanderson* [1897] 2 Ch. 534.

Kay L.J. said:[195]

It seems to me that, both on principle and on authority, when once the Court finds that an agreement has been come to between parties who were under a common mistake of a material fact, the Court may set it aside, and the Court has ample jurisdiction to set aside the order founded upon that agreement.

Similarly in *Allcard* v. *Walker*,[196] an order consenting to the variation of a post-nuptial marriage settlement was rescinded, the parties having erroneously assumed the settlement to be valid.

Solle v. *Butcher*

In *Solle* v. *Butcher*,[197] the facts of which have been previously noted[198] these and other cases[199] were used as the basis of a new and general doctrine of mistake in equity. In that case the parties contracted under a mutual mistake of fact that a flat leased to the plaintiff was a 'new' dwelling-house for the purpose of the Rent Restriction Acts and so could be let at a rent of £250 per year instead of the £140 which might lawfully be demanded. To an action by the plaintiff to recover the rent overpaid, the defendant pleaded that the lease should be rescinded on the ground of mistake. The Court ordered the rescission of the lease but on the terms (*inter alia*) that the plaintiff should be permitted to elect whether to accept the rescission or to claim a new lease at the full agreed rent of £250 per year. The judgment of Denning L.J. contains a statement of the circumstances in which the Court will intervene:[200]

Let me next consider mistakes which render a contract voidable, that is, liable to be set aside on some equitable ground. Whilst presupposing that a contract was good at law, or at any rate not void, the court of equity would often relieve a party from the consequence of his own mistake, so long as it could do so without injustice to third parties. The court, it was said, had power to set aside the contract whenever it was of opinion that it was unconscientious for the other party to avail himself of the legal advantage which he had obtained: *Torrance* v. *Bolton per* James L.J.[201]

The court had, of course, to define what is considered to be unconscientious, but in this respect equity has shown a progressive development. It is now clear that a contract will be set aside if the mistake of the one party has been induced by a material misrepresentation of the other, even though it was not fraudulent or fundamental; or if one party, knowing that the other is mistaken about the terms of an offer, or the identity of the person by whom it is made, lets him remain under his delusion and concludes a contract on the mistaken terms instead of pointing out the mistake . . .

A contract is also liable in equity to be set aside if the parties were under a common misapprehension either as to facts or as to their relative and respective rights, provided that the misapprehension was fundamental, and that the party seeking to set it aside was not himself at fault.

[195] At p. 284. See also Vaughan Williams J. at p. 276. Cf. Lindley L.J. at p. 281.
[196] [1896] 2 Ch. D. 369.
[197] [1950] 1 K.B. 671, followed in *Grist* v. *Bailey* [1967] Ch. 532; *Laurence* v. *Lexcourt Holdings Ltd.* [1978] 1 W.L.R. 1128. Contrast *Svanosio* v. *McNamara* (1956) 96 C.L.R. 186 (Australia); Slade (1954) 70 L.Q.R. 385, at p. 407; Shatwell (1955) 33 Can. Bar Rev. 164; Atiyah and Bennion (1961) 24 M.L.R. 421, at p. 439; Cartwright (1987) 103 L.Q.R. 594.
[198] *Ante*, p. 503. [199] *Post*, pp. 330, 331. [200] At p. 692.
[201] (1872) L.R. 8 Ch. App. 118, at p. 124, *post*, p. 331.

In cases of mutual mistake Denning L.J. stated that three requirements must be satisfied before the Court will grant relief.

(i) fundamental mistake

In the first place, one or both of the parties must have contracted under a mistake. If the mistake is mutual, then in some sense it must be 'fundamental' or 'material' before the Court will intervene. If it is unilateral, then we have seen that it need not be 'fundamental' but it must either have been induced by a misrepresentation or have been known to the other party when he concluded the contract.[202] Despite this requirement of 'fundamentality', the fact that the contract in *Solle* v. *Butcher* was rescinded shows that the category of operative mutual mistake is broader in equity than at common law. Rescission has also been ordered where there is a mistake as to the value of the subject matter of the contract.[203] The difference is also shown by *Magee* v. *Pennine Insurance Co. Ltd.*,[204] where the contrast with the common law position as laid down in *Bell* v. *Lever Brothers Ltd.* is highlighted by the similarity of the fact situation. Both concerned a contract made under a mistake as to the status of an earlier contract. In *Magee*'s case the later contract was a compromise of a claim made under the earlier contract, an insurance policy, which in fact was voidable for misrepresentation. The contract of compromise was set aside, Winn L.J. dissenting on the ground that the case was indistinguishable from *Bell* v. *Lever Brothers Ltd.*[205]

(ii) inequitable to rely on contract

Secondly, the circumstances of the case must be such that it would be inequitable for the party seeking to uphold the contract to rely on his strict rights at common law. Here, however, and unlike the case of unilateral mistake, the inequity does not appear to flow from the defendant's conduct.

(iii) No fault

Thirdly, the party seeking to set the contract aside must not himself have been at fault.[206] There must be some degree of blameworthiness beyond the mere fault of making a mistake but there has been little guidance as to how much. *Solle* v. *Butcher* is consistent with a concept of relative fault since although the defendant, the lessor, was seeking to have the lease rescinded, it was the plaintiff, the lessee, but also the defendant's agent for letting, who formed the opinion that the flat was not rent-controlled and advised the defendant accordingly.[207] As between the two parties it seems that the defendant was less responsible for the mistake.[208] *Grist* v. *Bailey*,[209] however, suggests that there must be some personal fault to preclude the rescission of the contract.

[202] *Ante*, p. 326.

[203] *Grist* v. *Bailey* [1967] Ch. 532, at p. 541, *post*, p. 330.

[204] [1969] 2 Q.B. 507. See also *William Sindall plc.* v. *Cambridgeshire C.C.* [1994] 1W.L.R. 1016, at p. 1042; *Associated Japanese Bank (International) Ltd.* v. *Crédit du Nord S.A.* [1989] 1 W.L.R. 255, at p. 270.

[205] There is doubt as to the ground of the decision. Lord Denning M.R. held the compromise was valid at law but voidable in equity. Fenton Atkinson L.J. agreed with Lord Denning but also (at p. 517) appeared to apply the proposition, based on *Bell* v. *Lever Brothers Ltd.*, that a contract is void when consensus is reached on a particular assumption which is not true.

[206] See *Grist* v. *Bailey* [1967] Ch. 532, at p. 542; *Lawrence* v. *Lexcourt Holdings Ltd.* [1978] 1 W.L.R. 1128, at pp. 1137–8 (no fault present).

[207] [1950] 1 K.B. 671, at pp 684, 694. See also *Laurence* v. *Lexcourt Holdings Ltd.* (*supra*, n. 206) (defendant's omission to make usual searches and inquiries of local authority did not bring about plaintiff's mistake and was not fault).

[208] Denning L.J. considered that the lease was induced by an innocent misrepresentation by the plaintiff (at p. 695) but did not decide the case on this ground.

[209] [1967] Ch. 532.

The defendant contracted to sell to the plaintiff a freehold house for £850, 'subject to the existing tenancy thereof'. The value of the house with vacant possession was £2,250. Both parties believed the house was occupied by a protected tenant but this was not the case. The person in possession had only a doubtful claim to be a protected tenant and subsequently left the house without making a claim.

It was held that the defendant was not at fault since, although a vendor should generally know who her tenants are, this was a case of a long-standing and informal tenancy. Rescission was ordered on the condition that the defendant entered into a new contract at the proper vacant possession price.[210]

The combination of a concept of inequity which does not depend on a party's conduct at the time of contracting and a narrow approach to fault means that the scope of equitable relief is potentially very wide and difficult to operate in a principled way. The approach of the Courts to rescission, in cases such as *Grist* v. *Bailey* and *Laurence* v. *Lexcourt Holdings Ltd.*,[211] is also open to the criticism that insufficient attention was paid to the question of contractual allocation of risk.[212] It is arguable that, as in the case of common law, an express or implied allocation of a particular risk should generally preclude the rescission of the contract for mistake.

Setting aside on terms

Rescission is a discretionary remedy, and, in the exercise of its discretion, the Court has power in equity to attach to the rescission such terms as justice may require in order to effect a *restitutio in integrum*. This was done in *Cooper* v. *Phibbs*,[213] a case in which the House of Lords set aside a contract on the ground of a mistake shared by both parties:

The appellant agreed with the respondents to take a lease of a salmon fishery which both parties believed to be the property of the respondents. It was later discovered that the fishery belonged to the appellant as tenant in tail. He filed a petition asking for cancellation of the agreement and for such further relief as 'the nature of the case might admit of, and as to the Court might seem fit'.

Lord Westbury said:[214]

If parties contract under a mutual mistake and misapprehension as to their relative and respective rights, the result is, that that agreement is liable to be set aside as having proceeded upon a common mistake.

But in granting rescission of the contract, the House of Lords ordered that the respondents should have a lien on the fishery for the money which they had spent on improving the property in the belief that it was theirs. Without this lien the appellants would have been unjustly enriched by the respondents mistaken expenditure.[215]

[210] At p. 543.

[211] [1978] 1 W.L.R. 1128, *ante*, p. 298.

[212] *William Sindall plc.* v. *Cambridgeshire C.C.* [1994] 1 W.L.R. 1016, *per* Hoffmann L.J. at p. 1035. See also *Associated Japanese Bank (International) Ltd.* v. *Crédit du Nord S.A.*: [1989] 1 W.L.R. 255.

[213] (1867) L.R. 2 H.L. 149. See also *Bingham* v. *Bingham* (1748) 1 Ves. Sen. 126; *Beauchamp (Earl)* v. *Winn* (1873) L.R. 6 H.L. 223.

[214] At p. 170; he dismissed any misrepresentation as immaterial.

[215] Cf. *Magee* v. *Pennine Insurance Co. Ltd.* [1969] 2 Q.B. 507, *ante*, p. 305, where no terms were imposed on the rescission of the compromise agreement even though this left the insurance company

In *Cooper* v. *Phibbs* the terms had the effect of unwinding the contract and restoring the *status quo ante* but this is not always the effect of such terms. Thus, in *Solle* v. *Butcher*, the defendant was permitted to rescind but the plaintiff was given the option of accepting this or claiming a new lease at the higher rent. The effect of this option, if taken up, would be to give effect to the expectation of the parties at the time of the original lease: there was no subversion of the bargain they thought they had made. On the other hand, in *Grist* v. *Bailey* the terms, which gave the purchaser the option of a new contract at the vacant possession price, may, as we have noted, have operated to reverse the risks of the original contract.

Unilateral mistake

Where the mistake is *unilateral*, that is to say, where only the party seeking to have the contract set aside was under a mistake, there is some doubt as to the circumstances in which rescission may be granted. On one view, there must be fraud or misrepresentation on the part of the other party before the equitable remedy is available.[216] On another, somewhat wider, view, which, as we have seen, formed the basis of the decision in *Solle* v. *Butcher*,[217] it is sufficient if the other party is guilty of some conduct which would render it inequitable to insist that the contract be performed. In *Torrance* v. *Bolton*:[218]

> Property was put up for sale by auction, having been advertised as an 'absolute freehold reversion'. But the conditions of sale, which were read out by the auctioneer, disclosed that it was encumbered by three mortgages. The plaintiff, who was deaf, did not hear this announcement, and bid on the assumption that he was buying something more substantial than a mere equity of redemption. The property was knocked down to him.

The agreement was set aside. The misleading advertisement cast upon the seller the duty of showing that the plaintiff had not been misled, and it was clear from the plaintiff's conduct that he did not know what he was buying. James L.J. pointed out that fraud was not the only ground upon which a contract might be set aside; rescission was available in any case 'in which the Court is of the opinion that it is unconscientious for a person to avail himself of the legal advantage which he has obtained'.[219]

The importance of the requirement of unconscionability is shown by *Riverlate Properties Ltd.* v. *Paul*.[220] The Court of Appeal held that there was no power to grant equitable relief on the grounds of mere unilateral mistake unless the party against whom relief is sought was aware, at the time of the transaction, that the other party was contracting under a mistake. Russell L.J. stated:[221]

> If a man may be said to be fortunate in obtaining a property at a bargain price, or on terms that make it a good bargain, because the other party unknown to him has made a miscalculation or other mistake, some high-minded men might consider it appropriate that he

with 3 years' premiums in respect of a policy for which they were not at risk. *Quaere* whether the premiums would have been recoverable as money paid for a consideration which had totally failed, *post*., p. 605. Cf. Fletcher [1969] C.L.J. 181, at 182.

[216] *May* v. *Platt* [1900] 1 Ch. 616, *per* Farwell J. at p. 623; *London Borough of Redbridge* v. *Robinson Rentals* (1969) 211 E.G. 1125; *Riverlate Properties Ltd.* v. *Paul* [1975] Ch. 133.
[217] [1950] 1 K.B. 671, *ante*, p. 328. [218] (1872) L.R. Ch. App. 118. [219] At p. 124.
[220] [1975] Ch. 133. See also *Taylor* v. *Johnson* (1983) 151 C.L.R. 422 (High Court of Australia).
[221] At p. 141. See also *William Sindall plc* v. *Cambridgeshire C.C.* [1994] 1 W.L.R. 1016, at p. 1035.

should agree to a fresh bargain to cure the miscalculation or mistake, abandoning his good fortune. But if equity were to enforce the views of those high-minded men, we have no doubt that it would run counter to the attitudes of much the greater part of ordinary mankind (not least the world of commerce), and would be venturing on the field of moral philosophy.

Rectification or rescission in unilateral mistake?

In the light of this decision, older cases which seem to decide that in cases of unilateral mistake in written contracts equity might give the defendant the option of accepting rectification or having the contract rescinded should perhaps be explained on the ground that on their facts there was knowledge of the mistake of the other party.[222] Even where there is such knowledge, the appropriate remedy, in the opinion of the Court of Appeal, is rectification alone.

[222] *Garrard* v. *Frankel* (1862) 30 Beav. 445 (defendant taken to know of mistake). *Paget* v. *Marshall* (1884) 28 Ch. D. 255 (Bacon V.-C. inclined to the opinion that defendant probably knew of the mistake but hesitated to find him guilty of fraud). See also *Harris* v. *Pepperell* (1867) L.R. 5 Eq. 1; *Bloomer* v. *Spittle* (1872) L.R. 13 Eq. 427 (mutual mistake).

9

Illegality

PUBLIC policy imposes certain limitations upon freedom of contract. An ostensibly valid contract may be tainted by illegality.[1] The source of the illegality may arise by statute or by virtue of the principles of common law. In some instances the law strikes at the agreement itself, and the contract is then by its very nature illegal but in the majority of cases the illegality lies in the object which one or both parties have in mind or in the method of performance. As a general rule, although all the other requirements for the formation of an agreement are complied with, an agreement that is illegal in one of these ways will not be enforceable.

Effects of illegality may vary

The subject of illegality is one of great complexity and the effects of illegality are by no means uniform. The reason for this is not hard to find. The seriousness of the illegality is not the same in all cases. Illegal objects may range from those which are tainted with gross moral turpitude, e.g. murder, to those where the harm to be avoided is relatively small. It is not surprising, therefore, that there are gradations in the degree of enthusiasm with which the judges are prepared to assist a person who has an illegal object in view or is party to an illegal transaction. Attempts have been made to distinguish between 'illegal' contracts and those which are 'nugatory' or 'void'. In the former case, it is said that the law will refuse to aid in any way a person whose cause of action is founded upon such a contract; in the latter case, the law simply says that the contract is not to have legal effect. Undoubtedly some contracts can thus be classified; but it is both impracticable and impossible to apply this classification over the whole field of the subject. Moreover, confusion is created by the fact that the judges have on many occasions treated the terms as interchangeable. It seems better to use the single word 'illegality' to cover the multitude of instances where the law, for some reason of public policy or as a result of a statutory prohibition, denies to one or both of the parties the rights under the contract to which he or she would otherwise be entitled.

[1] This chapter is concerned with initial illegality and illegality in performance and not with supervening illegality which is dealt with *post*, Chapter 14, Discharge by Frustration.

I. Statutory Illegality

(a) The Effect of Statutory Prohibition

Express prohibition: contract illegal

The nature and effects of statutory illegality may vary considerably. A statute may declare that a certain type of contract is expressly prohibited. There is then no doubt of the intention of the legislature that such a contract should not be enforced. 'What is done in contravention of the provisions of an Act of Parliament cannot be made the subject-matter of an action.'[2] Thus, in *Re Mahmoud and Ispahani*:[3]

A wartime statutory order prohibited the purchase or sale of linseed oil without a licence from the Food Controller. The plaintiff held a licence to sell to other licensed dealers. The defendant falsely assured him that he had a licence and the plaintiff agreed to sell a quantity of linseed oil to the defendant. The defendant later refused to accept the oil on the ground that he had no licence. The plaintiff brought an action for damages for non-acceptance.

The Court of Appeal rejected the plaintiff's claim even though he was ignorant, at the time the contract was made, of the facts which brought it within the statutory prohibition. 'The Order', said Bankes L.J.,[4] 'is a clear and unequivocal declaration by the Legislature in the public interest that this particular kind of contract shall not be entered into'.

Contract unenforceable by one party

Frequently, however, a statute will in express terms or on its true construction render a contract unenforceable only by the party whose duty it is to observe the statutory requirement. In such a case, if that party contravenes the provisions of the statute, the contract will be unenforceable by him or her but may yet be enforced by the other party.[5]

Legal inception, illegal performance

Statutory illegality may also arise in connexion with the performance of a contract. The method of performance adopted by one of the parties may violate some statutory prohibition, for example, the vendor of goods may deliver them to a purchaser without the required statutory invoice.[6] In such a situation the party in default will not be able to enforce any claim based on its own illegal performance. But since such a contract is lawful in its inception, notwithstanding that it has been performed in an unlawful manner, there is no reason why the other

[2] *Langton* v. *Hughes* (1813) 1 M. & S. 593, *per* Lord Ellenborough C.J. at 596.

[3] [1921] 2 K.B. 716. See also *Bostel Brothers Ltd.* v. *Hurlock* [1949] 1 K.B. 74; *Chai Sau Yin* v. *Liew Kwee Sam* [1962] A.C. 304; *Wilson, Smithett & Cope Ltd.* v. *Terruzzi* [1976] Q.B. 683.

[4] At p. 374.

[5] *Cope* v. *Rowlands* (1836) 2 M. & W. 149; *Victorian Daylesford Syndicate Ltd.* v. *Dott* [1905] 2 Ch. 624; *Fuji Finance Inc.* v. *Aetna Life Insurance Co. Ltd* [1994] 4 All E.R. 1025, at p. 1036; Consumer Credit Act 1974, s. 40; Sex Discrimination Act 1975, s. 77; Race Relations Act 1976, s. 72; Financial Services Act 1986, s. 132, on which see *Deutsche Ruckversicherung A.G.* v. *Walbrook Insurance Co. Ltd.* [1996] 1 All E.R. 791. Cf. *Phoenix General Insurance Co. of Greece S.A.* v. *Halvanon Insurance Co. Ltd.* [1988] 1 Q.B. 216 (statutory prohibition on *carrying out* contracts), the effect of which has been reversed by the Financial Services Act 1986, s. 132.

[6] *Anderson Ltd.* v. *Daniel* [1924] 1 K.B. 138; *B. & B. Viennese Fashions* v. *Losane* [1952] 1 All E.R. 909.

party, if *innocent*, should not be able to sue. The innocent party does not have to rely on the illegal performance in order to establish a cause of action. Thus in *Marles* v. *Philip Trant & Sons Ltd.*:[7]

The defendant, a firm of seed merchants, bought a quantity of wheat described as 'spring wheat' from M. It sold this wheat to various farmers, including the plaintiff, but the wheat was found not to be spring wheat and the crops failed. The plaintiff claimed damages from the defendant for breach of warranty. The defendant, as it was entitled to do, brought in M as third party to the action, claiming from him an indemnity in respect of the plaintiff's claim, and damages. M, however, raised the defence that the defendant had not, at the time of the sale, delivered to the plaintiff certain particulars in writing as required by section 1(1) of the Seeds Act 1920. M therefore contended that he was not bound to indemnify the defendant, as he could not be made liable on a contract which was illegal.

A majority of the Court of Appeal held that the contract between the defendants and the plaintiff was not illegal from the beginning, but was only rendered illegal later by the method of performance which did not comply with the statutory requirements. The plaintiff could recover damages for breach of warranty from the defendant, since the warranty was given on the lawful stage of the agreement. M's contention that he was not liable to compensate the defendant in respect of their liability under this head therefore failed.[8]

On the other hand, if the other party participates in, or assents to the illegal performance, it will likewise be unable to sue. In *Ashmore, Benson, Pease & Co. Ltd.* v. *A. V. Dawson Ltd.*:[9]

The defendant, a road haulage company, contracted with the plaintiff to carry two 25–ton tube banks to a port. The plaintiff's transport manager and his assistant watched the tube banks being loaded onto two lorries whose lawful maximum load was 20 tons. The plaintiff sued the defendant in respect of damage to one of the tubes when the lorry carrying it toppled over.

The Court of Appeal found that the plaintiff's manager must have realized that the lorries were overloaded, and that he had participated in the defendants' illegal performance of the contract by sanctioning the loading of the two vehicles with a load in excess of the statutory maximum. The plaintiff's claim therefore failed.

Penalty only

Although the fact that a statutory offence has been committed in the course of performance of a contract may render the contract unenforceable, it will not necessarily have this effect. The purpose of the statute may be simply to impose a penalty, and even the 'guilty' party can then sue. Thus in *St. John Shipping Corporation* v. *Joseph Rank Ltd.*:[10]

[7] [1954] 1 Q.B. 29. See also *Archbolds (Freightage) Ltd.* v. *Spanglett Ltd.* [1961] 1 Q.B. 374 (*post*, p. 385).

[8] Singleton and Denning L.J. Hodson L.J. dissenting, stated the defendants 'cannot rely upon the breach of warranty by a third party to prove their damages when those damages are to be measured by reference to a contract illegally performed by them'.

[9] [1973] 1 W.L.R. 828.

[10] [1957] 1 Q.B. 267. See also *Cope* v. *Rowlands* (1836) 2 M. & W. 149; *Archbolds (Freightage) Ltd.* v. *Spanglett Ltd.* [1961] 1 Q.B. 374, at pp. 385, 390, *post*, p. 385; *Dungate* v. *Lee* [1969] 1 Ch. 545;

The plaintiff shipowners contracted to carry a load of grain but overloaded the ship contrary to the Merchant Shipping (Safety and Loadline Conventions) Act 1932. The master was prosecuted and fined for this offence. The defendant, the consignee of part of the cargo, withheld a proportion of the freight due, i.e. a sum equivalent to the freight on the excess cargo carried.

Devlin J. held that it was not entitled to do so. The Act did not render unlawful the contract of carriage, but merely imposed a penalty in respect of its infringement. Similarly, a landlord who fails to provide a tenant with a proper rent-book is exposed to a criminal penalty, but is not precluded from recovering the rent.[11]

Purpose of statute

For the law to prescribe that the commission of any unlawful act in the course of performing a contract should inevitably deprive the wrongdoer of all contractual remedies might well inflict on the wrongdoer a loss far in excess of the statutory penalty. This would be unreasonable. For example, a road haulier might be unable to claim freight simply on the ground that the driver of the vehicle had exceeded the speed limit or the permitted driving hours. It is therefore necessary, in all cases of statutory illegality to have regard to the statutory language and to its scope and purpose. Was the statute intended to interfere with the contract under consideration, to render it unenforceable at the suit of a party who performs it illegally, or merely to impose a penalty on the offender?[12]

Void contracts

A statute may also declare a contract to be void, that is a nullity. Statutory provisions of this nature are numerous and are often (but by no means invariably)[13] connected with a failure to register the agreement[14] or to comply with certain requirements of form.[15] A party to such a contract cannot enforce it, but may be able to recover money or property transferred under it,[16] provided that this is not precluded by the express words of the statute[17] or by judicial interpretation.[18]

Contract not void or unenforceable

Finally, where a statutory provision is not directly contrary to the provisions of a statute by reason of any express or implied prohibition or even where the statute expressly states that a breach of its prohibition does not render any contract void or unenforceable,[19] the Court may still refuse to enforce the contract because this could lead to the Court asssisting in something illegal or because the contract is

Crédit Lyonnais v. *P. T. Barnard & Associates Ltd.* [1976] 1 Lloyd's Rep. 557; *Howard* v. *Shirlstar Container Transport Ltd.* [1990] 1 W.L.R. 1292; *Hughes* v. *Asset Managers plc* [1995] 3 All E.R. 669; *Thorne* v. *Silverleaf* [1994] 1 B.C.L.C. 637. See also *Nelson* v. *Nelson* (1995) 132 A.L.R. 133 (High Court of Australia), *post*, p. 396; *Mohamed* v. *Alaga & Co.*, *The Times*, 2 April 1998.

[11] *Shaw* v. *Groom* [1970] 2 Q.B. 504.

[12] *Archbolds (Freightage) Ltd.* v. *Spanglett Ltd.* (*supra*, n. 10); *Fuji Finance Inc.* v. *Aetna Life Insurance Co. Ltd* [1994] 4 All E.R. 1025.

[13] See, e.g. Marine Insurance Act 1906, s. 4(1); Sex Discrimination Act 1975, s. 77; Race Relations Act 1976, s. 72 (a *term* of contract that is unlawfully discriminatory is 'void', but is only unenforceable against the victim of the discrimination).

[14] Bills of Sale Act 1878, s. 10; Companies Act 1985, s. 395.

[15] Bills of Sale Act (1878) Amendment Act 1882, s. 9; Marine Insurance Act 1906, s. 22; see *ante*, p. 78.

[16] *North Central Wagon Finance Co. Ltd.* v. *Brailsford* [1962] 1 W.L.R. 1288.

[17] e.g. Gaming Act 1845, s. 18; *post*, p. 341.

[18] e.g. Life Assurance Act 1774, s. 1; *Harse* v. *Pearl Life Assurance Co.* [1904] 1 K.B. 558; see *post*, pp. 339, 392.

[19] See, e.g. Trade Descriptions Act 1968, s. 35.

associated with or furthers an illegal purpose.[20] This, however, is a question of illegality at common law, which is considered in Part III of this chapter.[21]

II. Gaming and Wagering Contracts

Gaming and wagering defined

GAMING and wagering contracts have frequently been the subject of statutory intervention and the intricacy of this legislation calls for special analysis. The definition of a gaming contract depends, for the most part, on certain statutory definitions of 'gaming';[22] but the classic definition of a wagering contract is contained in the judgment of Hawkins J. in *Carlill* v. *Carbolic Smoke Ball Co.*:[23]

> A wagering contract is one by which two persons, professing to hold opposite views touching the issue of a future uncertain event, mutually agree that, dependent on the determination of that event, one shall win from the other, and that other shall pay or hand over to him, a sum of money or other stake; neither of the contracting parties having any other interest in that contract than the sum or stake he will so win or lose, there being no other real consideration for the making of such contract by either of the parties. It is essential to a wagering contract that each party may under it either win or lose, whether he will win or lose being dependent on the issue of the event, and, therefore, remaining uncertain until that issue is known. If either of the parties may win but cannot lose, or may lose but cannot win, it is not a wagering contract.

Gain and loss

There must therefore be two parties, or two sides, and mutual chances of gain and loss. Thus persons who contribute to a sweepstake, place bets with a totalisator, take part in a bingo session, or enter coupons for a football pool do not make wagering contracts.[24] The organizers can neither win nor lose; they merely pay out a proportion of the money staked to those who are successful, less their own expenses.[25]

Uncertain event

In one respect, however, the definition of Hawkins J. requires amendment. An event may be uncertain, not only because it is a future event, but because it is not yet ascertained, at any rate to the knowledge of the parties. Thus a wager may be made upon the height of the Eiffel Tower, or upon the result of an election which is over, if the parties do not know in whose favour it has gone. The uncertainty then resides in the minds of the parties, and the subject of the wager may be said

[20] See *Chase Manhattan Equities Ltd.* v. *Goodman* [1991] B.C.L.C. 897, at pp. 931–4, and *post*, p. 381; *Nelson* v. *Nelson* (1995) 132 A.L.R. 133, at pp. 143, 178, (High Court of Australia).

[21] *Post*, p. 348.

[22] e.g. Gaming Act 1968, s. 52(1).

[23] [1892] 2 Q.B. 484, at p. 490, affirmed [1893] 1 Q.B. 256; *Weddle, Beck & Co.* v. *Hackett* [1929] 1 K.B. 321, at p. 329.

[24] *Ellesmere* v. *Wallace* [1929] 2 Ch. 1; *Tote Investors Ltd.* v. *Smoker* [1968] 1 Q.B. 509; *Peck* v. *Lateu* (1973) 117 Sol. J. 185; *One Life Ltd.* v. *Roy* [1996] 2 B.C.L.C. 608. But see the Betting, Gaming and Lotteries Act 1962 (as amended), and the Lotteries and Amusements Act 1976 as amended, *inter alia* by the National Lottery Act 1993.

[25] See also *Kloekner & Co. A.G.* v. *Gatoil Overseas Inc.* [1990] 1 Lloyd's Rep. 177 at p. 192 (agent's contract not a wagering contract because the agent had a right to commission in any event and could not lose).

to be the accuracy of each person's judgment rather than the determination of a particular event.

Sole condition

The parties must contemplate the determination of the uncertain event as the sole condition of their contract. The object of a wager is to make a gain purely as the result of that determination. The knowledge, skill, or luck of each party is backed against that of the other, and in a true wager this is the whole transaction. The Court will look at the substance of the contract, and not merely to the words in which it is expressed. Thus an agreement to buy a horse on terms that the price was to be £200 if it trotted at 18 miles per hour within one month, but a shilling if it did not, was held to be in reality a wager.[26]

We must, however, distinguish a wager from certain other transactions in which there may be chances of gain and loss to the parties depending upon the determination of an uncertain event, but in which these chances are merely incidental to some other object which the parties have in view.

Contracts of insurance and gaming

Contracts of insurance bear a certain superficial resemblance to wagering contracts, but they are really transactions of a different character, and in Hawkins J.'s definition of a wager set out above, they are excluded by the provision that the parties have no interest in the contract other than that which they create by the bet. If A Ltd. insures its cargo with B, an underwriter, that is to say, if A agrees with B that in consideration of its paying a premium of £50, B will pay A £5,000 if the cargo is lost by certain specified perils, A cannot, except by straining the use of words, be said to bet against the safety of its own cargo.[27] A's object is to preserve itself from a financial loss if its property perishes, and not that it should gain and B lose if an uncertain event turns out in a particular way. Similarly, if P insures her life by a policy involving the payment of premiums during her whole life, she cannot, without absurdity, be said to back herself for a short life; what she does do is to buy a certain future provision for her dependants at a price which will be fixed according to the number of years she lives. No doubt, if she has a long life, the transaction will prove financially unprofitable, but almost any commercial transaction may involve chances of profit and loss.

A genuine insurance transaction, therefore, is not a wagering contract, though a transaction purporting to be one of insurance may sometimes turn out to be nothing but a wager. This abuse has been dealt with by the legislature, which makes the existence or non-existence of an 'insurable interest' the distinction between a genuine insurance transaction and a wager.[28] The Marine Insurance Act 1906[29] provides that a contract of marine insurance is to be deemed to be a gaming or wagering contract if the insured has no 'interest', actual or prospective,

[26] *Brogden* v. *Marriott* (1836) 3 Bing. N.C. 88.

[27] *Wilson* v. *Jones* (1867) L.R. 2 Ex. 139, at p. 150.

[28] See *Glafki Shipping Co. S.A.* v. *Pinnion Shipping Co. (The Maira) (No 2)* [1984] 1 Lloyd's Rep. 660 at p. 667 (rev'd. on a different point [1986] 2 Lloyd's Rep. 12); *Anthony John Sharp* v. *Sphere Drake Insurance plc (The Moonacre)* [1992] 2 Lloyd's Rep. 501 at pp. 509–10 (insurable interest). See also *Newbury International Ltd.* v. *Reliance International Insurance Co.* [1994] 1 Lloyd's Rep. 83, at pp. 85, 91–3 (no insurable interest). See generally Clarke, *Policies and Perceptions of Insurance* (1997), p. 20 ff.

[29] s. 4. See also Marine Insurance (Gambling Policies) Act 1909.

in the adventure, or if the policy contains words which make proof of interest unnecessary. Also the Life Assurance Act 1774[30] deals with insurance generally (marine insurance excepted), and forbids insurances on the life of any person or other event wherein the person for whose benefit the policy is made has no interest.[31] This Act[32] further requires that the persons to benefit should be named in or identifiable from the policy, and provides that the insured should not recover a sum greater than its interest at the time of insurance.

Stock Exchange transactions and gaming

Stock Exchange transactions are another form of business transaction which can be seen as, and therefore need to be distinguished from, mere wagering contracts. The law does not frown upon speculation in stocks and shares as such, but if a transaction is no more than 'an agreement to pay differences', that is to say, if the parties do not intend a real transaction by the purchase and delivery of actual stocks and shares, but only that one shall receive from the other the difference between the contract price of a particular security and its market price on the settling day, they are doing no more than betting on the price of the security at a future date. If a transaction is found as a fact to be essentially an agreement to pay differences, a term to the effect that either party has the option to require completion of the purchase will not be enough to alter its character. Such a term has been said to be inserted only 'to cloak the fact that it was a gambling transaction, and to enable [the parties] to sue one another for gambling debts',[33] and is unenforceable at common law. But a licensed dealer in securities may not plead the Gaming Act,[34] and, where one of the parties to a contract for differences enters it by way of an investment business, it will be enforceable despite being a wager.[35]

The mere taking or not taking delivery of shares (or the mere existence of a right to call for delivery) is, however, not determinative of whether the contract is or is not a wagering contract. So if a buyer never intended to take delivery of shares but did intend to and did enter into a further sales contract, then the original contract will not be held to be a wager as it is a genuine sale contract and not merely an agreement for the payment of differences.[36]

Commodity futures and gaming

Similar considerations apply to dealings in commodity futures. If A contracts to sell goods to B, delivery to be made in 3 months' time, and the price to be the market price at the date of delivery, it may be said that A stands to lose or gain upon a future event, which is uncertain, that is to say, according as the market rises or falls. But this element of chance is merely an incident in the larger transaction of a contract of sale of goods on certain terms; it does not convert that

[30] s. 1.

[31] *Macaura* v. *Northern Insurance Co. Ltd.* [1925] A.C. 619.

[32] As amended by the Insurance Companies Amendment Act 1973.

[33] *Universal Stock Exchange Ltd.* v. *Strachan* [1896] A.C. 166, at p. 173. Cf. *Universal Stock Exchange Ltd.* v. *Stevens* (1892) 66 L.T. 612. But sums deposited for the purpose of gambling may be recovered provided the other party to the transaction has not appropriated the money in order to place or pay for a gaming transaction: *Re Futures Index Ltd.* [1985] F.L.R. 147. See also *Strachan* v. *Universal Stock Exchange Ltd. (No. 2)* [1895] 2 Q.B. 697.

[34] Licensed Dealers (Conduct of Business) Rules 1983 (SI 1983 No 585), r. 18(2).

[35] Financial Services Act 1986, s. 63. See *City Index Ltd.* v. *Leslie* [1992] 1 Q.B. 98 (share price indices).

[36] *Thacker* v. *Hardy* (1878) 4 Q.B.D. 685; *Kloeckner A.G.* v. *Gatoil Overseas Inc.* [1990] 1 Lloyd's Rep. 177; *Morgan Grenfell & Co. Ltd.* v. *Welmyn Hatfield D.C.* [1995] 1 All E.R. 1.

transaction into a wagering contract.[37] If, however, both parties use this means in order to gamble on future price differences and for no other purpose, it being in effect agreed between them that neither party should be entitled to call for performance, then the contract will be held to be a wager[38] and will not be enforced unless validated by statute.[39]

We now turn to the law relating to gaming and wagering contracts.

(a) Wagers at Common Law

Wagers at common law

At common law all wagers were enforceable, and, until the latter part of the eighteenth century, were only discouraged by some trifling difficulties of pleading.[40] Thus in 1771 Lord Mansfield heard without protest an action on a wager made at Newmarket by which two young men agreed 'to run their fathers (to use the phrase of that place) each against the other'; that is, to bet on the duration of their fathers' lives.[41] It also happened that the father of one was (unknown to either) already dead, and the arguments in the case were solely concerned with the question whether a term was to be implied into the contract analogous to the 'lost or not lost' term of a marine insurance policy.

But as the Courts found that frivolous or indecent matters were brought before them for decision, rules came to be established that a wager was not enforceable if it could only be proved by evidence which was indecent or was calculated to injure or pain a third person, or, as a matter of public policy, that any wager which tempted a person to offend against the law was illegal. Strange and even ludicrous reasoning was used by the Courts in their effort to discourage the litigation of wagers. A bet upon the duration of the life of Napoleon was stated to tend to weaken the patriotism of English people and, by encouraging the idea of the assassination of a foreign ruler, to tend to provoke retaliation upon the person of George III, 'a life most dear to us all'.[42] But it is evident that the substantial motive pressing upon the judges was 'the inconvenience of countenancing idle wagers in courts of justice', the feeling that 'it would be a good rule to postpone the trial of every action upon idle wagers till the Court had nothing else to attend to'.[43]

(b) Gaming Act 1845

No serious attempt was made by the legislature during the seventeenth and eighteenth centuries to interfere with the enforceability of wagers, although a number

[37] *Ironmonger & Co.* v. *Dyne* (1928) 44 T.L.R. 497, at p. 499; *Garnac Grain Co. Inc.* v. *H. M. Faure & Fairclough Ltd.* [1966] 1 Q.B. 650; *R. Pagnan & Fratelli* v. *N. G. J. Schouten N.V.* [1973] 1 Lloyd's Rep. 349; *Wilson, Smithett & Cope Ltd.* v. *Terruzzi* [1976] Q.B. 683 at p. 710. See also *City Index Ltd.* v. *Leslie* [1992] 1 Q.B. 98 (share price indices and commodity prices); *Morgan Grenfell & Co. Ltd.* v. *Welwyn Hatfield D.C.* [1995] 1 All E.R. 1, at pp. 12–14 (interest rate swaps).

[38] *R. Pagnan & Fratelli* v. *N. G. J. Schouten N.V.* (*supra*, n. 37), at pp. 356–7; *Wilson, Smithett & Cope Ltd.* v. *Terruzzi* (*supra*, n. 37), at p. 710.

[39] *Ante*, p. 339, nn. 34 and 35.

[40] *Jackson* v. *Colegrave* (1694) Carthew 338.

[41] *March* v. *Pigot* (1771) 5 Burr. 2802.

[42] *Gilbert* v. *Sykes* (1812) 16 East. 150, *per* Lord Ellenborough C.J. at p. 159.

[43] *Ibid.*, *per* Bayley J. at p. 162.

of statutes were passed which sought to regulate certain aspects of gaming. For example, it was enacted in an Act of 1664, now repealed, that any sum exceeding £100 lost at playing at games or pastimes, or in betting on the players, should be irrecoverable, and that all forms of security given for money so lost should be void. Also, as we shall see, securities for gaming were affected by a Gaming Act passed in 1710,[44] which was later amended by an Act of 1835.[45] But it was not until 1845 that Parliament took any decisive step to exclude litigation by the parties to a gaming or wagering contract from coming before the Courts.

Gaming Act 1845, s. 18

Section 18 of the Gaming Act 1845 provides:

> All contracts or agreements, whether by parole or in writing, by way of gaming or wagering, shall be null and void; and no suit shall be brought or maintained in any Court of Law or Equity for recovering any sum of money or valuable thing alleged to be won upon any wager, or which shall have been deposited in the hands of any person to abide the event on which any wager shall have been made.

All wagering contracts 'null and void'

The section, it will be observed, has three branches. The first makes all gaming and wagering contracts null and void. Thus if A makes a bet with B on the result of the Derby, or on the height of the Eiffel Tower, and wins, A cannot sue B for the amount. If A loses and pays, he cannot recover his money.[46] The second branch prevents any action being brought to recover any money or valuable thing alleged to be won on any wager. At first sight, it might seem that it merely restated in procedural terms a declaration of substantive law already contained in the first branch, but this is not the case.

Supplementary promises and covenants

In *Hill* v. *William Hill (Park Lane) Ltd.*,[47] this point was considered by the House of Lords:

> H, a racehorse owner, had failed to honour betting debts contracted with the respondents, a firm of bookmakers. They reported his default to the committee of Tattersalls, which acts as a sort of court of honour for bets on horse-racing. The committee held an inquiry and ordered H to pay the debts by instalments, but he failed to comply with the terms of the order. If the respondents had reported this non-compliance to the Stewards of the Jockey Club, H would have been posted as a defaulter and warned off the turf. They agreed, however, not to do this in consideration of his giving them a post-dated cheque for part of the amount due and promising to pay the balance by instalments. The cheque was dishonoured and the instalments were not paid.

In an action brought to recover the money promised to them, the respondents pointed out that they were not suing on the contract of wager (which was void under the 1845 Act) but on a collateral and later contract by which H promised to pay in consideration of their not reporting him to the Jockey Club. This, they argued, was not an agreement 'by way of gaming or wagering', the promise being a promise to pay money which, though equal to the amount of the bet, was not in

[44] Gaming Act 1710, s. 1; see *post*, p. 343. [45] s. 1.

[46] *Bridger* v. *Savage* (1884) 15 Q.B.D. 363, at p. 367. See also *Re Futures Index Ltd.* [1985] F.L.R. 147. Cf. *Universal Stock Exchange Ltd.* v. *Strachan* [1896] A.C. 166 (deposit recoverable).

[47] [1949] A.C. 530, overruling the earlier decision of the Court of Appeal in *Hyams* v. *Stuart-King* [1908] 2 K.B. 696.

fact the bet, but compensation for its non-payment. It was caught neither by the first (substantive) branch of section 18, nor by the second (procedural) branch. It was a distinct and enforceable contract.

The House of Lords, by a majority of four to three, refused to accept this contention. They held that the action was brought to recover a sum of money 'alleged to be won upon any wager', and so was caught by the wider language of the second or procedural part. Lord Normand said:[48]

> The purpose of this part of s. 18 is not to strike a second and an unnecessary blow at contracts and agreements already stricken with nullity, but to strike at any suit for recovering money or valuables won by wagering. The language is appropriate for that purpose and it is a purpose which is a logical sequel and reinforcement of the first branch of the section. The legislature cannot have been unmindful that a provision making gaming and wagering contracts and agreements null and void might be rendered nugatory by additional promises or covenants given or entered into for security or in satisfaction of money lost by gaming or wagering. The preamble to the Act of 1845 shows that such supplementary promises and covenants were familiar to Parliament.

This decision does not necessarily strike down all arrangements between a bookmaker and a defaulting client,[49] but it clearly prevents the recovery, whether directly or indirectly, and even from a third party who would otherwise be liable to pay,[50] of a sum of money or valuable thing alleged to have been won upon the wager. The legislation cannot be circumvented by using chips instead of money. The use of chips acts as a 'convenient mechanism for facilitating gambling with money' and does not affect the invalidity of the gaming contract whether or not the supply of chips is made under a separate contract.[51]

Restitution: No recovery of money paid to winner

Although *prima facie* money paid under a void contract can be recovered back in a restitutionary action,[52] 'a gaming loss, whenever paid, is a completed voluntary gift from the loser to the winner', and is irrecoverable.[53] It has also been held that a mistaken overpayment to a punter by a bookmaker cannot be recovered, *inter alia* because this would be to recognize 'wagering transactions as producing legal obligations and therefore doing the very thing which the Gaming Act, 1845, does not permit to be done'.[54] But where stolen money has been used for gambling (whether the transaction is illegal or only void under the 1845 Act), the person from whom the money was stolen may recover it as paid without consideration,[55] subject to the restitutionary defence of change of position which protects a payee

[48] At p. 565.

[49] *Re Browne* [1960] 1 W.L.R. 692.

[50] *Coral* v. *Kleyman* [1951] 1 All E.R. 518; *A. R. Dennis & Co. Ltd.* v. *Campbell* [1978] Q.B. 365.

[51] *Lipkin Gorman* v. *Karpnale Ltd.* [1991] 2 A.C. 548 at p. 575. Cf. Lord Templeman *ibid.*, at p. 562 (only one contract) and Lord Goff *ibid.*, at pp. 576–7 (two contracts).

[52] See *ante*, Chapter 5 and *Re London County Commercial Reinsurance Office Ltd.* [1922] 2 Ch. 67 (marine insurance policies void under the Marine Insurance Act 1906, s.4).

[53] *Lipkin Gorman* v. *Karpnale Ltd.* [1991] 2 A.C. 548 *per* Lord Templeman at p. 562. See also *ibid.*, pp. 561, 575, 577.

[54] *Morgan* v. *Ashcroft* [1938] 1 K.B. 49, at pp. 61, 69. See also *Re London County Commercial Reinsurance Office Ltd.* (*supra*, n. 52) (the peace policies void and illegal under the Life Assurance Act 1774).

[55] *Clarke* v. *Shee* (1774) 1 Cowp. 197; *Lipkin Gorman* v. *Karpnale Ltd.* (*supra*, n. 53) at pp. 562, 564, 575, 577.

whose position has so changed that it would be inequitable in the circumstances to require repayment.[56]

Money deposited with a stakeholder

The third branch of section 18 concerns the situation where the parties deposit money with a stakeholder to abide the event of a wager. In such a case the winner cannot sue to recover any winnings. But the construction which has been put upon this part of section 18 is that it does not preclude either party from recovering his or her own deposit from the stakeholder until it has been paid over to the winner. In *Diggle* v. *Higgs*:[57]

D and S agreed together to compete in a walking match. They both deposited £200 with a third party, H, each betting on himself to win. S was adjudged the winner, but D claimed to recover his stake from H.

It was held that he could do so, the money having not yet been paid over.

Proviso & exception

The section, however, contains a proviso:

Provided always, that this enactment shall not be deemed to apply to any subscription or contribution, or agreement to subscribe or contribute, for or toward any plate, prize, or sum of money to be awarded to the winner or winners of any lawful game, sport, pastime or exercise.

Prizes in any lawful and genuine competition can therefore be recovered. Moreover, as we have noted, statute exempts certain dealings from section 18, for example contracts for differences entered into by way of investment business.[58]

(c) Securities

Securities as between parties to contract and third parties

Subject to any validating legislation, if a security, e.g. a cheque, is given to the winner by the loser in payment of a sum lost under a gaming or wagering contract, the security is unenforceable by the winner, who can no more sue on the security than for the amount that has been won.[59] But the position is more complicated where the security consists of a negotiable instrument which is subsequently transferred to a third party.

Gaming securit

Section 1 of the Gaming Act 1710 enacted that securities of every kind which have been given wholly or in part for any money or valuable thing won by gaming, or by playing at any game or by betting on any game, or for repaying any money lent for such gaming or betting, or lent at the time and place of play to any person so gaming or betting, should be 'utterly void, frustrate, and of none effect'. Cases of hardship, however, resulted from the operation of this section. For example, a cheque given to the winner might be transferred to a third party, who might take it for valuable consideration and in ignorance of its origin. Such a person, when seeking to enforce the cheque, would discover, too late, that he had paid value for an instrument which was by statute wholly void as against the party

[56] *Lipkin Gorman* v. *Karpnale Ltd.* (*supra*, n. 53) at pp. 562, 579–80.

[57] (1877) 2 Ex. D. 422; *Varney* v. *Hickman* (1847) 5 C.B. 271; *Burge* v. *Ashley & Smith Ltd.* [1900] 1 Q.B. 744 (on the effect of the 1892 Act, *infra*). The stakeholder will even be liable if he disregards the demand: *Hampden* v. *Walsh* (1876) 1 Q.B.D. 189.

[58] *Ante*, p. 339.

[59] *Richardson* v. *Moncreiffe* (1926) 43 T.L.R. 32.

losing at play. Section 1 of the Gaming Act 1835 therefore enacted that securities which would have been void under the 1710 Act should henceforth be deemed to have been made, drawn, accepted, given, or executed *for an illegal consideration*. The effect of this is that the holder of a cheque given as security for a gaming debt may nevertheless enforce it, despite its origin, but only if the holder can affirmatively prove that, subsequent to the illegality, value has in good faith been given for the cheque.[60]

Non-gaming securities

It will be observed, however, that the 1710 Act only deals with securities given in relation to playing at or betting on *games* (which includes horse-racing).[61] It does not affect securities given in respect of wagers of other kinds, such as a wager on the result of a contested election. But since the 1845 Act, securities given in respect of non-gaming wagers are affected by the fact that the transaction in respect of which they were given is said by the statutes to be null and void. Here, however, the defect is not that they are deemed to have been given for an illegal consideration, but that they have been given for no consideration at all. In such a case, the rules which govern the transfer and enforcement of negotiable instruments (such as cheques) provide that, if consideration has at some time during the history of the instrument been given, it is enforceable by the holder thereof.[62] Moreover it is for the original drawer of the cheque to *disprove* the giving of such consideration, for the holder is presumed to be a holder in due course unless the contrary is proved. To illustrate the distinction between gaming and non-gaming securities, and the burden of proof in either case, let us take the following example:

Suppose that A makes a bet with B on the result of the Cheltenham Gold Cup, and loses. A gives B a cheque for £100. B indorses the cheque in favour of C Ltd., a trader, in return for a television set.

Since the wager was one on a 'game', namely, horse-racing, the cheque is deemed to have been given for illegal consideration. It is for C to prove that consideration has at some time been given, either by itself or by some other holder, without notice of the circumstances which gave rise to the illegality. But had the same bet been made, for instance, on the height of the Eiffel Tower, then this would have been a non-gaming wager. The burden of proof would have been upon A to show that value had not been given. Knowledge of the circumstances of the wager would this time be immaterial.[63]

Securities for money lent for gaming

The 1710 and 1835 Acts also apply to securities given for the repayment of money knowingly lent for gaming, or betting on the players, or given for the repayment of money lent at the time of play to those gaming or betting. Thus if A lends B a sum of money in order to enable B to bet on a game, and B gives A a cheque as security for the amount of the loan, the cheque is deemed to have been given for an illegal consideration. And the same rule applies where A lends no

[60] Bills of Exchange Act 1882, s. 30(2)—but cf. ss. 29(3), 81. See also *Tatam* v. *Haslar* (1889) 23 Q.B.D. 345; *Woolf* v. *Hamilton* [1898] 2 Q.B. 337; *Ladup Ltd.* v. *Shaikh* [1983] Q.B. 225; and *post*, p. 467.

[61] *Applegarth* v. *Colley* (1842) 10 M. & W. 723.

[62] See *post*, pp. 96, 467.

[63] *Lilley* v. *Rankin* (1887) 56 L.J.Q.B. 248.

actual money, but provides B with 'chips' which represent money, and receives a cheque as security.[64]

Gaming Act 1968, s. 16

A certain validity, however, is accorded to cheques given in connection with loans for gaming by section 16 of the Gaming Act 1968.[65] Part II of the Act establishes a system for the licensing or registration of premises for gaming. If the holder of the licence accepts a cheque and gives in exchange for it cash or tokens to enable a person to take part in gaming, the cheque is enforceable provided certain conditions are fulfilled. It must not be a post-dated cheque, and must be exchanged for cash or tokens to the amount or value for which it is drawn.[66] The holder of the licence must also cause the cheque to be delivered to a bank for payment or collection not more than 2 banking days after accepting it.

(d) Principal and Agent

Principal and agent

Since the Gaming Act 1845 merely declared that gaming and wagering contracts were void and unenforceable, no taint of illegality attached to a transaction whereby one person employed another to make debts, the ordinary rules which govern the relation of principal and agent applied in such a case.

Gaming Act 1892, s. 1

Section 1 of the Gaming Act 1892 altered the law in this respect:

> Any promise, express or implied, to pay any person any sum of money paid by him under or in respect of any contract or agreement rendered null and void by the Gaming Act 1845, or to pay any sum of money by way of commission, fee, reward, or otherwise in respect of any such contract, or of any services in relation thereto or in connection therewith shall be null and void, and no action shall be brought or maintained to recover any such sum of money.

The effect of this enactment is that no action can be brought to recover a commission or reward promised for making or for paying bets; and if one person employs another to make bets, the person making the bet (the agent) can bring no action if the principal fails to pay the money due. This was not the rule at common law, but the contract is clearly caught by the Act.[67] Also if the agent fails to place the bet, no action can be brought for breach of the contract of agency, or to recover the sums which would have been won had the principal's instructions been faithfully carried out by the agent.[68] Likewise, no action lies if the bet made by the agent was not authorized by the principal.[69] It has been held, however, that

[64] *Stuart* v. *Stephen* (1940) 56 T.L.R. 571. The same analysis appears to apply under the Gaming Acts 1845 and 1968 for security given for chips: see *Lipkin Gorman* v. *Karpnale Ltd.* [1991] 2 A.C. 548 and *Crockfords Club Ltd.* v. *Mehta* [1992] 1 W.L.R. 355.

[65] As amended by the Gaming (Amendment) Act 1986. See also the Acts of 1987 and 1990. A security given for a wager that would be invalid under the Gaming Act 1945, s. 18 may also be saved by Financial Services Act 1986, s. 63.

[66] *Ladup Ltd.* v. *Shaikh* [1983] Q.B. 225; *Crockfords Club Ltd.* v. *Mehta* [1992] 1 W.L.R. 355, at pp. 365–6.

[67] *Law* v. *Dearnley* [1950] 1 K.B. 400. Unless the agent made the wagers in the course of an investment business: Financial Services Act 1986, s. 63 and Sched. 1, paras 9 and 12.

[68] *Cohen* v. *Kittell* (1889) 22 Q.B.D. 680; *Thomas Cheshire & Co.* v. *Vaughan Bros. & Co.* [1920] 3 K.B. 240.

[69] *A. R. Dennis & Co. Ltd.* v. *Campbell* [1978] Q.B. 365.

an agent who receives the winnings cannot keep them. This is money received on behalf of another; there is thus no promise to pay the principal a sum of money *paid* in respect of a wagering contract but there is an implied promise to pay over monies *received* by the agent; and such an action lies outside the provisions of the 1892 Act.[70]

(e) Loans

oans affected by 1892 Act

Section 1 of the 1892 Act may prevent the recovery of money paid by one person to settle the gaming or wagering losses of another. A loan of money made in discharge of the bets of another is irrecoverable if it has been paid direct to the winner, for the lender has paid it 'under or in respect of' a contract avoided by the Act of 1845.[71] By the same token, a loan of money cannot be recovered if it is a term in the contract that the money lent shall be used for the payment of such a debt.[72] But in *Re O'Shea*,[73] the Court of Appeal held that money lent to pay wagering debts can be recovered provided that it is not paid direct to the winner, but remains *at the free disposition of the borrower* to use as the borrower thinks fit. In such a case, the money is not paid 'under or in respect of' a contract rendered null and void by the Gaming Act 1845; accordingly, it does not fall under the Act of 1892, and may still be recovered.

Loans for wagering

Secondly, the Act may possibly prevent the recovery of money lent for the purpose of wagering. It is submitted that, if a loan of money is made subject to a stipulation that it is to be used to make a bet, or if it is otherwise not at the free disposition of the borrower, any promise to repay the money is void and ineffective as it has been paid 'under or in respect of' a contract made void by the Act of 1845.[74] On the other hand, if it is at the free disposition of the borrower, it probably lies outside the Act of 1892. But here we have also to ask whether the Acts of 1710 and 1835 make such a loan irrecoverable.

Loans for gaming

It will be remembered that these Acts deal only with gaming, and in their terms only apply to *securities* given in relation to gaming. If A lends money to B knowing that it will be used for gaming, and B gives A a cheque as security for the loan, there is no doubt that A cannot sue B on the cheque. The cheque was void under the 1710 Act, and must now be taken to have been given for an illegal consideration under the Act of 1835. But could A disregard the security and recover on the contract of loan, which would strictly not be affected by the enactments referred to? The older authorities are inconsistent,[75] but the question was answered in the negative by the Divisional Court in *Carlton Hall Club Ltd.* v. *Laurence*:[76]

[70] *Bridger* v. *Savage* (1884) 15 Q.B.D. 363; *De Mattos* v. *Benjamin* (1894) L.J.Q.B. 248. It is unlikely that this has been affected by the decision in *Hill* v. *William Hill (Park Lane) Ltd.* [1949] A.C. 530; *ante*, p. 341.

[71] *Woolf* v. *Freeman* [1937] 1 All E.R. 178. See also *C. H. T. Ltd.* v. *Ward* [1965] 2 Q.B. 63 (provision of 'chips').

[72] *Macdonald* v. *Green* [1951] 1 K.B. 594.

[73] [1911] 2 K.B. 981.

[74] *Carney* v. *Plummer* [1897] 1 Q.B. 634.

[75] *Barjeau* v. *Walmsley* (1746) 2 Stra. 1249; *Robinson* v. *Bland* (1760) 1 W. Bl. 234; *Alcinbrook* v. *Hall* (1766) 2 Wils. 309: loan recoverable. Contrast *Young* v. *Moore* (1757) 2 Wils K.B. 67; *Applegarth* v. *Colley* (1842) 10 M. & W. 723: loan irrecoverable.

[76] (1929) 98 L.J.K.B. 305. This report is considered superior to that in [1929] 2 K.B. 153: see

The plaintiff was the proprietor of a social club. It supplied to members wishing to play billiards and poker for money 'chips' in return for cheques made out by those members. The defendant bought some £28 worth of chips, giving the plaintiff a cheque for that amount. The cheque was dishonoured.

The Court rejected the plaintiff's argument that a loan of money for gaming,[77] as distinct from the security for the loan, was not affected by the Acts of 1710 and 1835, but was valid and enforceable. It held that the Acts rendered illegal not only the security but also the consideration. The loan was therefore irrecoverable.[78]

The interpretation thus placed by the Court on the meaning of the Acts is open to reconsideration,[79] and it has been criticized. The effect of the decision as reported in the Law Journal would either be to prevent any recovery whatever of money knowingly lent for the purpose of playing upon even a perfectly lawful game[80]—a consequence which does not seem to have been intended by the legislature—or to prevent recovery of such a loan only if a security happened to have been given—a distinction which has no basis of logic or public policy. But the decision was assumed to be correct by the Court of Appeal in *Crockfords Club Ltd.* v. *Mehta*,[81] although Lloyd L.J. stated that nothing in the Acts of 1710 and 1835 affected the underlying loan.[82] Nevertheless, the *Crockfords* case also showed that the impact of the *Carlton Hall Club* case has been restricted by section 16 of the Gaming Act 1968 which, as we have noted,[83] makes the giving of a cheque which complies with its conditions enforceable, and thus removes the basis for the argument that the underlying loan is illegal or unenforceable.[84]

Gaming Act 1968, s. 16

By section 16 of the Gaming Act 1968 the holder of a licence in relation to premises for gaming is prohibited, under criminal penalty, to make directly or indirectly any loan (in money or tokens)[85] in order to enable a person to take part in the gaming, or in respect of any losses incurred by a person in the gaming. Any such loan will therefore be illegal and irrecoverable, although, as we have seen, pursuant to section 16(2), subject to certain conditions the acceptance of a cheque

C.H.T. Ltd. v. *Ward* [1965] 2 Q.B. 63, at p. 85; *Crockfords Club Ltd.* v. *Mehta* [1992] 1 W.L.R. 355 at p. 366.

[77] The better view appears to be that there is a loan when a cheque is given at the time of an advance: see *R.* v. *Knightsbridge Crown Court, ex p. Marcrest Properties Ltd.* [1983] 1 W.L.R. 300 at p. 309 and *Crockfords Club Ltd.* v. *Mehta* [1992] 1 W.L.R. 355. Cf. *Cumming* v. *Mackie* 1973 S.L.T. 242.

[78] Cf. the different position where the loan is governed by the law of another country and is enforceable under that law, because the Gaming Acts do not have extra-territorial effect on transactions, the proper law of which is that of a foreign legal system: *Société Anonyme des Grands Etablissements du Touquet-Paris-Plage* v. *Baumgart* (1927) 43 T.L.R. 278.

[79] *C.H.T. Ltd.* v. *Ward* [1965] 2 Q.B. 63, at p. 86.

[80] (*Supra*, n. 76) at 307 (cf. that in the Law Reports, (*supra*, n. 76) at 164). At the time of the decision playing these games of chance in a common gaming house was unlawful (*C.H.T. Ltd.* v. *Ward* [1965] 2 Q.B. 63, at p. 85 so explains it) but this had not been raised by the defendant: see 45 T.L.R. 195.

[81] [1992] 1 W.L.R. 355, at pp. 366, 369. [82] *Ibid.*, at p. 365. [83] See *ante*, p. 345.

[84] [1992] 1 W.L.R. 355, at pp. 366, 369. The position would be similar where the Financial Services Act 1986, s. 63 applies.

[85] See *R.* v. *Knightsbridge Crown Court, ex p. Marcrest Properties Ltd.* (*supra*, n. 77); *Crockfords Club Ltd.* v. *Mehta* (*supra*, n. 77).

in exchange for cash or tokens to enable a person to take part in the gaming does not infringe this enactment and is a lawful grant of credit.[86]

(f) Illegal Gaming

Illegal gaming

Certain games, such as hazard and roulette, were previously unlawful by statute, as were games of chance if played in a place habitually kept for gaming.[87] But the law has now been altered and consolidated in the Gaming Act 1968.[88] Gaming of certain kinds is now lawful provided that the very stringent conditions laid down by the Act are complied with. But this transition to legality has not of itself, except in so far as the 1968 Act provides to the contrary, altered the law relating to gaming and wagering as laid down in the Gaming Acts discussed above.[89] Gaming which transgresses the provisions of the 1968 Act is unlawful and illegal.

III. Illegality at Common Law

Illegality at common law

THERE are a number of situations where a contract cannot be enforced even though these are not the subject of any positive legislative enactment. Remedies are denied at common law by virtue of the operation of rules of public policy.

Public policy

The policy of the law, or public policy, is a concept which is frequently used in assessing the enforceability of contracts. Its origins are ancient and obscure. By the begining of the nineteenth century the lack of definition and consequent uncertainty of the concept led to judicial statements against the extension of public policy which was described as 'a very unruly horse' which 'you never know where it will carry you'.[90] The view was also expressed that it was not the function of the Courts to create new law, but to interpret and elucidate existing principles,[91] and that there was a public interest in upholding freedom of contract. In Chapter 1 we noted that the effect of the emphasis on freedom of contract was reluctance to interfere with a contract on the ground of public policy.[92] It is in reconciling this freedom of contract with other public interests that the difficulty arises.

In the second half of the twentieth century, however, the positive function of the Courts in matters of public policy has been increasingly recognized. As Lord

[86] *R.* v. *Knightsbridge Crown Court, ex p. Marcrest Properties Ltd.* [1983] 1 W.L.R. 300 at p. 310. See also *Crockfords Club Ltd.* v. *Mehta* (*supra*, n. 77).
[87] Unlawful Games Act 1541; Gaming Act 1845, s. 1.
[88] The Act has been amended by the Gaming (Amendment) Acts of 1973, 1980, 1982, 1986, 1987, and 1990.
[89] *Ladup Ltd.* v. *Shaikh* [1983] Q.B. 225.
[90] *Richardson* v. *Mellish* (1824) 2 Bing. 229, *per* Burrough J. at p. 252.
[91] *Re Mirams* [1891] 1 Q.B. 594, at p. 595; *Mogul Steamship Co.* v. *McGregor, Gow & Co.* [1892] A.C. 25, at p. 45.
[92] *Ante*, p. 4, and see especially *Printing and Numerical Registering Co.* v. *Sampson* (1875) L.R. 19 Eq. 462, *per* Jessel M.R. at p. 465.

Denning M.R. has said: 'With a good man in the saddle, the unruly horse can be kept in control. It can jump over obstacles'.[93] Moreover, some flexibility is clearly desirable in matters of public policy: 'The law relating to public policy cannot remain immutable. It must change with the passage of time. The wind of change blows upon it'.[94] Certain aspects of public policy are more susceptible to change than others, though the policy of the law has, on some subjects, been worked into a set of tolerably definite rules. The principles applicable to agreements in restraint of trade, for example, have on a number of occasions been modified or extended to accord with prevailing economic conditions,[95] and this process still continues.[96] So, too the principles applicable to transactions between cohabitants have been modified to accord with prevailing social conditions.[97] For the rest, the application of canons of public policy to particular instances necessarily varies with the progressive development of public opinion and morality, but, as Lord Wright has said extra-judicially:[98]

> Public policy like any other branch of the common law ought to be, and I think is, governed by the judicial use of precedents . . . If it is said that rules of public policy have to be moulded to suit new conditions of a changing world, that is true; but the same is true of the principles of the common law generally.

Contracts invalidated

Contracts which the Courts will not enforce because they are contrary to public policy may be arranged under certain heads.

(a) Agreements to Commit a Crime or Civil Wrong, or to Perpetrate a Fraud

Agreements to commit a crime

It is plain that the Courts will not enforce an agreement which has as its object the deliberate commission of a criminal offence (whether by statute or at common law),[99] although the fact that an offence is committed in the course of an otherwise legal agreement will not necessarily render the contract unlawful.[100]

Civil wrong or fraud

Nor will the Courts enforce an agreement to commit a tort. An agreement to commit an assault has therefore been held to be void, as in *Allen* v. *Rescous*,[101] where one of the parties undertook to beat up someone. So too, has an agreement involving the publication of a libel,[102] deceit,[103] or the perpetration of a fraud.[104] And in *Mallalieu* v. *Hodgson*[105] a secret agreement by which a debtor agreed to pay the plaintiff part of his debt in full, when the debtor had agreed to pay all his creditors 6*s*. 8*d*. in the pound was held to be a fraud on the other creditors, each of whom had promised to forgo a portion of his debt in consideration that the

[93] *Enderby Town F.C. Ltd.* v. *The Football Association Ltd.* [1971] Ch. 591, at p. 606.
[94] *Nagle* v. *Feilden* [1966] 2 Q.B. 633, *per* Danckwerts L.J. at p. 650.
[95] See *post*, p. 360.
[96] See *post*, pp. 360, 374.
[97] *Post*, p. 356.
[98] *Legal Essays and Addresses*, iii. 76, 78.
[99] See e.g. *Levy* v. *Yates* (1838) 8 A. & E. 129; *Bigos* v. *Bousted* [1951] 1 All E.R. 92 (*post*, p. 390); *Tinsley* v. *Milligan* [1994] 1 A.C. 340.
[100] See *ante*, p. 335; *post*, p. 385.
[101] (1677) 2 Lev. 174.
[102] *Clay* v. *Yates* (1856) 1 H. & N. 73.
[103] *Brown Jenkinson & Co. Ltd.* v. *Percy Dalton (London) Ltd.* [1957] 2 Q.B. 621.
[104] *Willis* v. *Baldwin* (1780) 2 Doug. K.B. 450.
[105] (1851) 16 Q.B. 689.

others would forgo theirs in like proportion. The agreement to prefer one creditor was unenforceable.[106] On the same ground, an agreement by the promoters of a company to defraud prospective shareholders,[107] or to rig the market for shares,[108] has been held to be fraudulent and unenforceable.

Agreements to defraud the revenue

One of the most common types of illegal agreement is one to defraud the revenue, whether that of the central or local government. In *Alexander* v. *Rayson*:[109]

A let a flat in Piccadilly to R at a rent of £1,200 a year. The transaction was effected by two documents: (1) a lease of the flat at a rent of £450 p.a., covering certain services to be rendered by the lessor A, and (2) an agreement to render services (which were substantially the same) in consideration of an extra £750 p.a. A dispute having arisen, R declined to pay an instalment due under the agreement. When sued by A, R pleaded that the object of the two documents was that only the lease was to be disclosed to the local authority in order to deceive them as to the true rateable value of the premises.

The Court of Appeal held that, if the documents were to be used for this fraudulent purpose, A was not entitled to the assistance of the law in enforcing either the lease or the agreement.

Contracts of indemnity

We may perhaps also classify under this head a principle of public policy which denies effect to a contract of indemnity in so far as its enforcement would enable persons to commit crimes or torts with impunity. The law will not allow a person to claim an indemnity against loss incurred as a result of that person's own deliberate criminal or tortious act. Although it has been held that a motorist may recover under a policy of insurance against third party risks even if the motorist's own gross or criminal negligence caused the loss,[110] an assured cannot claim indemnity against the consequences of an intentional wrongful act.[111] In *Geismar* v. *Sun Alliance and London Insurance Ltd.*,[112] for example:

G had brought into the United Kingdom certain jewellery which he failed to declare to the customs and on which he failed to pay customs duty. He claimed indemnity from the defendant insurers for the loss through theft at his home of the uncustomed jewellery.

It was held that G could not enforce the contract of indemnity. And shipowners, who had been promised an indemnity by a shipper of cargo if they would issue false bills of lading, were unable to enforce the promise as it was one to indemnify them against the consequences of the tort of deceit.[113]

[106] *Ibid.*, *per* Erle J. at p. 711 ('altogether void'). See also Insolvency Act 1986, ss. 339–40.
[107] *Begbie* v. *Phosphate Sewage Co. Ltd.* (1876) 1 Q.B.D. 679.
[108] *Scott* v. *Brown, Doering, McNab & Co.* [1892] 2 Q.B. 724.
[109] [1936] 1 K.B. 169; see also *Miller* v. *Karlinski* (1945) 62 T.L.R. 85; *Napier* v. *National Business Agency Ltd.* [1951] 2 All E.R. 264; *Corby* v. *Morrison* [1980] I.R.L.R. 218; *Tinsley* v. *Milligan* [1994] 1 A.C. 340, *post*, p. 395 (social security authorities).
[110] *Tinline* v. *White Cross Insurance Co. Ltd.* [1921] 3 K.B. 327. See also *Hardy* v. *Motor Insurers' Bureau* [1964] 2 Q.B. 745.
[111] *Gray* v. *Barr* [1971] 2 Q.B. 554; *Reg.* v. *Chief National Insurance Commissioner* [1981] Q.B. 758 (but see now the Forfeiture Act 1982, s. 4) (intentional manslaughter); *Lancashire C.C.* v. *Municipal Mutual Insurance Ltd.*, *The Times*, 8 April 1996 (exemplary damages). See also *W. H. Smith & Son* v. *Clinton* (1908) 25 T.L.R. 34 (intentional libel).
[112] [1978] Q.B. 383.
[113] *Brown Jenkinson & Co. Ltd.* v. *Percy Dalton (London) Ltd.* [1957] 2 Q.B. 621. See also *Haseldine* v. *Hosken* [1933] 1 K.B. 822.

(b) Agreements which Injure the State in its Relations with Other States

Contracts with alien enemies which involve commercial relations with the enemy are illegal in time of war and it is unlawful to enter into or to perform such a contract even one made before war broke out.[114] Further, a contract which expressly provides for the suspension of all rights and obligations arising under it during a war may yet be held to be void on grounds of public policy as tending, merely by its continued existence, to promote the economic interests of the enemy state or to prejudice those of the United Kingdom.[115]

Contracts with an alien enemy

An agreement which contemplates action hostile to a friendly foreign government is unlawful and cannot be enforced. So the Courts will afford no assistance, for example, to persons in England who 'enter into engagements to raise money to support the subjects of a government in amity with our own, in hostilities against their government'.[116] It is also contrary to public policy to allow the enforcement in English Courts of agreements to be performed in a foreign state in breach of the laws of that state. 'This country', it has been said,[117] 'should not assist or sanction the breach of the laws of other independent states'. Thus the Court of Appeal has refused to entertain an action arising out of certain transactions which had for their object the importation of whisky contrary to the prohibition laws of the United States of America.[118]

Contracts hostile to a friendly state

But this does not mean to say that the Court must necessarily refuse to enforce a contract merely because its performance will involve a foreign defendant in a breach of its own law.[119] Moreover, if a foreign law is repugnant to English conceptions of liberty or freedom of action—if, for example, it involves persecution of such a character that its breach would be regarded as meritorious[120] or if it imposes a contractual incapacity which is foreign to the ideas of English law,[121] it will not be enforced here. Although the same principle has been said to apply to the penal, political, or revenue laws of other countries,[122] this formulation is too

[114] *Potts* v. *Bell* (1800) 8 Term. R. 548; *Kuenigl* v. *Donnersmarck* [1955] 1 Q.B. 515; Trading with the Enemy Act 1939. For the contractual incapacity of an alien enemy, see *Porter* v. *Freudenberg* [1915] 1 K.B. 857.

[115] *Ertel Bieber & Co.* v. *Rio Tinto Co.* [1918] A.C. 260.

[116] *De Wütz* v. *Hendricks* (1824) 2 Bing. 314, *per* Best C.J. at p. 316.

[117] *Ralli Brothers* v. *Compania Naviera Sota y Aznar* [1920] 2 K.B. 287, *per* Scrutton L.J. at p. 304. See also *Libyan Arab Foreign Bank* v. *Bankers Trust Co.* [1989] 1 Q.B. 728, *per* Staughton J., at p. 743–6; *Soleimany* v. *Soleimany*, *The Times*, 4 March 1998.

[118] *Foster* v. *Driscoll* [1929] 1 K.B. 470.

[119] *Kleinwort Sons & Co.* v. *Ungarische Baumwolle Aktiengesellschaft* [1939] 2 K.B. 678; *British Nylon Spinners Ltd.* v. *I.C.I. Ltd.* [1953] Ch. 37; *Toprak Mahsulleri Ofisi* v. *Finagrain Compagnie Commerciale Agricole et Financière* [1979] 2 Lloyd's Rep. 98.

[120] *Regazzoni* v. *K. C. Sethia (1944) Ltd.* (*infra*, n. 124), at p. 325. See also *Lemenda* v. *African Middle East Petroleum Ltd.* [1988] Q.B. 448, at p. 461; *Howard* v. *Shirlstar Container Transport Ltd.* [1990] 1 W.L.R. 1292.

[121] *In re Selot's Trusts* [1902] 1 Ch. 488.

[122] *Holman* v. *Johnson* [1775] 1 Cowp. 341, at p. 343; *Government of India Ministry of Finance* v. *Taylor* [1955] A.C. 491; *Brokaw* v. *Seatrain U.K. Ltd.* [1971] 2 Q.B. 476; *Att.-Gen. of New Zealand* v. *Ortiz* [1982] Q.B. 349. Cf. [1984] A.C. 1 at p. 46.

wide; the Court is not prepared to disregard them altogether.[123] And if two people knowingly contract to *break* such a law, they cannot expect the Court to enforce their agreement. In *Regazzoni* v. *K. C. Sethia (1944) Ltd.*:[124]

> The respondent agreed to sell and deliver to the appellant at Genoa in Italy a quantity of jute bags to be shipped from India. At that time the government of India, because of a dispute with the South African Government over the treatment of Indian nationals in that country, had prohibited the direct export of jute to South Africa, and also imposed penalties on any indirect shipments. Both the respondent and the appellant knew that the jute bags were to be shipped to South Africa in violation of the Indian prohibition. The bags were not delivered and the appellant brought an action for non-delivery.
>
> The House of Lords held that, since the contract required the export of goods from India in breach of the law of that country, it could not be enforced in this country, even though the law might be classed as a political law. The appellant accordingly failed.

(c) Agreements which Tend to Injure Good Government

Sale of offices

The public has an interest in the proper performance of their duty by public servants, and is entitled to be served by the fittest persons procurable. The Courts hold contracts to be illegal which have for their object the sale of public offices or the assignment of the salaries of such offices.

Other contracts injurious to the public service

The law will not uphold a contract whereby one of the parties agrees to use influence or position for the purpose of securing a title, contract, or some other benefit from the government for the other;[125] or an agreement whereby a member of Parliament in consideration of receiving a salary from a political association agreed to vote on every subject in accordance with the directions of the association;[126] or an agreement whereby a donation to a charity is made in consideration of a promise to secure the donor a knighthood.[127] The public has a right to demand that public officials shall not be induced merely by considerations of personal gain to act in a manner other than that which the public interest demands, and that no-one shall enter or refrain[128] from entering the public service for the same reason.

But agreements that may influence the proceedings before a public official are not necessarily against the public interest. Thus, it has been held not to be against public policy for a party to a commercial transaction involving the disposition of an interest in land to enter into a covenant to support and not to oppose a planning application by the other party.[129]

[123] *Re Emery's Investment Trusts* [1959] Ch. 410; *Empresa Exportadora De Azucar* v. *Industria Azucarera Nacional S.A.* [1983] 2 Lloyd's Rep. 171. Cf. *Re Helbert Wagg & Co. Ltd.'s Claim* [1956] Ch. 323, at p. 352.

[124] [1958] A.C. 301. Cf. *Pye* v. *B. G. Transport Service* [1966] 2 Lloyd's Rep. 300; *Fielding & Platt Ltd.* v. *Najjar* [1969] 1 W.L.R. 357.

[125] *Montefiore* v. *Menday Motor Components Co.* [1918] 2 K.B. 241.

[126] *Osborne* v. *Amalgamated Society of Railway Servants* [1910] A.C. 87.

[127] *Parkinson* v. *College of Ambulance Ltd.* [1925] 2 K.B. 1.

[128] *Re Beard* [1908] 1 Ch. 383 (armed forces).

[129] *Fulham Football Club Ltd.* v. *Cabra Estates plc* [1994] 1 B.C.L.C. 363, *per* Neill L.J. at pp. 390–1.

Assignment of salaries

The rule that the salary of a public officer cannot be assigned or charged is based on a somewhat different principle. In *Wells* v. *Foster*,[130] Lord Abinger explained it on the ground that 'it is fit that the public servants should retain the means of a decent subsistence, without being exposed to the temptations of poverty'. Agreements to assign the future instalments of salaries payable out of national funds are therefore prohibited.[131]

(d) Agreements which Tend to Pervert the Course of Justice

Promises of secrecy

The Courts will normally refuse to enforce an undertaking not to disclose misconduct which is of such a nature that it ought in the public interest to be disclosed to others who have a proper interest to receive it.[132] Nevertheless, a promise not to disclose the fact that a crime has been committed may still be lawful in the circumstances stated by Greene L.J. in *Howard* v. *Odhams Press Ltd.*: 'It may well be permissible for a person against whom frauds have been and are intended to be committed to give a promise of secrecy in order to obtain information relating to them which will enable him, by taking steps himself, to prevent the commission of future frauds'.[133] But such a promise is void if its effect is not merely to enable the protection of the party to whom the information is given, but to preclude that party from disclosing information as to frauds committed or contemplated against others to whom such information would be of use in preventing the commission of such frauds.

Compromise of criminal offences

Until the passing of the Criminal Law Act 1967, although the compromise of a prosecution for a misdemeanour which was of a private character, e.g. assault or libel, was permissible,[134] an agreement not to prosecute a felony or a misdemeanour of a public nature was not enforceable,[135] and the compounding of a felony was itself a criminal offence.[136] The Act abolished the distinction between felonies and misdemeanours and further provided that the compounding of an offence (other than treason) was no longer to be criminal by English law. Section 5 of the Act, however, established a new crime of concealing an arrestable offence[137] which is committed if a person accepts as the price of not disclosing such an offence any consideration other than the making good of loss or injury occasioned by the offence, or the making of any reasonable compensation for that loss or injury. The effect of this provision in the law of contract is enigmatic. It

[130] (1841) 8 M. & W. 149, at p. 151. See also *Roberts* v. *Roberts* [1986] 1 W.L.R. 437 (statutory prohibition of assignment of soldiers' pay and benefits).

[131] *Cooper* v. *Reilly* (1829) 2 Sim. 560. Cf. *Re Mirams* [1891] 1 Q.B. 594.

[132] *Initial Services Ltd.* v. *Putterill* [1968] 1 Q.B. 396; *Lion Laboratories Ltd.* v. *Evans* [1985] 1 Q.B. 526. See also *A.G.* v. *Guardian Newspapers Ltd.* [1990] 1 A.C. 109 at pp. 268–9.

[133] [1938] 1 K.B. 1, at p. 42.

[134] *Baker* v. *Townsend* (1817) 7 Taunt. 422; *Fisher & Co.* v. *Apollinaris Co.* (1875) L.R. 10 Ch. App. 297. See also *Keir* v. *Leeman* (1844) 6 Q.B. 308, at p. 321, affirmed (1846) 9 Q.B. 371.

[135] *Windhill Local Board of Health* v. *Vint* (1890) 45 Ch. D. 351 (obstruction of highway); *Clubb* v. *Hutson* (1865) 18 C.B.N.S. 414 (obtaining by false pretences).

[136] It was also probably an offence to compound a misdemeanour of a public nature.

[137] An offence the sentence for which is fixed by law or for which a person may be sentenced to imprisonment for 5 years, and attempts to commit such an offence.

can be argued that, subject to the rules of duress,[138] an agreement to compromise a prosecution is now legal and enforceable, provided that it is not one which is rendered criminal by the Act of 1967. The better view, however, is that the abolition of the offence of compounding did not in itself affect the rules of public policy administered by the Courts, for these were not dependent upon the fact that the agreement itself constituted a crime. Further, an agreement to compromise a criminal offence may, in certain circumstances, expose one (or possibly both) of the parties to a charge of attempting or conspiring to pervert the course of justice,[139] and the agreement will in consequence be illegal in that event.

(e) Agreements which Tend to Abuse the Legal Process

Abuse of legal process

Maintenance and champerty are two forms of agreement which the law regards as unlawful because they tend to encourage speculative litigation. It is not thought right that a person should buy an interest in another's quarrel, or should incite another to litigation by offers of assistance for which there is an expectation of payment. Someone who does this might be tempted, for personal gain, to inflame the damages, to suppress evidence, or even to suborn witnesses.[140] This head of public policy, which rests on the perceived need to protect the integrity of public justice,[141] has been significantly altered by the Courts and Legal Services Act 1990, the regulations made under it and subsequent developments.[142]

Maintenance

Maintenance occurs where a person supports litigation in which he has no legitimate concern without just cause or excuse.[143] But today, when much litigation is supported by some association or other, e.g. by trade unions or insurance companies, the concept of what is a just cause or excuse has been widened considerably.[144] Thus it has been held not to be maintenance where an employer supported an action for libel brought by an employee to protect his reputation attacked by reason of acts done by him in the course of his employment,[145] and where a national anglers' society provided funds for an action by a riparian owner against a company alleged to be polluting a particular river.[146] A genuine commercial interest may also suffice.[147] But the legitimacy of the interest of the person supporting the

[138] See *ante*, p. 270.
[139] *R.* v. *Grimes* [1968] 3 All E.R. 179; *R.* v. *Panayiotou* [1973] 1 W.L.R. 1032.
[140] *Re Trepca Mines Ltd.* [1963] Ch. 199, *per* Lord Denning M.R. at p. 219.
[141] *Giles* v. *Thompson* [1993] 3 All E.R. 321, *per* Steyn L.J. at p. 328; [1994] 1 A.C.142, *per* Lord Mustill at 164.
[142] *Post*, p. 355.
[143] *Hill* v. *Archbold* [1968] 1 Q.B. 686, at p. 694.
[144] See the historical survey in *Giles* v. *Thompson* [1993] 3 All E.R. 321, *per* Steyn L.J., at pp. 328–33, approved (*ibid.*) [1994] 1 A.C. 142, at 164, *Thai Trading Co.* v. *Taylor*, *The Times*, 6 March 1998.
[145] *Hill* v. *Archbold* (*supra*, n. 143). See also *Bourne* v. *Colodense Ltd.* [1985] I.C.R. 291 (support by trade union). Contrast *Neville* v. *London Express Newspaper Ltd.* [1919] A.C. 368 (support by newspaper).
[146] *Martell* v. *Consett Iron Co. Ltd.* [1955] Ch. 363.
[147] *British Cash and Parcel Conveyors Ltd.* v. *Lamson Stores Service Co. Ltd.* [1908] 1 K.B. 1006; *Bourne* v. *Colodense Ltd.* (*supra*, n. 145) *Trendtex Trading Cpn.* v. *Crédit Suisse* [1980] 1 Q.B. 629, at 668; [1982] A.C. 679; *Giles* v. *Thompson* [1994] 1 A.C. 142 at p. 164; *Camdex International Ltd.* v. *Bank of Zambia* [1996] 3 All E.R. 431; *Norglen Ltd.* v. *Reeds Rains Prudential Ltd.* [1997] 3 W.L.R. 1177.

action must be distinct from the benefit which that person seeks to derive from the agreement to support it.[148]

There is a conflict of judicial views on the position where a person with a legitimate interest in maintaining an action, agrees to do so but does not agree to pay the costs of action if the action of the person supported does not succeed. It is submitted that the better view is that an agreement by a person with a legitimate interest in maintaining the action will not be illegal solely on the ground that it makes no provision for the maintainer to pay the costs if the action does not succeed.[149]

Champerty

Champerty, where 'he who maintains another is to have by agreement part of the land, or debt, in suit',[150] is said to be an aggravated form of maintenance.[151] The Courts, until recently, looked with particular disfavour upon champertous agreements between solicitors and their clients under which the solicitor is to receive a share of the proceeds of the client's litigation.[152]

Agreements 'savouring of champerty'

Agreements which 'savour of champerty' will also be struck down. It is not unlawful to agree to supply information which will enable property to be recovered, in consideration of receiving a part of the property when recovered;[153] but if the person giving such information is to recover the property or actively to assist in the recovery by procuring evidence or other means, the arrangement is contrary to the policy of the law and void.[154] The question to what extent the purchase of a right of action already accrued is obnoxious to the rules against champerty is considered later in connection with the subject of assignment of choses in action.[155]

Courts and Legal Servives Act 1990, s. 58

Parliament has recognized that where legal aid is not available certain agreements which are champertous at common law confer a benefit to the public by increasing access to justice. Section 58 of the Courts and Legal Services Act 1990 permits certain speculative actions undertaken on a 'no win, no fees' basis, and validates certain agreements between lawyers and their clients for a percentage uplift in the fees in the event of success. The maximum increase under the regulations is 100 per cent.[156] Such conditional fee agreements must be in writing and must comply with the relevant regulations.[157] Conditional fee agreements

[148] *Giles* v. *Thompson* [1994] 1 A.C. 142 at p. 163.

[149] *Hayward* v. *Giffard* (1838) 4 M. & W. 194, at p. 196; *Shah* v. *Karanjia* [1993] 4 All E.R. 792; *Murphy* v. *Young & Co's Brewery plc* [1997] 1 Lloyd's Rep. 236; *Tharros Shipping Co. Ltd. and Den Norske Bank plc* v. *Bias Shipping Ltd.* [1997] 1 Lloyd's Rep. 246, at p. 250. Cf. *Hill* v. *Archbold* (*supra*, n. 143) at p. 694–5; *McFarlane* v. *E.E. Caledonia (No. 2)* [1995] 1 W.L.R. 366.

[150] Com. Dig., vol. 5, p. 22.

[151] *Giles* v. *Thompson* [1993] 3 All E.R. 321, *per* Steyn L.J. at p. 328.

[152] *Grell* v. *Levy* (1864) 16 C.B.N.S. 73; *Wild* v. *Simpson* [1919] 2 K.B. 544; *Re Trepca Mines Ltd.* [1963] Ch. 199. See also Solicitors Act 1974, s. 59; *Wallersteiner* v. *Moir (No. 2)* [1975] Q.B. 373 (contingency fees); *Aratra Potato Co. Ltd.* v. *Taylor Joynson Garrett (a firm)* [1995] 4 All E.R. 695 (acceptance of a lower fee for lost cases). See now *Thai Trading Co.* v. *Taylor*, (*supra* n. 144) (policy needed to be reconsidered afresh).

[153] *Rees* v. *De Bernardy* [1896] 2 Ch. 437.

[154] *Stanley* v. *Jones* (1831) 7 Bing. 369. See also Theft Act 1968, s. 23.

[155] See *post*, p. 459.

[156] Conditional Fees Agreements Order 1995 (S.I. 1995 No. 1674), reg. 3. But the Law Society's conditions provide for the fee to be limited to 75% of the damages recovered.

[157] Conditional Fees Agreements Regulations 1995 (S.I. 1995 No. 1675).

by clients who do not have legal aid are permitted in proceedings for personal injuries, by or on behalf of insolvent companies, and before the European Commission of Human Rights and the European Court of Human Rights.[158] It is proposed to extend this permission to all money and damages claims except family cases.[159]

Crime and tort abolished

Maintenance and champerty were both torts and crimes at common law. They were abolished by the Criminal Law Act 1967.[160] But section 14(2) of the Act expressly provides that this abolition is not to affect cases in which a contract is to be treated as contrary to public policy or otherwise illegal.

(f) Agreements which are Contrary to Good Morals

Sexual immorality

Although it has sometimes been said that contracts *contra bonos mores* are void, the only aspect of immorality with which Courts of law have actually dealt is sexual immorality.[161] The traditional approach of the Courts has been to refuse to enforce any contract which directly or indirectly promotes sexual immorality. Thus a promise by a man to pay a woman money if she would become his mistress has been held to be illegal and unenforceable.[162] And a landlord who let premises to a woman who was, to the knowledge of the landlord's agent, the kept mistress of a man who was in the habit of visiting her there, and who was expected to pay the rent, was not permitted to recover the rent reserved in the lease.[163] It is doubtful, however, whether the Courts would today adopt the same attitude to agreements involving extra-marital cohabitation.[164]

As an Australian judge has said:[165] 'The social judgments of today upon matters of "immorality" are as different from those of the last century as is the bikini from a bustle'. The law has to a considerable extent come to terms with the fact that a man and woman may set up home together and produce children in a stable relationship without being married and has afforded to the woman rights in the 'matrimonial home' equivalent to those of a wife.[166] Such rights (which may be contractual in nature) have not been denied on the ground of immorality. And

[158] Conditional Fees Agreements Order 1995 (S.I. 1995 No. 1674), reg 2.
[159] See Bawden [1997] N.L.J. 1559; Hoon (*ibid.*) 1611; Tunkel (*ibid.*) 1784; Harrison (*ibid.*) 1786.
[160] ss. 13, 14.
[161] *Coral Leisure Group Ltd.* v. *Barnett* [1981] I.C.R. 503, at p. 506.
[162] *Walker* v. *Perkins* (1764) 1 W. Bl. 517; *Benyon* v. *Nettlefold* (1850) 3 Mac. & G. 94. But a promise made in consideration of past illicit cohabitation merely lacks consideration, and is not illegal: *Beaumont* v. *Reeve* (1846) 8 Q.B. 483.
[163] *Upfill* v. *Wright* [1911] 1 K.B. 506.
[164] See Dwyer (1977) 93 L.Q.R. 386.
[165] *Andrews* v. *Parker* [1973] Qd. R. 93, *per* Stable J. at p. 104.
[166] *Eves* v. *Eves* [1975] 1 W.L.R. 1338; *Tanner* v. *Tanner* [1975] 1 W.L.R. 1346; *Paul* v. *Constance* [1977] 1 W.L.R. 527. See also the Domestic Violence and Matrimonial Proceedings Act 1976, s. 1(2) (to be repealed and replaced by Part IV of the Family Law Act 1996, see especially s. 62 defining cohabitants); *Davis* v. *Johnson* [1979] A.C. 264; *Tinsley* v. *Milligan* [1994] 1 A.C. 340, *post*, p. 395 (where what made the agreement illegal was that its purpose was to defraud the social security, rather than that it concerned lesbian cohabitees). See also *Barclays Bank plc* v. *O'Brien* [1994] 1 A.C. 180, at p. 198; *Marvin* v. *Marvin* 557 P. 2d 106 (1976); *Whorton* v. *Dillingham* 202 Cal. App. 3d 447 (1988) (California).

the Court of Appeal has held that an agreement to advertise telephone sex lines is not unenforceable on the grounds of immorality.[167]

On the other hand, it seems unlikely that an agreement which involves prostitution would be enforced. An action cannot be maintained to recover the rent of premises knowingly let for the purposes of prostitution,[168] or upon a contract of employment which requires the employee to procure prostitutes for customers of the employer.[169] Also in *Pearce* v. *Brooks*:[170]

The plaintiffs, a firm of coach-builders, agreed with a prostitute to hire to her an ornamental brougham of an intriguing design, with the knowledge that it was to be used by her in the furtherance of her trade. She failed to pay the hire, and the plaintiffs brought an action to recover the money.

It was held that they could not recover.

(g) Agreements which Affect the Freedom or Security of Marriage or the Due Discharge of Parental Duty

Restraint of marriage

Such agreements, in so far as they restrain the freedom of marriage, are discouraged on public grounds as injurious to the moral welfare of the citizen. Thus a promise under seal by a man 'not to marry with any person besides Mrs. Catherine Lowe; and if I do, to pay to the said Mrs. Catherine Lowe the sum of £2,000' was held void, as there was no promise of marriage on either side and the agreement was purely restrictive.[171]

Marriage brokage

Marriage brokage contracts, or promises made upon the consideration of procuring a marriage between two persons, are held illegal 'not for the sake of the particular instance or the person, but of the public, and that marriages may be on a proper foundation'.[172] And even an agreement to introduce a person to others of the opposite sex with a view to marriage (as in the case of a matrimonial bureau or dating agency) has been held invalid, although there is a choice given of a number of persons, and not an effort to bring about marriage with a particular person.[173] It is submitted that decisions such as these require reconsideration in the light of modern conditions. If they remain good law the transactions between the many marriage bureaux and dating agencies and their clients may be unenforceable.

Promises by person already married

At common law, the breach of a promise to marry after his wife's death, made by a married man to a woman who knew him to be married, was not actionable.[174]

[167] *Armhouse Lee Ltd.* v. *Chappell*, *The Times*, 7 August 1996.
[168] *Girardy* v. *Richardson* (1793) 1 Esp. 13.
[169] Cf. *Coral Leisure Group Ltd.* v. *Barnett* [1981] I.C.R. 503.
[170] (1866) L.R. 1 Ex. 213. See also *Armhouse Lee Ltd.* v. *Chappell*, *The Times*, 7 August 1996 (agreements to promote sex dating probably illegal).
[171] *Lowe* v. *Peers* (1768) 4 Burr. 2225.
[172] *Cole* v. *Gibson* (1750) 1 Ves. Sen. 503, *per* Lord Eldon at p. 506.
[173] *Hermann* v. *Charlesworth* [1905] 2 K.B. 123. *Sed quaere*, and note (*post*, p. 391) the liberal approach to the restitution of money paid under such an agreement after substantial performance, and compare the general approach, *post*, p. 388.
[174] But if she did not know, she could bring an action for breach: *Shaw* v. *Shaw* [1954] 2 Q.B. 429. See now the Inheritance (Provision for Family and Dependents) Act 1975; *post*, p. 411 n. 27.

Such a contract, it was said, was 'not only inconsistent with that affection which ought to subsist between married persons, but is calculated to act as a direct inducement to immorality'.[175] Actions for breach of promise of marriage have now, however, been abolished.[176]

Agreements for separation

Agreements providing for the separation of husband and wife are valid if made in prospect of an immediate separation; but it is otherwise if they contemplate a possible separation in the future, because they then give inducements to the parties not to perform their matrimonial duties, in the fulfilment of which society has an interest.[177]

Parental duty

For the same reason a parent cannot by contract transfer to another his or her rights and duties in respect of a child, because the law imposes such duties in respect of the minor and for its benefit.[178] In a proper case, however, an adoption order can be obtained from the Court under the Adoption Act 1976. Statute expressly provides that a surrogacy agreement, i.e. an agreement by a woman to carry and bear a child at the behest of another with a view to that other person subsequently assuming the parental role, is unenforceable.[179]

(h) Agreements which Oust the Jurisdiction of the Courts

Ousting jurisdiction of Courts

At common law an agreement which purports to oust the jurisdiction of the Courts is contrary to public policy and void.[180] It is the policy of the common law that citizens have the right to have their legal position determined by the ordinary tribunals. In the case of arbitration, the common law position has been substantially modified by statute, particularly in the case of arbitrations involving foreign nationals and companies.

Arbitration clauses

There is no objection to contracts which contain a clause that any dispute or difference between the parties is to be referred to and settled by arbitration. Such a clause is valid and binding. An arbitration clause which requires as a condition precedent to the accrual of any cause of action that the arbitrator shall have made an award is not contrary to public policy. Such a clause is common in arbitration agreements and is known as a '*Scott* v. *Avery*' clause.[181] It does not oust the jurisdiction of the Court but merely provides that the cause of action shall not be complete until the arbitration award is made. A similar provision known as an '*Atlantic Shipping*' clause is also frequently inserted, and this provides that no claim shall

[175] *Wilson* v. *Carnley* [1908] 1 K.B. 729, *per* Farwell L.J. at p. 740. Cf. *Fender* v. *St. John-Mildmay* [1938] A.C. 1.

[176] Law Reform (Miscellaneous Provisions) Act 1970, s. 1. But see s. 2 and *Mossop* v. *Mossop* [1988] 2 F.L.R. 173 (regarding disputes about property).

[177] *Cartwright* v. *Cartwright* (1853) 3 De G.M. & G. 982.

[178] *Humphreys* v. *Polak* [1901] 2 K.B. 385. See also Children Act 1989, s 2.

[179] Human Fertilisation and Embryology Act 1990, s. 36. See also *Re P. (Minors) (Wardship: Surrogacy)* [1987] 2 F.L.R. 421.

[180] *Czarnikow* v. *Roth Schmidt* [1922] 2 K.B. 478. But cf. *Jones* v. *Sherwood Computer Services plc.* [1992] 1 W.L.R. 277; Kendall (1993) 109 L.Q.R. 385 (question remitted to expert); *West of England Shipowners Mutual Insurance Association* v. *Crystal Ltd.* [1996] C.L.C. 241, at p. 248 (a chosen tribunal may be the final arbiter on questions of fact).

[181] *Scott* v. *Avery* (1855) 5 H.L.C. 811. Cf. Arbitration Act 1996, ss. 9(4)–(5).

arise unless it is put forward in writing and an arbitrator appointed within a limited period.[182] Its validity rests upon the same foundation.

Provision is made in the Arbitration Act 1996 for an appeal to the Court on points of law arising out of an arbitrator's award.[183] There are, however, a number of limits on this right. For example, unless all the parties agree to the appeal then leave of the Court is required.[184] Moreover, the parties may agree to exclude the jurisidiction of the Court. In the case of a domestic arbitration agreement[185] such an exclusion will be upheld if entered into during arbitration proceedings.[186] In the case of non-domestic arbitration agreements, the freedom of the parties to include such a clause is not restricted in any way.[187]

Foreign jurisdiction clauses

The Courts will normally uphold a clause in a contract whereby any dispute between the parties is to be referred to the exclusive jurisdiction of a foreign court. But such a clause is not absolutely binding, and may be overridden if England is the more convenient forum.[188]

Maintenance agreements

Another example of an agreement which ousts the jurisdiction of the Courts is one in which a wife contracts not to apply to the Courts for maintenance in return for a promise by the husband that he will make her a definite allowance.[189] The right of the Court to award maintenance cannot be ousted, although the financial arrangements are not thereby rendered void or unenforceable.[190]

(i) Anti-Competitive Agreements: Restraint of Trade[191]

Restraint of trade defined

An agreement in restraint of trade has been defined as 'one in which a party (the covenantor) agrees with any other party (the covenantee) to restrict his liberty in the future to carry on trade with other persons not parties to the contract in such a manner as he chooses'.[192] This definition will do well as a working definition, provided it is not applied too literally. In one sense, all commercial contracts restrain trade; for when one person binds another by contract, say to sell a Sheraton writing table or a particular cargo of oil, the seller is restricted in its future liberty to deal lawfully in that subject-matter with persons not parties to the contract. Yet ordinary commercial contracts are clearly not tainted with invalidity. It is only such contracts as the Courts from time to time recognize to fall

[182] *Atlantic Shipping and Trading Co.* v. *Dreyfus (L.) & Co.* [1922] 2 A.C. 250. But see Arbitration Act 1996, s. 12.

[183] *Ibid.*, s. 69(1). See also ss. 70 and 71.

[184] *Ibid.*, s. 69(2)–(3).

[185] Defined in *ibid.*, s. 85, and broadly, not involving foreign nationals, residents, and companies.

[186] *Ibid.*, ss. 69 and 87(1).

[187] *Ibid.*, s. 69(1).

[188] *The Fehmarn* [1958] 1 W.L.R. 159; *The Eleftheria* [1970] P. 54; *The Adolf Warski* [1976] 1 Lloyd's Rep. 107. But see the Civil Jurisdiction and Judgments Act 1982, Sched. 1, art. 17.

[189] *Hyman* v. *Hyman* [1929] A.C. 601. See Cretney, in Rose ed., *Consensus ad idem* (1996), pp. 269–74.

[190] Matrimonial Causes Act 1973, s. 34. Cf. *Sutton* v. *Sutton* [1984] Ch. 184. A financial agreement which is then embodied in a consent order will bar further application to the Court. *De Lasala* v. *De Lasala* [1980] A.C. 546, at p. 560.

[191] See Heydon, *The Restraint of Trade Doctrine* (1971).

[192] *Petrofina (Great Britain) Ltd.* v. *Martin* [1966] Ch. 146, *per* Diplock L.J. at p. 180, adopted by Lord Hodson in *Esso Petroleum Co. Ltd.* v. *Harper's Garage (Stourport) Ltd.* [1968] A.C. 269, at p. 317. See also *ibid.*, p. 307 (Lord Morris).

within this category which will be considered as 'agreements in restraint of trade'. Two classes of agreement have long been so regarded.

Traditional categories

First, agreements between employers and employees, whereby the employees covenant not to set up business on their own account on leaving the employers' service or to enter into employment with a rival firm. Secondly, an agreement between the buyer and seller of a business together with its goodwill, whereby the seller covenants not to carry on a business which will compete with that of the buyer.

Outside of these traditional instances, there is no definitive way of determining whether or not an agreement is in restraint of trade. Indeed, Lord Wilberforce has said:[193]

> The common law has often (if sometimes unconsciously) thrived on ambiguity and it would be mistaken, even it were possible, to try to crystallise the rules of this, or any, aspect of public policy into neat propositions. The doctrine of restraint of trade is one to be applied to factual situations with a broad and flexible rule of reason.

The factual situations which invite the application of the doctrine will change with prevailing economic and social conditions, and it is important to bear in mind that those referred to later in this chapter are not exhaustive: 'the classification must remain fluid and the categories can never be closed'.[194] But at this point of time, when economic theory indicates that a competitive economy produces more beneficial results—from the point of view of the public—than a non-competitive economy, it is tempting to define a contract in restraint of trade as being one which is designed to restrict competition,[195] although it must be admitted that there is no judicial authority for this formulation and it has been authoritatively stated that the reason for the Courts' intervention in cases of restraint of trade is simply to protect the weaker party against oppression.[196]

The law concerning restraint of trade has also changed from time to time, both in form and in spirit, in response to changes in conditions of trade. In modern law the operation of the common law doctrine, particularly concerning agreements for exclusive dealing and market-sharing, has been significantly affected by both national and European Community legislation which seeks to control anti-competitive practices, which are of wider application than the common law doctrine and which are primarily administered by regulatory authorities.[197]

(i) History of the doctrine

General and partial restraints

The earliest cases show a disposition to avoid all contracts 'to prohibit or restrain any person to use a lawful trade at any time, or at any place', as being 'against the benefit of the Commonwealth'.[198] But soon it became clear that the public inter-

[193] *Esso Petroleum Co. Ltd.* v. *Harper's Garage (Stourport) Ltd.* (*supra*, n. 192), at p. 331.
[194] *Ibid.*, at p. 337.
[195] Guest (1968) 2 J.A.L.T. 3. Contrast *Texaco Ltd.* v. *Mulberry Filling Station Ltd.* [1972] 1 W.L.R. 814, at p 827; Heydon (1969) 85 L.Q.R. 229.
[196] *A. Schroeder Music Publishing Co. Ltd.* v. *Macaulay* [1974] 1 W.L.R. 1308, *per* Lord Diplock at pp. 1315–16.
[197] *Post*, pp. 372–4, 376.
[198] *Colgate* v. *Bachelor* (1569) Cro. Eliz. 872.

est would not suffer if a person who sold the goodwill of a business undertook an obligation not to enter into immediate competition with the buyer. By the beginning of the eighteenth century it was established that contracts in *partial* restraint, if reasonable and not contrary to the public interest, would be upheld,[199] but that a general restraint, that is not limited to a place and in time, remained unenforceable.[200] But as trade expanded and the dealings of individuals ceased to be confined to a particular locality, the distinction between general and partial restraints began to appear anomalous, and inapplicable to the prevailing conditions of trade. In the sale of the goodwill of a business the buyer might, in earlier times, have been sufficiently protected by limited restrictions as to the place or persons with whom the seller should henceforth deal, but this is not so where an individual or a company supplies goods or services in a national or international market.

Reformulation of the doctrine

The policy of the law in respect of restraint of trade was adapted once again in 1894 by the House of Lords in *Nordenfelt* v. *Maxim Nordenfelt Guns and Ammunition Co. Ltd.*:[201]

The appellant, Nordenfelt, was a maker and inventor of guns and ammunition. He sold his business to the respondent company for £287,500 and entered into a covenant (later to be repeated in a contract of service) that he would not for 25 years 'engage . . . either directly or indirectly in the trade or business of a manufacturer of guns, gun mountings or carriages, gunpowder explosives or ammunition, or in any business competing or liable to compete in any way with that for the time being carried on by the company', but expressly reserved the right to deal in explosives other than gunpowder, in torpedoes or submarine boats, and in metal castings or forgings. After some years Nordenfelt entered into a business with a rival company dealing with guns and ammunition, and the respondents sought an injunction to restrain him from so doing.

It is clear that the restraint entered into by Nordenfelt was of a general, and not merely a partial, nature, since there was no limit placed on the area to which it was to extend. Nevertheless, it was held that this did not, of itself, mean that the covenant was void. Their Lordships were of the opinion that the covenant not to compete with the company 'in *any* business competing or liable to compete in any way with that for the time being carried on by the company' was unreasonable, as it attempted to protect not only the business as it was when sold, but any future activities of the company. It was therefore void; but this clause was distinct and severable from the rest of the agreement. As for the remainder of the restraint, in so far as it protected the business actually sold, it was reasonable between the parties, because Nordenfelt not only received a large sum of money, but also by his reservation retained scope for the exercise of his inventive and manufacturing skill. Moreover, the wide area over which the business extended necessitated a restraint co-extensive with that area for the protection of the respondents. Finally it could not be said to be contrary to the public interest since it transferred to an English company the making of guns and ammunition for foreign lands. The restraint was therefore valid.

[199] *Rogers* v. *Parry* (1613) Bulst. 136.
[200] *Mitchel* v. *Reynolds* (1711) 1 Peere Wms. 181, at p. 191.
[201] [1894] A.C. 535.

The House of Lords, however, after considering the previous authorities, went on to express the view that the division of agreements in restraint of trade into two classes—general and partial (the former being necessarily void and unenforceable in all cases, the latter only if unreasonable or injurious to the public interest)—could no longer be sustained as a rule of the common law. All contracts, said Lord Macnaghten, which had for their object the restraint of trade, were *prima facie* void, but all might be justified if they were reasonable in the interests of the parties and of the public:

> The true view at the present time I think, is this: The public have an interest in every person's carrying on his trade freely: so has the individual. All interference with individual liberty of action in trading, and all restraints of trade of themselves, if there is nothing more, are contrary to public policy, and therefore void. That is the general rule. But there are exceptions: restraints of trade and interference with individual liberty of action may be justified by the special circumstances of a particular case. It is a sufficient justification, and indeed it is the only justification, if the restriction is reasonable—reasonable, that is, in the interests of the public, so framed and so guarded as to afford adequate protection to the party in whose favour it is imposed, while at the same time it is in no way injurious to the public.[202]

(ii) The modern law

Modern rules as to restraints

Lord Macnaghten's speech in the *Nordenfelt* case is the foundation of the modern law on the subject, and as a result of it and later cases in which it has been elucidated we may lay down certain propositions of law:

(1) All restraints of trade, in the absence of special justifying circumstances, are contrary to public policy and do not give rise to legally binding obligations, and in that sense are void.[203] But in this context being void does not mean that the agreement will be disregarded for all purposes, and it has been said that a contract in restraint of trade should more properly be spoken of as one 'which the law will not enforce'.[204] It is not unlawful for the parties to agree to implement it, and if the parties do so the courts will not later allow them to recover sums paid under the agreement or property transferred on the basis that the agreement is of no effect whatsoever.[205] But, as we shall see, in certain situations it is the effect of an agreement on third parties which renders the agreement in unreasonable restraint

[202] At p. 565.

[203] This proposition, as Younger L.J. pointed out in *Attwood* v. *Lamont* [1920] 3 K.B. 571, at pp. 585, 587, nevertheless runs counter to a number of cases decided both before and after the *Nordenfelt* case in which the lower Courts have held that a partial restraint was *prima facie* valid: *Mills* v. *Dunham* [1891] 1 Ch. 576, at p. 586; *Haynes* v. *Doman* [1899] 2 Ch. 13, at p. 30. But in *Mason* v. *Provident Clothing & Supply Co. Ltd.* [1913] A.C. 724, the House of Lords confirmed Lord Macnaghten's assertion and it is now beyond challenge.

[204] *Joseph Evans & Co. Ltd.* v. *Heathcote* [1918] 1 K.B. 418, *per* Bankes L.J. at p. 431.

[205] *Boddington* v. *Lawton* [1994] I.C.R. 478, *per* Nicholls V.-C. at pp. 491–3. See also *Joseph Evans & Co. Ltd.* v. *Heathcote* [1918] 1 K.B. 418; *Esso Petroleum Co. Ltd.* v. *Harper's Garage (Stourport) Ltd.* [1968] A.C. 269, at p. 297; *Schroeder Music Publishing Co. Ltd.* v. *Macaulay* [1974] 1 All E.R. 174, at p. 181, aff'd [1974] 1 W.L.R. 1308.

of trade, and, in such cases, the third parties may be able to challenge the agreement.[206]

(2) It is a question of law for the decision of the Court whether the special circumstances adduced do or do not justify the restraint; and if a restraint is not justified, the Court will, if necessary, take the point, since it relates to a matter of public policy, and the Court does not enforce agreements which are contrary to public policy.[207]

(3) A restraint can only be justified if it is reasonable (a) in the interests of the contracting parties, and (b) in the interests of the public.

(4) The onus of showing that the restraint is reasonable between the parties rests upon the person alleging that it is so, that is to say, upon the covenantee.[208] The onus of showing that, notwithstanding that a covenant is reasonable between the parties, it is nevertheless injurious to the public interest and therefore void, rests upon the party alleging it to be so, that is to say, usually upon the covenantor.[209] But once the agreement is before the Court it is open to scrutiny in all its surrounding circumstances as a question of law.[210]

(5) Covenants in restraint of trade are construed (a) with reference to the object sought to be obtained, that is the protection of one of the parties against competition in trade, and (b) in their context and in the light of the factual matrix when the agreement was made.[211]

Reasonableness as a test for the validity of a restraint, however, requires further consideration.

(iii) Reasonableness in the interests of the parties

Reasonableness between parties

The application of this test will depend on the answers to two questions: what is it that the covenantee is entitled to protect, and how far can such protection extend?

Interests of the covenantee

A covenant cannot be considered reasonable unless it is designed to protect the legitimate interests of the covenantee. The nature of the interests recognized as legitimate by the law will vary according to the subject-matter of the contract. For example, the buyer of a business with its goodwill is entitled to prevent the seller from competing with the business sold. The buyer has acquired a business which, from the nature of the case, has been immune from competition by the person who has sold it, and the goodwill of that business is an interest which the buyer is legitimately entitled to protect. On the other hand, an employer cannot in the same way prevent competition by a former employee, or restrict the use by the employee of personal skill and knowledge acquired in the course of the

[206] *Post*, p. 380.

[207] *Wyatt* v. *Kreglinger and Fernau* [1933] 1 K.B. 793, at p. 806; *North Western Salt Co. Ltd.* v. *Electrolytic Alkali Co. Ltd.* [1914] A.C. 461, at p. 470.

[208] *Mason* v. *Provident Clothing & Supply Co. Ltd.* [1913] A.C. 724, at p. 733; *Herbert Morris Ltd.* v. *Saxelby* [1916] 1 A.C. 688, at p. 700; *Attwood* v. *Lamont* [1920] 3 K.B. 571, at p. 587.

[209] *Herbert Morris Ltd.* v. *Saxelby* (*supra*, n. 209), at pp. 700, 708; *Att.-Gen. of Commonwealth of Australia* v. *Adelaide Steamship Co. Ltd.* [1913] A.C. 781, at p. 795.

[210] *Esso Petroleum Co. Ltd.* v. *Harper's Garage (Stourport) Ltd.* [1968] A.C. 269, at p. 319.

[211] *Clarke* v. *Newland* [1991] 1 All E.R. 397, at p. 402.

employment. The employer is entitled only to protect its trade secrets, and to prevent the use by the employee of influence acquired over its clients or customers.[212] The social policy which lies behind this distinction was thus explained by Lord Shaw in *Herbert Morris Ltd.* v. *Saxelby*:[213]

> When a business is sold the vendor, who, it may be, has inherited it or built it up, seeks to realize this piece of property, and obtains a purchase upon a condition without which the whole transaction would be valueless. He sells, he himself agreeing not to compete; and the law upholds such a bargain, and declines to permit a vendor to derogate from his own grant. Public interest cannot be invoked to render such a bargain nugatory: to do so would be to use public interest for the destruction of property. Nothing could be a more sure deterrent to commercial energy and activity than a principle that its accumulated results could not be transferred save under conditions which would make its buyer insecure.
>
> In the case of restraints upon the opportunity to a workman to earn his livelihood, a different set of considerations comes into play. No actual thing is sold or handed over by a present to a future possessor. The contract is an embargo upon the energies and activities and labour of a citizen; and the public interest coincides with his own in preventing him, on the one hand, from being deprived of the opportunity of earning his living, and in preventing the public, on the other from being deprived of the work and service of a useful member of society. In this latter case there is not a something already realized, made over to and for the use of another; but there is something to be created, developed, and rendered to the individual advantage of the worker and to the use of the community at large.

Even in the case of an agreement between the buyer and seller of a business, the law will not permit a covenant which merely restricts competition, and does not protect the interest of the buyer in the business actually sold.[214] But where the question of restraint of trade is raised in relation to non-traditional agreements, the law, as we shall see,[215] adopts a much more lenient attitude, and recognizes as a legitimate interest the right of the covenantee to secure its competitive position in the market, or to maintain the effectiveness and stability of its organization.[216] What interests can be protected will therefore depend upon the nature of the contract.

Extent of protection

Once it is established that the covenantee has a legitimate interest which it is entitled to protect, the question then arises as to the extent of the protection which it is entitled to claim for it. The general rule is that it must not be longer in point of time, or wider in area, or otherwise be more extensive in scope than is necessary to protect that interest. Particular instances in which this rule has been applied will be noted hereafter.[217] Again, however, the answer to this question in any individual case must necessarily depend upon the interest to be protected, the nature of the contract and the relative positions of the contracting parties.

[212] *Faccenda Chicken Ltd.* v. *Fowler* [1987] Ch. 117, at p. 137.
[213] [1916] 1 A.C. 688, at pp. 713–14.
[214] See *post*, p. 370.
[215] See *post*, p. 374.
[216] *Eastham* v. *Newcastle United Football Club Ltd.* [1964] Ch. 413; *Esso Petroleum Co. Ltd.* v. *Harper's Garage (Stourport) Ltd.* [1968] A.C. 269. See also *McEllistrim* v. *Ballymacelligott Co-operative Agriculture and Dairy Society Ltd.* [1919] A.C. 548, at pp. 563–4.
[217] See *post*, pp. 368, 374.

Restraint must be reasonable for both parties

The restraint must be reasonable not only in the interests of the covenantee, but of both parties. At first sight it might appear that any restraint, since it protects the covenantee alone, must be opposed to the interests of the covenantor, but if the transaction is regarded as a whole this is clearly not so. If the vendor of a business could not covenant not to compete with the person to whom it is being sold, the business would command a lower price; if employees could not bind themselves not to convey trade secrets to their employers' rivals, they might not so readily obtain proper training or employment. 'As long as the restraint to which he subjects himself is no wider than is required for the adequate protection of the person in whose favour it is created, it is in his [i.e. the covenantor's] interest to be able to bind himself for the sake of the indirect advantages he may obtain by so doing.'[218]

Consideration

It has been said that the Court will not 'weigh the advantages accruing to the covenantor under the contract against the disadvantages imposed upon him by the restraint';[219] in other words, it will not consider the adequacy of the consideration which the covenantor has received. But this has been doubted,[220] and the better view is that a restraint can be reasonable or otherwise according to whether sufficient compensation has been given to the covenantor: 'the quantum of consideration may enter into the reasonableness of the contract'.[221]

Time

The reasonableness of the restraint is normally to be determined at the time the covenant was entered into. But in *Shell U.K. Ltd.* v. *Lostock Garage Ltd.*,[222] Lord Denning M.R. held that a covenant which, though at its inception was reasonable, could become unenforceable if it was found afterwards to operate unreasonably or unfairly in circumstances that were not envisaged beforehand. This approach did not, however, receive the support of the other members of the Court of Appeal in the case.[223]

(iv) Reasonableness in the interests of the public

Reasonableness in the interests of the public

Cases in which a restraint has been held void as not being reasonable in the interests of the public are not common. Indeed, in 1913, the Judicial Committee of the Privy Council observed that 'their Lordships are not aware of any case in which a restraint, though reasonable in the interests of the parties, has been held unenforceable because it involved some injury to the public',[224] and it was further said that 'if once the Court is satisfied that the restraint is reasonable as between the parties this onus [of proving injury to the public] will be no light one'.[225] More recently, however, in relation to certain types of agreement such as cartels[226] and

[218] *Herbert Morris Ltd.* v. *Saxelby* [1916] 1 A.C. 688, *per* Lord Parker at p. 707. See also Lord Shaw, quoted *ante*, p. 364.
[219] *Ibid.*
[220] *Esso Petroleum Co. Ltd.* v. *Harper's Garage (Stourport) Ltd.* [1968] A.C. 269, at pp. 300, 318, 323.
[221] *Nordenfelt* v. *Maxim Nordenfelt Guns and Ammunition Co. Ltd.* [1894] A.C. 535, *per* Lord Macnaghten at p. 565; *Allied Dunbar (Frank Weisenger) Ltd.* v. *Weisinger* [1988] I.R.L.R. 60.
[222] [1976] 1 W.L.R. 1187.
[223] Ormrod and Bridge L.JJ.
[224] *Att.-Gen. of Commonwealth of Australia* v. *Adelaide Steamship Co.* [1913] A.C. 781, at p. 795.
[225] *Ibid.*, at p. 797.
[226] See *post*, p. 370.

er forms of restrictive trading agreements,[227] there has been a distinct shift of phasis in favour of recognizing the importance of the interests of the public.[228] ch agreements are, as a general rule, freely entered into between traders who perfectly capable of deciding for themselves what is reasonable in their own interests. So the real point at issue is whether the maintenance of the restraint is detrimental to the interests of the public.

Single test approach

Even where cases are decided on the basis of reasonableness between the parties, it is *ultimately* on the ground of public policy that the Court will decline to enforce an unreasonable restraint. As Lord Pearce has said: 'There is not, as some cases seem to suggest, a separation between what is reasonable on grounds of public policy and what is reasonable as between the parties. There is one broad question: is it in the interests of the community that this restraint should, as between the parties, be held to be reasonable and enforceable?'[229]

(v) Different types of contract

Classes of contract in restraint of trade

Having thus briefly examined the principles applicable to all contracts in restraint of trade, it is now necessary to consider more particularly some of the various types of contract to which the doctrine has been applied. But it should be noted that the issue of whether a covenant in restraint of trade is reasonable ultimately falls to be decided by reference to the legitimate interests that are sought to be protected and not by a classification of the relationship between the parties.[230]

Between employer and employee

(1) *Covenants between employer and employee.* Covenants imposing restraints upon an employee which operate only during the currency of the contract of employment cannot normally be challenged on the ground that they are unreasonable. During this period an employer has the exclusive right to the services of the employee and the doctrine of restraint of trade will have no application unless the employee is too unilaterally fettered or the contract has as its object the sterilizing rather than the absorption of a person's capacity for work.[231]

But if covenants are imposed which restrain the employee's freedom to work *after* the termination of the employment, those covenants must be reasonable in the interests of the parties and of the public. Whether a clause is or is not in restraint of trade will be judged by the effect the clause has in practice,[232] and this is determined by the circumstances that existed at the time of formation.[233]

[227] See *post*, p. 374.

[228] *Esso Petroleum Co. Ltd.* v. *Harper's Garage (Stourport) Ltd.* [1968] A.C. 269, at pp. 300–1, 318–19, 321, 324, 330, 340–1. See also *Dickson* v. *Pharmaceutical Society of Great Britain* [1970] A.C. 403, at p. 441. But cf. the more cautious approach adopted by Ungoed-Thomas J. in *Texaco Ltd.* v. *Mulberry Filling Station Ltd.* [1972] 1 W.L.R. 814, at pp. 826–9; *post*, p. 378. See also *Alec Lobb (Garages) Ltd.* v. *Total Oil (Great Britian) Ltd.* [1985] 1 W.L.R. 173 at p. 191.

[229] *Esso Petroleum Co. Ltd.* v. *Harper's Garage (Stourport) Ltd.* (*supra*, n. 228), at p. 324.

[230] *Bridge* v. *Deacons* [1984] 1 A.C. 705, at p. 714.

[231] *Young* v. *Timmins* (1831) 1 Cr. & J. 331; *Esso Petroleum Co. Ltd.* v. *Harper's Garage (Stourport) Ltd.* (*supra*, n. 228), at pp. 294, 328, 329; *A. Schroeder Music Publishing Co. Ltd.* v. *Macaulay* [1974] 1 W.L.R. 1308; *Clifford Davis Management Ltd.* v. *W.E.A. Records Ltd.* [1975] 1 W.L.R. 61.

[232] See e.g. *Stenhouse Australia Ltd.* v. *Phillips* [1974] A.C. 391; *Sadler* v. *Imperial Life Assurance Co. of Canada Ltd.* [1988] I.R.L.R. 388. Cf. *Watson* v. *Prager* [1991] 1 W.L.R. 726 at p. 749.

[233] *Briggs* v. *Oates* [1991] 1 All E.R. 407 at p. 417; *Watson* v. *Prager* [1991] 1 W.L.R. 726 at p. 738. But where the contract has been discharged because of the *employer's* breach, the employee is released

Interest of employer

As has already been seen, an employer is generally entitled to protect its trade secrets or other confidential information, and to prevent the misuse by the employee of acquaintance with the employer's clients or customers.[234] An employer also has an interest in a stable workforce, and will be able to impose restrictions on the solicitation of employees.[235] But an employer cannot inhibit the use of the employee's own skill and experience, even if this is acquired during the course of the employment:

> The reason, and the only reason, for upholding such a restraint on the part of an employee is that the employer has some proprietary right, whether in the nature of trade connection or in the nature of trade secrets, for the protection of which such a restraint is—having regard to the duties of the employee—reasonably necessary. Such a restraint has, so far as I know, never been upheld, if directed only to the prevention of competition or against the use of personal skill and knowledge acquired by the employee in his employer's business.[236]

Yet the dividing line between confidential information and personal skill and knowledge may not be easy to draw. In 1909, in the case of *Sir W. C. Leng & Co. Ltd.* v. *Andrews*:[237]

> A Sheffield newspaper took from one of its junior reporters a covenant that he would not, after leaving his employment, be connected with any other newspaper within 20 miles of that city. The newspaper claimed that this was necessary to protect its 'organisation' and 'sources of information'.

It was held that these interests did not merit protection. Today, however, business 'know-how' is regarded as a thing of value, a saleable commodity. Although it is not precisely of the same nature as a trade secret, it is nevertheless not simply part of the employee's stock of experience. If 'know-how' involves an element of confidentiality it can be protected,[238] and in principle the Courts should recognize 'know-how' as an interest capable of protection in its own right where it

from the covenants; *General Billposting Co. Ltd.* v. *Atkinson* [1909] A.C. 118; *Rock Refrigeration Ltd.* v. *Jones* [1997] 1 All E.R. 1, Phillips L.J. *dubitante*, and see *post* pp. 546, 551.

[234] *Faccenda Chicken Ltd.* v. *Fowler* [1987] Ch. 117 at p. 137; *Systems Reliability Holdings plc* v. *Smith* [1990] I.R.L.R. 377; *Dawnay, Day & Co. Ltd.* v. *de Braconier D'Alphen* [1997] I.R.L.R. 285, aff'd *The Times*, 24 June 1997. But it has been stated *obiter* (*Faccenda Chicken Ltd.* v. *Fowler*, *ibid.* at p. 136) that confidential information falling short of a trade secret or its equivalent cannot, to the extent that it is inevitably carried away in the employee's head as part of the employee's skill and knowledge, be protected after the employment has ended. *Sed quaere*. Cf. *Roger Bullivant Ltd.* v. *Ellis* [1987] I.C.R. 464, at p. 473; *Systems Reliability Holdings plc* v. *Smith* (*supra*) at p. 384.

[235] *Dawnay, Day & Co. Ltd.* v. *de Braconier D'Alphen* (*supra*, n. 234). See also Sales (1988) 104 L.Q.R. 600.

[236] *Herbert Morris Ltd.* v. *Saxelby* [1916] 1 A.C. 688, *per* Lord Parker at p. 710. See also *Faccenda Chicken Ltd.* v. *Fowler* (*supra*, n. 234) at p. 137; *Office Angels Ltd.* v. *Rainer-Thomas and O'Connor* [1991] I.R.L.R. 214.

[237] [1909] 1 Ch. 763.

[238] *Printers and Finishers Ltd.* v. *Holloway* [1965] 1 W.L.R. 1, at p. 5; *Commercial Plastics Ltd.* v. *Vincent* [1965] 1 Q.B. 623, at p. 642. See also *Lansing Linde Ltd.* v. *Kerr* [1991] 1 W.L.R. 251, at pp. 260, 270 (trade secrets can include highly confidential information of a non-technical nature, e.g. names of customers and goods they buy); *Johnson & Bloy (Holdings) Ltd.* v. *Wolstenholme Rink plc* [1989] 1 F.S.R. 135; *Universal Thermosensors Ltd.* v. *Hibben* [1992] 1 W.L.R. 840.

can be separated from what the employee can legitimately claim to be his own skill and experience, albeit acquired during the course of the employment.[239]

Scope of restraint

A covenant will not be adjudged reasonable between the parties unless it does no more than protect the legitimate interests of the employer. The employer is not entitled to restrain the employee from carrying on a business different from that in which the trade secrets exist or the customer connection has been built up and in which the employee was employed. Thus a covenant 'not to carry on any business whatsoever' is void.[240] And a baker cannot restrain an employee employed to sell bread from opening a restaurant, even though he himself keeps a restaurant or contemplates doing so in the future.[241] However, a covenant which appears unduly wide in this respect may, on its proper construction, be limited to the business in which the employee was employed. In *Home Counties Dairies Ltd.* v. *Skilton*,[242] a milk roundsman covenanted not to sell or solicit orders for 'milk or dairy produce' from any of the employer's customers. It was argued that the covenant was too wide in that, on its literal meaning, it would prevent the milkman from entering into employment with a grocer who sold butter and cheese. But the Court of Appeal construed the words 'dairy produce' as limited to the sort of dairy produce with which the milkman had been concerned in his employment. Finally, it has been held that if an employer expressly states the interest to be protected then the employer may not justify the restraint by reference to some other interest. It follows that if no interest is stated then the Court may resort to both the wording and surrounding circumstances to ascertain the interest to be protected.[243]

Area of restraint

The restraint must not be more extensive in area than the employer's interests require. Thus in *Mason* v. *Provident Clothing & Supply Co.*,[244] where a canvasser in the company's Islington branch district covenanted not to work in any similar business for 3 years within 25 miles of London, the restraint was held to be unreasonable as it extended further than was legitimately warranted. But in *Foster & Sons Ltd.* v. *Suggett*[245] a covenant by a works manager not to engage in glass-making anywhere in the United Kingdom was considered reasonable for the protection of his employers' business, as he had been instructed in secret methods of making glass and the employers' trade extended throughout the country. Again, however, a covenant which is unlimited in area, i.e. is literally world-wide, may be construed by reference to the business of the employer to which it relates, and so be limited to the area in which that business is in fact carried on.[246] But it has been said that Courts should not strive to find implicit limitations within

[239] Cf. *Faccenda Chicken Ltd.* v. *Fowler*, (*supra* n. 234) at p. 136. See also *Lock International plc* v. *Beswick* [1989] 1 W.L.R. 1268, at pp. 1273–5.

[240] *Baker* v. *Hedgecock* (1888) 39 Ch. D. 520.

[241] *Bromley* v. *Smith* [1909] 2 K.B. 235, at p. 241.

[242] [1970] 1 W.L.R. 526. See also *Plowman & Son Ltd.* v. *Ash* [1964] 1 W.L.R. 568; *Littlewoods Organisation Ltd.* v. *Harris* [1977] 1 W.L.R. 1472; *Edwards* v. *Worboys* [1984] 1 A.C. 724 *per* Dillon L.J. at pp. 727–8.

[243] *Office Angels Ltd.* v. *Rainer-Thomas and O'Connor* [1991] I.R.L.R. 214, at p. 219.

[244] [1913] A.C. 724. See also *Office Angels Ltd.* v. *Rainer-Thomas and O'Connor* [1991] I.R.L.R. 214 at p. 221.

[245] (1918) 35 T.L.R. 87.

[246] *Littlewoods Organisation Ltd.* v. *Harris* [1977] 1 W.L.R. 1472.

covenants which on their face are too wide and thus to make them enforceable since employers would otherwise have no reason to impose restraints in appropriately limited terms.[247]

Length of restraint

The duration of the restraint is also an important factor, and a restraint may be struck down on the ground that it is too extensive in time. The protection of trade secrets does not justify keeping someone out of trade indefinitely,[248] and an employee's connections with the customers of a former employer must necessarily weaken with the passage of time. So, in *M. & S. Drapers* v. *Reynolds*,[249] where a collector-salesman of a drapery firm covenanted not to canvass his employer's customers for a term of 5 years from the determination of his employment, this period was held to be too long in view of the humble position which he occupied. Nevertheless, even restraints without limit of time will be allowed in appropriate cases, particularly, for example, where the protection of a solicitor's or other professional practice is concerned. Thus in *Fitch* v. *Dewes*:[250]

A solicitor's clerk at Tamworth agreed with his employer that after leaving his employment he would not practise within 7 miles of Tamworth town hall. The covenant was unlimited in point of time.

Its validity was upheld by the House of Lords. It was pointed out that a solicitor's managing clerk must, in the course of his duties, acquire a knowledge of the affairs and of the clients of the practice which puts him in a position, if not restrained, gravely to impair the goodwill of the employer's business; and the restriction was held to be not more than was necessary for doing this.

Nature of employment

The nature of the employment is also material. It is clear, for example, that a greater measure of protection will be allowed to the employer against the subsequent activities of a senior employee, such as a managing director,[251] than in the case of a temporary or subordinate employee such as a travelling sales representative.[252] Each case must be considered in the light of its own circumstances.

Public interest

Covenants in a contract of employment which are reasonable between the parties will seldom be invalidated on the ground that they are contrary to the public interest. In *Wyatt* v. *Kreglinger and Fernau*,[253] however, the public interest was considered:

The plaintiff had worked for the defendants' firm as a wool broker. On his retirement, they wrote him a letter offering him a pension of £200 a year on condition that he did not engage in the wool trade. There was some doubt whether this offer was ever specifically accepted by the plaintiff, but the defendants paid him the pension for 9 years, after which time they ceased to do so, claiming that there was no proper contract, or if there was a contract, it was unenforceable as being in unreasonable restraint of trade.

[247] *J. A. Mont (U.K.) Ltd.* v. *Mills* [1993] I.R.L.R. 173, *per* Simon Brown L.J at p. 176. See also *post*, p. 400 (severance).
[248] *Kerchiss* v. *Colora Printing Inks Ltd.* [1960] R.P.C. 235.
[249] [1957] 1 W.L.R. 9. See also *Home Counties Dairies Ltd.* v. *Skilton* [1970] 1 W.L.R. 526 (milk roundsman: one year).
[250] [1921] 2 A.C. 158. See also *Bridge* v. *Deacons* [1984] 1 A.C. 705. See further *Edwards* v. *Worboys* [1984] 1 A.C. 724. Cf. *Oswald Hickson Collier & Co.* v. *Carter-Ruck* [1984] 1 A.C. 720.
[251] *Nordenfelt* v. *Maxim Nordenfelt Guns and Ammunition Co. Ltd.* [1894] A.C. 535.
[252] *M. & S. Drapers Ltd.* v. *Reynolds* [1957] 1 W.L.R. 9.
[253] [1933] 1 K.B. 793.

The Court of Appeal upheld the defendants' plea. They differed as to whether there was a proper contract, but held unanimously that the restraint was invalid as being contrary to the public interest, as well as being unreasonable between parties. The reason given was that such covenants deprived the country of the services of able-bodied persons who might still be of benefit to it in their own trade.

This judgment has been justly criticized, since the person seeking to evade his obligations was the very person who had imposed the unreasonable stipulation and there were several million unemployed at the time.[254] But it is possible to conceive of situations where it would be injurious to the public interest, say, in the case of a distinguished engineer or economist, that a person should be tied by an agreement which, though reasonable from the point of view of the protection of the employer's proprietary interest, is yet detrimental to the community at large. Indeed, in one case, a condition of a pension scheme that a former salesman of a company should not engage in any activity which competed with the company was said to be invalid on the ground that it would deprive the public of his skilled services in promoting the export trade.[255]

Between vendor and purchaser of goodwill

(2) *Sale of the goodwill of a business.* Considerably more latitude is allowed to covenants which accompany the sale of the goodwill of a business than in the case of contracts between employer and employee,[256] but the rules relating to the area and length of the restraint are in principle the same.

Covenants in gross, however, which do not protect the business actually sold, and whose object is merely to restrain competition, will not be upheld. In the *Nordenfelt* case[257] we saw that a covenant 'not to engage in any business liable to compete with that for the time being carried on by the company' was considered unreasonable. Also in *Vancouver Malt & Saké Brewing Co. Ltd.* v. *Vancouver Breweries Ltd.*:[258]

> The appellants held a Dominion brewer's licence for the manufacture of beer, but the only trade actually carried on by them was the manufacture of saké, a Japanese rice spirit. They assigned their brewer's licence to the respondents for $15,000, and covenanted not to brew beer for 15 years thereafter.

The Judicial Committee of the Privy Council held that this covenant was void. There was at the time of the assignment no brewing business to protect; the covenant was therefore in gross and unenforceable.

There seems to be no reported case in which an otherwise reasonable covenant has been struck down as contrary to the public interest.

Horizontal trading agreements

(3) *Cartel agreements.* A common feature of business organizations in a capitalist society is that they frequently enter into cartels, that is to say, agreements to regulate the production and marketing of the commodities manufactured by them, and to maintain prices and standards in relation to those commodities. Cartel agreements are, like all other agreements in restraint of trade,

[254] But see *Howard F. Hudson Pty. Ltd.* v. *Ronayne* (1972) 126 C.L.R. 449 (Australia).
[255] *Bull* v. *Pitney-Bowes Ltd.* [1967] 1 W.L.R. 273. See also *J. A. Mont (U.K.) Ltd.* v. *Mills* [1993] I.R.L.R. 173.
[256] *Ante*, p. 363. [257] [1894] A.C. 535; *ante*, p. 361. [258] [1934] A.C. 181.

prima facie void at common law and must be justified as being reasonable in the interests of the parties and of the public.

Reasonableness between parties

In this type of agreement, however, it is clear that the parties can be regarded 'as the best judges of what is reasonable between themselves'.[259] Unlike the case of agreements between employer and employee, who are in unequal positions of bargaining, these agreements are in most cases freely negotiated. They are entered into for the purpose of avoiding undue competition and carrying on trade without excessive fluctuations or uncertainty. As a result, it is difficult for a Court to say that they are unreasonable between the parties, and in fact the Courts have only done so if an agreement contains no provision, or virtually no provision, for voluntary withdrawal.[260]

Interests of the public

The real interest to be consulted in such agreements is that of the public; yet traditionally, because nineteenth-century economic theory demanded an attitude of neutrality to a free play of economic forces, the position adopted by the common law has been to regard cartels at least as being not injurious to the public,[261] and in some cases even as positively beneficial.[262] In the USA, where the promotion of competition has long been federal policy, an energetic use by the Courts of the public policy aspects of the Sherman Act 1890 resulted in a body of 'anti-trust' law designed to eliminate restraints on competition and to prevent the domination of industry by the accumulation of economic power. But no such movement was initiated in England, and the Courts virtually excluded the possibility that a cartel should be held contrary to the public interest by requiring it to be one which was calculated to produce 'a pernicious monopoly, that is to say, a monopoly calculated to enhance prices to an unreasonable extent'.[263]

Legislation controlling anti-competitive practices

But even if the Courts had, in fact, adopted a different economic attitude, the doctrine of restraint of trade could not have been employed to any real effect in the suppression of cartels, since, save in very exceptional circumstances,[264] a cartel agreement would only have come before the Courts if one of the parties failed to perform it and was sued for the breach. In 1956 legislation[265] was enacted rendering restrictive trading agreements affecting the supply, acquisition, or process of manufacture of goods, or the prices to be charged for them void, unless they are shown positively to be in the public interest and can pass through one of

[259] *North Western Salt Co.* v. *Electrolytic Alkali Co. Ltd.* [1914] A.C. 461, at p. 471; *English Hop Growers* v. *Dering* [1928] 2 K.B. 174, at p. 180.

[260] *McEllistrim* v. *Ballymacelligott Co-operative Agriculture and Dairy Society Ltd.* [1919] A.C. 548; *Evans (J.) & Co.* v. *Heathcote* [1918] 1 K.B. 418; *Bellshill and Mossend Co-operative Society* v. *Dalziel Co-operative Society* [1960] A.C. 832.

[261] *Att.-Gen. of Commonwealth of Australia* v. *Adelaide Steamship Co.* [1913] A.C. 781.

[262] *North Western Salt Co. Ltd.* v. *Electrolytic Alkali Co. Ltd.* [1914] A.C. 461.

[263] *Att.-Gen. of Commonwealth of Australia* v. *Adelaide Steamship Co.* (*supra*, n. 261), at p. 796.

[264] See *post*, p. 379.

[265] Restrictive Trade Practices Act 1956, re-enacted in the Restrictive Trade Practices Act 1976, and amended by the Restrictive Trade Practices Act 1977 and the Competition Act 1980. Agreements as to the collective *enforcement* of conditions as to resale prices are rendered unlawful and prohibited by the Resale Prices Act 1976. See also Restrictive Practices Court Act 1976.

the eight 'gateways' provided by the Act.[266] Since the accession of the United Kingdom to the European Communities a separate regime of European Community competition law has also been directly applicable in English law.[267] A Competition Bill introduced before Parliament at the end of 1997 proposes to replace the United Kingdom legislation with prohibitions closely based on those in Articles 85 and 86 of the European Community Treaty.[268] The Director General of Fair Trading will be responsible for investigating and enforcing breaches of the statutory prohibitions[269] and appeals from the Director's decisions will lie to the proposed Competition Commission's Appeal Tribunal and then to the Court of Appeal.[270]

Control of competition under European Community Law

The provisions of the European Community Treaty that relate to competition are designed not merely to promote competition within the Community, but to ensure that the objective of establishing a common market is not defeated by the existence of agreements which endanger, either directly or indirectly, freedom to trade between Member States. Accordingly, Article 85(1) of the Treaty states:

> The following shall be prohibited as incompatible with the common market: all agreements between undertakings, decisions by associations of undertakings and concerted practices which may affect trade between Member States and which have as their object or effect the prevention, restriction or distortion of competition within the common market, and in particular those which:
>
> (a) directly or indirectly fix purchase or selling prices or any other trading conditions;
> (b) limit or control production, markets, technical development, or investment;
> (c) share markets or sources of supply;
> (d) apply dissimilar conditions to equivalent transactions with other trading parties, thereby placing them at a competitive disadvantage;
> (e) make the conclusion of contracts subject to acceptance by the other parties of supplementary obligations which, by their nature or according to commercial usage, have no connection with the subject of such contracts.[271]

Infringement of Article 85(1) not only renders a prohibited agreement automatically void and unenforceable in England,[272] but may expose the parties to the risk of heavy fines by the Commission of the European Communities[273] or to an order that the infringement be discontinued.[274] By Article 85(3), however, provision is made for the individual and 'block' exemption (considered below)[275] of agree-

[266] Restrictive Trade Practices 1956, s. 10(1). See e.g. *Re Motor Vehicle Distribution Scheme Agreement* [1961] 1 W.L.R. 92. On the scope of the Act, see e.g. *M.G. Foods plc* v. *Baines* [1997] I.C.R. 652.

[267] European Communities Act 1972, s. 2; *De Geus* v. *Bosch* (Case 13/16) [1962] E.C.R. 45; *Belgische Radio en Televisie* v. *S.V.S.A.B.A.M.* (Case 127/73) [1974] 1 E.C.R. 51.

[268] Competition Bill 1997, clauses 2–40, 58.

[269] *Ibid.*, clause 25. The maximum penality will be 10% of a firm's turnover: *ibid.*, clause 35.

[270] *Ibid.*, clauses 47–8.

[271] The corresponding United Kingdom provision is likely to be the Chapter 2 prohibition in the Competition Bill 1997, clause 2.

[272] Article 85(2). See *Delimitis* v. *Henninger Bräu A.G.* (Case C-234/89) [1991] E.C.R. I-935. Whether severence is possible is governed by English law: *Société de Vente de Ciments et Béton* v. *Kerpen & Kerpen* (Case 319/82) [1983] E.C.R. 4173.

[273] Regulation 17, art. 15(2)(a).

[274] *Ibid.*, art. 3.

[275] *Post*, p. 377.

ments or concerted practices,[276] or Community regulations provide that an agreement may be notified to the Commission for the purpose of obtaining an individual exemption.[277] Alternatively, the parties can apply to the Commission for a declaration that their agreement does not fall within Article 85(1).[278] This latter procedure is known as 'negative clearance'.

Article 85(1) does not affect only agreements and practices which prohibit exports or imports within the common market, although clearly such agreements and practices are the most likely to be caught. If an agreement or practice has the effect of maintaining a purely national market for goods, and so inhibits their free movement within Member States, it may be struck down. Cartels, even if entered into between undertakings carrying on business within the same State,[279] may therefore fall within Article 85(1), for such agreements can partition trade within national boundaries. There is already a considerable body of law within the Community on the operation of the Article, and detailed treatment would be out of place in this book.[280] It suffices to say that agreements to fix prices, including target prices,[281] and market-sharing and segmentation agreements fall within Article 85, even where the arrangements between the parties are an informal and non-binding 'gentlemen's agreement'.[282] The concept of 'concerted practices' includes the knowing substitution of practical co-operation for the risks of competition, and although this will not be inferred from parallel behaviour, it will where, in the light of the economic structure of the market, such behaviour cannot be otherwise explained.[283]

Abuse of a dominant position

Article 86 of the Treaty, which is also directly applicable in English law,[284] further provides that 'Any abuse by one or more undertakings of a dominant position within the common market or in a substantial part of it shall be prohibited as inconsistent with the common market in so far as it may affect trade between Member States', and proceeds to give illustrations of such abuse, for example, 'limiting production, markets or technical development to the prejudice of consumers'.[285] Article 86 enables control to be exercised by the Commission and by

[276] The agreement or concerted practice must (a) improve production or distribution, or promote technical or economic progress, (b) allow consumers a fair share of such benefits, (c) contain only indispensible restrictions, and (d) not afford the parties the possibility of eliminating competition in respect of a substantial part of the products in question.

[277] *Ibid.*, art. 4. See also Article 85(3) of the Treaty.

[278] Regulation 17/62 [1962] O.J. L13/204, art. 2. Cf. *Esso Petroleum Co. Ltd.* v. *Kingswood Motors (Addlestone) Ltd.* [1974] Q.B. 142.

[279] See e.g. *Re German Ceramic Tiles Agreement* [1971] C.M.L.R. D6; *Vereeniging van Cementhandeleren* v. *E.C. Commission* (Case 8/72) [1972] E.C.R. 977; *Groupement des Fabricants de Papiers Peints de Belgique* v. *E.C. Commission* (Case 74/74) [1975] E.C.R. 1491. Cf. *Brasserie de Haecht* v. *Wilkin (No. 1)* (Case 23/67) [1967] E.C.R. 407.

[280] See Bellamy and Child, *Common Market Law of Competition*, 4th edn. (1993), ed. Rose.

[281] *Cementhandelaren* v. *Commission* (Case 8/72) [1972] E.C.R. 977.

[282] *A.C.F. Chemiefarma N.V.* v. *Commission* (Cases 41, 44 and 45/69) [1970] E.C.R. 661.

[283] *I.C.I.* v. *Commission* (Case 48/69) [1972] E.C.R. 557. Cf. *Ahlström Osakeyhtio* v. *Commission* (Joined Cases C-89, 104, 114, 116, 117, 125–129/85) [1993] E.C.R. I-1307 (burden on Commission).

[284] *Belgische Radio en Televisie* v. *S.V.S.A.B.A.M.* (Case 127/73) [1974] 1 E.C.R. 51; *Garden Cottage Foods Ltd.* v. *Milk Marketing Board* [1983] 3 W.L.R. 143.

[285] Article 86(b). The corresponding United Kingdom provision is likely to be the Chapter 3 prohibition in the Competition Bill 1997, clause 18.

the Courts over 'abusive' practices, and over mergers by dominant firms when these substantially reduce competition.[286]

Vertical trading agreements

(4) *Exclusive dealing agreements.* A firm may enter into an agreement by which it undertakes to buy all that it requires of a certain commodity from a single seller and from no other source, or to sell its whole output of a certain commodity to a single buyer and to no other. We shall see that such agreements will usually fall within the prohibition in Article 85 of the European Community Treaty. But we shall first consider the doctrine of restraint of trade. It was previously uncertain whether such agreements fell within the doctrine,[287] although they clearly did impose restraints upon the liberty of the buyer or seller to trade with persons not parties to the contract.

'Solus' ties

In *Esso Petroleum Co. Ltd.* v. *Harper's Garage (Stourport) Ltd.*,[288] the House of Lords held that a 'solus' agreement relating to the purchase of petrol was an agreement in restraint of trade:

> The respondent, HG, owned two garages. In relation to the first garage, it entered into a 'solus' agreement whereby it undertook to purchase from the appellant for 4 years and 5 months all its requirements of petrol to be sold at that garage, and to buy from no other source. The agreement contained a 'continuity' clause under which, if HG sold the garage, it was bound to procure the buyer to enter into a similar agreement with the appellants. The agreement also contained a 'keep open' clause under which HG was to keep open the garage at all reasonable times for the sale of petrol. In return HG received a certain rebate per gallon off the scheduled wholesale price of the petrol supplied.
>
> In relation to the second garage, in return for a loan of £7,000, HG entered into a mortgage of the garage premises in favour of the appellants. HG covenanted to repay the loan with interest during 21 years, and not to redeem the mortgage before this time. They also covenanted that, during the continuance of the mortgage, they would observe obligations similar in nature to those contained in the agreement relating to the first garage.
>
> The respondents commenced to sell another brand of petrol and, when sued, pleaded that both transactions were in unreasonable restraint of trade.

The House of Lords held that the agreement for 4 years and 5 months on the first garage was (despite its onerous covenants) reasonable in the interests of the parties, since it was reasonably required to protect the legitimate interest of the appellants in securing the continuity of their selling outlets, their system of distribution, and the stability of their sales; it was also not contrary to the public interest. But the agreement for 21 years on the second garage was longer than was necessary to protect the appellants' interests and was therefore unenforceable.

Restrictive covenants on land

Their Lordships unanimously held that the fact that the agreement relating to the second garage was contained in a mortgage of land did not prevent the application of the doctrine of restraint of trade. This incursion of restraint of trade into

[286] *Europemballage & Continental Can Co. Inc.* v. *E.C. Commission* (Case 6/72) [1973] 1 E.C.R. 215; *United Brands Co.* v. *E.C. Commission* (Case 27/76) [1978] 1 E.C.R. 207. Cf. *Garden Cottage Foods Ltd.* v. *Milk Marketing Board* (*supra*, n. 284).

[287] *Catt* v. *Tourle* (1869) L.R. 4 Ch. App. 654; *Clegg* v. *Hands* (1880) 44 Ch. D. 503; *Biggs* v. *Hoddinott* [1898] 2 Ch. 207. Cf. *Servais Bouchard* v. *Prince's Hall Restaurant* (1904) 20 T.L.R. 574; *Foley* v. *Classique Coaches* [1934] 2 K.B. 1.

[288] [1968] A.C. 269. See also *Petrofina (Great Britain) Ltd.* v. *Martin* [1966] Ch. 146.

the sphere of land raises some difficult questions as to the extent of the doctrine in this sphere. A majority of their Lordships considered that it had no application to covenants contained in leases or conveyances on purchase.[289] So a person who purchases a petrol station, or takes a lease of one from an oil company, where the conveyance or lease contains a petrol 'solus' agreement, could not on this view challenge the 'solus' agreement as being in restraint of trade. The reason for this is given by Lord Reid:[290]

> Restraint of trade appears to me to imply that a man contracts to give up some freedom which otherwise he would have had. A person buying or leasing land had no previous right to be there at all, let alone to trade there, and when he takes possession of that land, subject to a negative restrictive covenant he gives up no right or freedom which he previously had.

This reasoning does not appear entirely convincing, for the economic effect of a 'solus' agreement contained in a lease or conveyance is no different from one which is contained in a mortgage or is in gross. Undoubtedly, what their Lordships had in mind in the *Esso Petroleum* case was the disastrous inconvenience which would occur if familiar restrictive covenants in the form say, not to use leased premises for the purpose of trade, or not to use them for the purpose of carrying on any offensive trade, e.g. a fried fish shop, could be challenged under the restraint of trade doctrine. It is submitted, however, that a more satisfactory criterion would be to inquire whether or not the covenant was imposed in order to restrict the covenantor from competing with the covenantee, or to restrict competition by third parties by removing the covenantor's freedom to trade with them. Most restrictive covenants on lease or on sale are imposed to preserve the amenities of the particular or neighbouring property; they would therefore not be subject to the doctrine. But if the covenant was imposed by a covenantee who owned a fried fish shop, and wished to be secure against competition, or if the covenantee wished to secure the covenantor's custom to the exclusion of any competitors (as in a 'solus' agreement), then the doctrine of restraint of trade could, and should, apply. This would accord with the opinion, previously expressed,[291] that in the modern law the answer to the problem of defining a contract in restraint of trade is to be found in terms of its anti-competitive effect. Nevertheless a number of cases have subsequently endorsed the view that a person's freedom to trade is not restricted when that person takes possession of land under a lease or conveyance which contains restrictions on the use to which the land may be put.[292]

Lease and lease-back

Suppose, however, that P, the proprietor of a filling station, leases it to an oil company for a period of (say) 50 years in return for the payment of a capital sum. Immediately afterwards the company leases the filling station back to P for a term

[289] [1968] A.C. 269, at pp. 298, 309, 316–17, 325.

[290] At p. 298.

[291] See *ante*, p. 300.

[292] *Cleveland Petroleum Co. Ltd.* v. *Dartstone Ltd.* [1969] 1 W.L.R. 116; *Robinson* v. *Golden Chips (Wholesale) Ltd.* [1971] N.Z.L.R. 257; *Quadramain Pty. Ltd.* v. *Sevastopol Investments Pty. Ltd.* (1976) 133 C.L.R. 390 (Australia); *Re Ravenseft Properties Ltd.'s Application* [1978] Q.B. 52; *Irish Shell Ltd.* v. *Elm Motors Ltd.* [1982] I.L.R.M. 519 (Ireland).

of 50 years less one day by an underlease which contains a 'solus' tie, and P repays the capital sum and interest in the form of rent. Does the fact that the 'solus' tie is now contained in a lease place it outside the doctrine of restraint of trade? Or will the lease and lease-back be treated as a single transaction whereby the filling station proprietor gives up his existing freedom to trade? In *Amoco Australia Pty. Ltd.* v. *Rocca Bros. Motor Engineering Cp. Pty. Ltd.*,[293] the Judicial Committee of the Privy Council held, in respect of a similar device, that the lease-back was unenforceable by reason of the 'solus' tie and that , since both the lease and the underlease formed part of a single transaction, neither of them could be enforced. Also in *Alec Lobb (Garages) Ltd.* v. *Total Oil Great Britain Ltd.*:[294]

The plaintiff company was a family company of which L and his mother were the only directors and shareholders. It owned a petrol filling station. The company got into financial difficulties and arranged with the defendants, an oil company, that the defendants would take a lease of the station forecourt for 51 years in return for a premium of £35,000 and a nominal rent. On the same day the defendants leased-back the station to L and his mother at a rent of £2,500 per annum for 21 years by an underlease with a 'solus' tie in favour of the defendants. The object of the lease-back to L and his mother was to avoid any challenge to the validity of the tie.

It was held by the Court of Appeal that the lease and lease-back were to be treated as one transaction by which the plaintiff company gave up its existing freedom to trade, partially for the first 21 years and wholly for the last 30, and that the doctrine of restraint of trade could not be circumvented by the transparent device of the lease-back to L and his mother. Notwithstanding the absence of evidence of economic necessity which the decision in the *Esso Petroleum* case stated would be required to uphold a tie of this length (21 years), the validity of the tie was upheld. The court relied on the authority, considered above[295] and approved in the *Esso Petroleum* case, that 'the quantum of consideration may enter into the reasonableness of the contract', and on the fact that the plaintiff had received the benefit of the £35,000.[296] It was also noted that there was provision for the plaintiff to end the tie after 7 and 14 years, and that public interest did not require the tie to be set aside because the land could only be used as a garage and it made no difference to the public who supplied the petrol.[297]

Application of Article 85 to exclusive dealing agreements

The prohibition in Article 85, considered above, will often apply to exclusive dealing agreements. For example, in *Consten and Grundig* v. *Commission of the European Communities*:[298]

Grundig, a German manufacturer of radios, television and similar equipment, appointed Consten, a French company, the sole distributor of its products within France. Consten undertook (*inter alia*) not to export any Grundig products outside France, and, in turn, Grundig imposed on all its other distributors outside France an obligation not to export

[293] [1975] A.C. 561. [294] [1985] 1 W.L.R. 173. [295] *Ante*, p. 374.
[296] [1985] 1 W.L.R. 173 at pp. 179, 185, 189–90.
[297] [1985] 1 W.L.R. 173 *per* Dunn and Waller L.JJ. at pp. 186, 191 (to uphold the tie may encourage the rescue of businesses in financial hardship).
[298] (Cases 56/64, 58/64) [1966] E.C.R. 299. For the remedies of a third party affected by such an agreement, see *Cutsforth* v. *Mansfield Inns Ltd.* [1986] 1 W.L.R. 558.

Grundig products outside their respective territories. It further assigned to Consten the trademark 'GINT' which would enable Consten to sue any third party, importing Grundig products into France, for infringement of this trade mark. The object of this arrangement was to confer upon Consten absolute territorial protection within France from competing Grundig products imported from outside.

The European Court of Justice held that Consten could not rely upon the agreement with Grundig, nor upon the trade mark or on French national law, to prevent the importation of Grundig products into France. The agreement prevented other distributors in a national market, i.e. France, from obtaining supplies of Grundig products from elsewhere in the Community. It accordingly fell within Article 85(1).

Certain categories of exclusive dealing agreements have been accorded a block exemption, provided they contain the required provisions and do not contain those proscribed.[299] Where an agreement does not fall within a block exemption, it remains open to the parties to apply for individual exemption provided the requirements of Article 85(3) are fulfilled.[300]

Other forms of exclusive dealing agreements

A further problem raised in the speeches in the *Esso Petroleum* case is whether other forms of exclusive dealing agreement are subject to the doctrine of restraint of trade. In *A. Schroeder Music Publishing Co. Ltd.* v. *Macaulay*:[301]

M, a young and unknown song-writer, entered an 'exclusive services' agreement with the defendant music publishing company, under which he undertook to assign the full copyright in present and future works produced by him to the defendant for a period of 5 years, or for 10 years if his royalties exceeded £5,000. The defendant was under no obligation to publish any of the works, could terminate the agreement by one month's notice, and could assign its benefit. In fact M was a great success.

The House of Lords held that the agreement was subject to the doctrine and was unreasonable. It took account of the extent of the inequality of bargaining power between the parties, and the contrast between the total commitment on the part of the song-writer and the lack of obligation on the part of the defendant. But there is more difficulty with 'sole agency' agreements (under which a person is given the sole right to supply a manufacturer's goods within a certain area)[302] and tied public houses[303] The view was expressed by some of their Lordships in the *Esso Petroleum* case that these were exempt because they had gained general commercial acceptance.

The House of Lords placed considerable emphasis on the public interest test in the application of the doctrine to exclusive dealing agreements.[304] But what is

[299] The major ones are: Regulation 1983/83 Exclusive Distribution; Regulation 1984/83 Exclusive Purchasing; Regulation 2349/84 Patent Licensing; Regulation 123/85 Motor Vehicle Distribution; Regulation 418/85 Research and Development; Regulation 4087/88 Franchising; Regulation 556/89 Know-how Licensing.

[300] *Ante*, p. 373, n. 276.

[301] [1974] 1 W.L.R. 1308.

[302] [1968] A.C. 269, at pp. 296, 310–11, 320, 328, 336.

[303] [1968] A.C. 269, at pp. 298, 325, 333–4, 341. See also *ante*, p. 374, n. 287.

[304] *Esso Petroleum Co. Ltd.* v. *Harper's Garage (Stourport) Ltd.* [1968] A.C. 269, at pp. 300–1, 318–19, 321, 324, 330, 340–1.

meant by 'reasonableness in the interests of the public' in this context? In *Texaco Ltd.* v. *Mulberry Filling Station Ltd.*,[305] a case which also concerned the validity of a petrol 'solus' agreement, the parties adduced evidence of a general economic nature in an attempt to show the relative advantages and disadvantages to the public of the abolition or retention of the 'solus' tie system. Ungoed-Thomas J., however, considered that much of this evidence was irrelevant. The public interest test was, in his view, only the expression of a rule of public policy reflecting the desire of the law to secure to every individual the liberty to trade; it was not concerned with ultimate economic advantage to the public in general:

> If it refers to interests of the public at large, it might not only involve balancing a mass of conflicting economic, social and other interests which a court of law might be ill-adapted to achieve; but, more important, interests of the public at large would lack sufficiently specific formulation to be capable of judicial as contrasted with unregulated personal decision and application—a decision varying, as Lord Eldon put it, like the length of the Chancellor's foot.[306]

Although, at first sight, this might appear to be a somewhat narrow approach, it is nevertheless true to say that the Courts of common law are unlikely to be willing to assume the task of weighing, without any specific guidance, conflicting economic judgments and predictions. Where, as in *A. Schroeder Music Publishing Co. Ltd.* v. *Macaulay*, the Courts do strike down a restriction, their conclusions may be open to question on economic grounds. So it has been argued, on the basis of an analysis of the risky music publishing business, where there are many failures for every success such as M's, that the effect of the decision would be to make it more difficult for unknown composers to be taken up by publishers.[307] The task of weighing conflicting economic judgments and predictions is, indeed, better entrusted to government, regulatory agencies, such as the Director General of Fair Trading, or to specialized tribunals such as the Restrictive Practices Court and the proposed Competition Commission Appeal Tribunal. But where, as in *A. Schroeder Music Publishing Co. Ltd.* v. *Macaulay*, there is great inequality of bargaining power, the primary concern of the Court is the reasonableness of the restriction as between the parties and not the broader economic issues that are involved in determining whether it is 'reasonable in the interests of the public'. The deep concern of the common law with the personal liberty of the citizen led to the legal principle favouring the right of an individual to work and not to be disabled from supporting himself or herself by an unreasonable restriction.

Agreements between employers

(5) *Labour and services.* Agreements between employers which attempt to regulate labour and to impose mutual restrictions upon the re-employment of former employees may be struck down as being employer-employee covenants in

[305] [1972] 1 W.L.R. 814.

[306] *Ibid.*, at p. 827. Sometimes there will be such evidence. In the *Esso Petroleum* case account was taken of a Report into the Distribution of Retail Petrol (H.C. No. 264 of 1965).

[307] Trebilcock (1976) 26 U. of Tor. L.J. 359.

disguise or as being contrary to the public interest.[308] In *Eastham* v. *Newcastle United Football Club Ltd.*:[309]

By the rules of the Football Association, the defendant club operated a 'retain and transfer' system. A football player employed by the club could be retained after the determination of his contract of employment and so be debarred from playing for any other club, although there was no obligation to re-employ him. He could also be placed on a transfer list, and then he could not obtain employment with any other club in the Football League which was not willing to pay a stipulated transfer fee, only a proportion of which went to the player himself. The plaintiff, a professional football player employed by the club, claimed that these conditions were not binding on him as being in unreasonable restraint of trade, and were invalid. The club contended that they were required for the proper and stable organization of the game of football in England.

Wilberforce J. was prepared to accept this interest as legitimate,[310] but was not satisfied that the 'retain and transfer' system imposed no greater restraint on the plaintiff's liberty of employment than was necessary to protect this interest. He therefore granted a declaration that the system was invalid, not only against the defendant club, but also in respect of the rules of the Football Association. Although these rules constituted an agreement between employers only, they were calculated to affect the employees' freedom of employment and so could be challenged by the football player on the same grounds as if they had been contained in an agreement between him and his employer. A similar decision was reached in *Greig* v. *Insole*[311] by Slade J., who held void as being in unreasonable restraint of trade a resolution of the International Cricket Conference disqualifying from playing in Test Matches any player who took part in a match arranged by a private promoter (Mr. Kerry Packer) during a certain period, and a resolution of the Test and County Cricket Board similarly disqualifying any such player from playing in county matches.

Trade unions

Trade unions are, to a large extent, protected from the doctrine of restraint of trade by section 11 of the Trade Union and Labour Relations (Consolidation) Act 1992, which provides that the purposes of any trade union are not, by reason only that they are in restraint of trade, unlawful so as to make any agreement or trust void or voidable and its rules are not similarly unlawful or unenforceable. In *Faramus* v. *Film Artistes' Association*:[312]

The respondent association was a trade union which looked after the interests of those employed as film extras. A rule of the association provided that no person who had been convicted of a criminal offence should be eligible for or retain membership of the association. The appellant, who was a member of the association, had been convicted of

[308] *Mineral Water Bottle Exchange and Trade Protection Socy.* v. *Booth* (1887) 36 Ch. D. 465; *Kores Manufacturing Co. Ltd.* v. *Kolok Manufacturing Co. Ltd.* [1959] Ch. 108; *Esso Petroleum Co. Ltd.* v. *Harper's Garage (Stourport) Ltd.* [1968] A.C. 269, at pp. 300, 319. But see Trade Union and Labour Relations Act 1992, s. 128 (purposes of employers' associations, defined in s. 122, not, by reason only that its purpose is in restraint of trade, unlawful or unenforceable).

[309] [1964] Ch. 413. See also *Buckley* v. *Tutty* (1971) 46 A.L.J.R. 23; *Hall* v. *Victorian Football League* [1982] V.R. 64 (Australia).

[310] At p. 432.

[311] [1978] 1 W.L.R. 302.

[312] [1964] A.C. 925 (decided on the similar wording of the Trade Union Act 1871, s. 3).

two criminal offences in Jersey, one of them during the German occupation of the island. When this fact was discovered, he was excluded from the association. He challenged the rule, *inter alia*, on the ground that it was in unreasonable restraint of trade.

The House of Lords held that the agreement constituted by the rules of the association was one which related or was directed to the purposes of the union. It could not therefore be challenged on the ground that it was in unreasonable restraint of trade, and the appellant's exclusion was upheld.

Services and professional bodies

By the Restrictive Trade Practices (Services) Order 1976[313] all services, save for carriage by land, sea and air, and banking and insurance, are subject to the Restrictive Trade Practices Act 1976.[314] Service 'cartels', like those relating to goods, are therefore subject to scrutiny by the Restrictive Practices Court to determine whether or not they are in the public interest.[315] This regime will, however, be replaced with one closely based on that in Articles 85 and 86 of the European Community Treaty if the Competition Bill 1997 is enacted.[316] In principle, as is the case under the present law,[317] these provisions cover services[318] including the rules of professional bodies, although certain professional services, such as those of lawyers, doctors, surveyors, accountants, architects, and insolvency practitioners will, if designated by the Secretary of State, be excluded from the prohibition (corresponding to that in Article 85 of the European Community Treaty) in Chapter 1 of the Bill.[319]

Although in this area the field has largely been left to modern legislation promoting competition or proscribing certain forms of discrimination, the common law doctrine of restraint of trade also extends to cover the rules of professional bodies. Thus the Court of Appeal refused to strike out a claim that a rule of the Jockey Club preventing a woman from holding a trainer's licence was invalid,[320] and a rule of the Pharmaceutical Society restricting the types of goods in which their members might deal has been held invalid.[321] But the basis upon which a person who is not a member of the relevant professional body, and thus a party to the restrictive agreement, can challenge it, has recently been put into question.[322]

[313] S.I. 1976 No. 98.

[314] Amended by the Restrictive Trade Practices Act 1977 and the Competition Act 1980.

[315] Restrictive Trade Practices Act 1976, s. 19 (as amended). For the position at common law, see *Collins* v. *Locke* (1879) 4 App. Cass. 474.

[316] Competition Bill 1997, clauses 2–40.

[317] Restrictive Trade Practices Act 1976, ss. 16, 20.

[318] See, for example, *Italy* v. *Commission* (Case 41/83) [1985] E.C.R. 873 (telecommunications); *Verband der Sachversicherer* v. *Commission* (Case 45/85) [1987] E.C.R. 405 (insurance); *C.B. and Europay* v. *Commission* (Cases T-39 and T-40/92) [1994] E.C.R. II-49 (banking). See also Council Regulation 2408/92 O.J. 1992, L 240, p. 8 (air transport).

[319] Competition Bill 1997, Sched. 4, Part II. The present exemptions are in Sched. 1 to the Restrictive Trade Practices Act 1976.

[320] *Nagle* v. *Feilden* [1966] 2 Q.B. 633. See also *Greig* v. *Insole* [1978] 1 W.L.R. 302; *Adamson* v. *N.S.W. Rugby League Ltd.* (1991) 103 A.L.R. 319.

[321] *Pharmaceutical Society of Great Britain* v. *Dickson* [1970] A.C. 403.

[322] Privity of contract precludes an action in contract (see *post*, Chapter 10), and in *R.* v. *Disciplinary Committee of the Jockey Club, ex parte Aga Khan* [1993] 1 W.L.R. 909 it was said by Hoffmann L.J. at p. 933 that gaps in private law remedies should not be filled by subjecting them to public law and the judicial review procedure. Where there is unlawful discrimination or the restriction seeks to prevent those subject to the rules from dealing with a non-party, there may be a remedy: *Cutsforth* v. *Mansfield Inns Ltd.* [1986] 1 W.L.R. 558.

The doctrine may even apply to the rules of professional bodies the members of which do not technically engage in 'trade',[323] though possibly not to those rules which are related solely to the maintenance of professional honour or standards.[324]

Monopolies and Mergers Commission

(6) *Monopolies.* In 1948, Parliament enacted the Monopolies and Restrictive Practices (Inquiry and Control) Act,[325] which set up an advisory body, now named the Monopolies and Mergers Commission, and to be renamed the Competition Commission.[326] The Commission is empowered to investigate and report on monopoly situations,[327] mergers of enterprises,[328] and anti-competitive practices.[329] The Commission is independent of government, but it has itself no power to initiate an investigation or to implement its own recommendations. References to the Commission can be initiated only by the Secretary of State or by the Director General of Fair Trading and any orders made in consequence of its reports are made by the Secretary of State.

IV. The Effect of Illegality

Effect of illegality may vary

IT has already been pointed out that the single word 'illegal' may embrace varying degrees of impropriety,[330] and it should not be supposed that the effect of illegality is always identical.

In some cases, the law adopts a very severe attitude and refuses to assist a person implicated in the illegality in any way whatsoever. In others, public policy does not require that such a person should be so completely denied a remedy. Money paid or property transferred may be recoverable;[331] collateral transactions may not be tainted;[332] and the Court may be prepared to sever the illegal part of the contract from that which is legal, and enforce the legal part alone.[333] In this section, however, unless otherwise stated, we shall be dealing with those situations where the law rigorously discourages the claims of those who found their cause of action upon an illegal transaction. Even in these situations, there is some variation in the rules to be applied.[334] Moreover, in some instances, the Courts will refuse their aid only to a party who intends to break the law; in others, the contract is unlawful *per se*. Thus, although general rules can be set out, each case must be examined in order to discover the precise effect of the illegality.

The fundamental principle of policy

The fundamental principle upon which the Courts will act when they have to deal with an illegal contract was long ago explained by Lord Mansfield:[335]

[323] *Ibid.*, at pp. 420, 427, 430, 436, 441.
[324] *Ibid.*, at pp. 421, 436.
[325] This has now been repealed.
[326] Competition Bill 1997, clause 44.
[327] The definition of a 'monopoly situation' is a complicated one, but, in general, it exists if one-quarter of goods or services of one description are supplied by or to a single company or group of companies.
[328] Only large mergers are controlled.
[329] Competition Act 1980, ss. 2–19 (as amended).
[330] See *ante*, p. 333.
[331] See *post*, pp. 388, 391.
[332] See *post*, p. 397.
[333] See *post*, p. 398.
[334] See *post*, pp. 388, 391.
[335] *Holman* v. *Johnson* (1775) 1 Cowp. 341, at p. 343. See also Glanville Williams (1942) C.L.J. 51; Grodecki (1955) 71 L.Q.R. 254.

The objection, that a contract is immoral or illegal as between plaintiff and defendant, sounds at all times very ill in the mouth of the defendant. It is not for his sake, however, that the objection is ever allowed; but is founded in general principles of policy, which the defendant has the advantage of, contrary to the real justice, as between him and the plaintiff, by accident, if I may so say. The principle of public policy is this: *ex dolo malo non oritur actio*. No court will lend its aid to a man who founds his cause of action upon an immoral or an illegal act. If, from the plaintiff's own stating or otherwise, the cause of action appears to arise *ex turpi causa*, or the transgression of a positive law of this country, there the court says he has no right to be assisted. It is upon that ground the court goes; not for the sake of the defendant, but because they will not lend their aid to such a plaintiff. So if the plaintiff and defendant were to change sides, and the defendant was to bring his action against the plaintiff, the latter would then have the advantage of it; for where both are *equally* at fault, *potior est conditio defendentis*.

It has recently been said that:

> the principle is not a principle of justice: it is a principle of policy, whose application is indiscriminate and so can lead to unfair consequences as between the parties to litigation. Moreover the principle allows no room for the exercise of any discretion by the court in favour of one party or the other.[336]

The consequence is that, subject to exceptions, discussed below, no person who is aware of the illegal nature of a contract can enforce it, or recover money or property transferred under it.

The 'public conscience' test

It is generally said that that the justification for the rule that an illegal contract cannot be enforced by a guilty party is that the rule exists not for the sake of the defendant but because the Courts will not lend their aid to such a plaintiff. It does not accordingly matter that the defendant shares the guilt. But, as we have noted and will also see below, questions of illegality involve varying degrees of impropriety, of participation and responsibility, of injustice because of unjust enrichment, and of relationship between the illegality and the claim.[337] This, as well as the harshness of the consequences of the application of the *ex turpi causa* maxim, led to the adoption in some decisions of an approach, originating in cases concerned with the effect of illegality on a claim in tort,[338] whereby the courts would help such a plaintiff unless to do so 'would be an affront to public conscience'.[339] Although the 'public conscience' test seeks to address the underlying policy issues and would lead to a more unified approach to the effect of illegality in the law of obligations, and a greater harmony between common law and equitable rules, it has been rejected by the House of Lords. In *Tinsley* v. *Milligan* their Lordships

[336] *Tinsley* v. *Milligan* [1994] 1 A.C. 340, *per* Lord Goff, at p. 355.

[337] Tan (1988) 104 L.Q.R. 523, at p. 526. See also Buckley (1994) 110 L.Q.R. 3; Rose (1996) J.C.L. 271.

[338] *Thackwell* v. *Barclays Bank plc* [1986] 1 All E.R. 676; *Saunders* v. *Edwards* [1987] 1 W.L.R. 1116. On the test in tort, see further *Kirkham* v. *Chief Constable of Greater Manchester* [1990] 2 Q.B. 283; *Pitts* v. *Hunt* [1991] 1 Q.B. 24 and *post*, p. 393.

[339] *Euro Diam Ltd.* v. *Bathurst* [1990] Q.B. 1, at p. 35. See also *Howard* v. *Shirlstar Container Transport Ltd.* [1990] 1 W.L.R. 1292, although *Tinsley* v. *Milligan* (*supra*, n. 336) at p. 360 has now explained this case as an example of the principle stated in *St John Shipping Corp.* v. *Rank* [1957] 1 Q.B. 267, *ante*, pp. 335–6.

stated that it was 'inconsistent with numerous authorities' and with Lord Mansfield's principle, it was 'imponderable', and that its adoption would replace a system of rules by a discretionary balancing operation.[340] Lord Goff considered that to introduce a system of discretionary relief[341] is a matter for the legislature after a full inquiry rather than for a court.

(a) The Intention of the Parties and Enforceability of the Contract

Intention is material

It must, however, be emphasized at the outset that most contracts are not legal or illegal in the same way that eggs are good or bad. The effect of illegality will in most cases turn on the intention of the parties, i.e. whether one or both of them entered into the contract intending to do an act forbidden by the law. Their rights and remedies will depend upon whether they knew of or participated in the illegal intention.

Guilty parties

A party who enters into a contract for an illegal purpose or intending to perform it in an illegal manner, or a contract which to the knowledge of that party involves or has as its object the commission of an illegal act, cannot bring any action upon the contract or enforce it in any way.[342] And if both parties share the unlawful intention, as in *Pearce* v. *Brooks*,[343] where both knew that the brougham was to be used for the purpose of prostitution, no action can be maintained by either party.

Innocent parties: (i) furtherance of illegal purpose

On the other hand, a party who is innocent of any illegal intention is not without remedy. If the contract is one to do something which is lawful in itself, but which one of the parties intends to use for the furtherance of some illegal purpose or to perform in an illegal manner, the agreement can be the subject-matter of an action *at the suit of the innocent party*. Provided that there was no knowledge of the illegal intention of the other party, the innocent party is entitled to recover what may be due under the contract, or to obtain damages in full.[344] An innocent party who becomes aware of the illegality before the transaction is completed or while it is still executory, may refuse to perform the contract. Thus in *Cowan* v. *Milbourn*:[345]

[340] [1994] 1 A.C. 340, respectively at pp. 358 and 361 (*per* Lord Goff), p. 369 (*per* Lord Browne-Wilkinson), and pp. 358 and 363–4 (*per* Lord Goff). This decision is open to criticism on other grounds; *post*, p. 396.

[341] See the New Zealand Illegal Contracts Act 1970 and N.Z. Law Commission Report No. 25 *Contract Statutes Review* (1993) pp. 21, 173 ('in practice' this statute 'has worked reasonably well').

[342] *Cowan* v. *Milbourn* (1867) L.R. 2 Ex. 230 (*infra*, n. 345); *Alexander* v. *Rayson* [1936] 1 K.B. 169, at p. 182. Cf. *Edler* v. *Auerbach* [1950] 1 K.B. 359. On the attribution of knowledge to a company, see *Meridian Global Funds Management Asia Ltd.* v. *Securities Commission* [1995] 2 A.C. 500. See further *Selangor United Rubber Estates Ltd.* v. *Cradock (No. 3)* [1968] 1 W.L.R. 1555, at p. 1655.

[343] (1866) L.R. 1 Ex. 213; *ante*, p. 357. See also *Alexander* v. *Rayson* (*supra*, n. 342); *ante*, p. 350; *Corby* v. *Morrison* [1980] I.R.L.R. 218.

[344] *Mason* v. *Clarke* [1955] A.C. 778, at pp. 793, 805. See also *Fielding & Platt Ltd.* v. *Najjar* [1969] 1 W.L.R. 357; *Newland* v. *Simons and Willer (Hairdressers) Ltd.* [1981] I.C.R. 521.

[345] (1867) L.R. 2 Ex. 230. The definition of blasphemy in this case must be revised in the light of *Bowman* v. *Secular Society Ltd.* [1917] A.C. 406.

The defendant, M, agreed to let a set of rooms to C for certain days; then he discovered that it was proposed to use the rooms for the delivery of lectures which were unlawful because blasphemous within the meaning of 9 & 10 Will. III, c. 32. M refused to carry out the agreement.

It was held that he was entitled to do so. But should the illegal purpose be discovered before it is carried into effect, an innocent party who allows it to proceed none the less cannot recover. In *Cowan* v. *Milbourn*, M could not have recovered the rent of his rooms if, having let them in ignorance of the plaintiff's intentions, he had allowed the rooms to be used after he had learned of the illegal purpose which his tenant contemplated.

Innocent parties: (ii) commission of illegal act

The same principle applies where the contract is not unlawful '*per se*'[346] and one party is unaware that it involves or has as its object the commission of an illegal act. The contract itself is still valid, and an innocent party who was ignorant of the facts which constitute the illegality can enforce it. In *Bloxsome* v. *Williams*:[347]

B contracted with W on a Sunday for the purchase of a horse, W warranting that the horse was not more than 7 years old and sound. Unknown to B, W was a horse-dealer and the Sunday Observance Act 1677 imposed a penalty on a horse-dealer for exercising his trade on a Sunday. The horse was 17 years old and unsound, and B sued for damages for breach of warranty.

The Court of King's Bench held that the illegality was no defence to the action for breach of contract as B was ignorant of the fact that W was a horse-dealer. It is also possible for an innocent party who has executed part of such a contract before discovering the illegality to recover reasonable renumeration for the work already done in a restitutionary action. So in *Clay* v. *Yates*[348] a printer was able to recover the value of work done towards the publication of a treatise which, after the major part of it had been printed, he found to contain defamatory material.

Legal formation but illegal performance

Different considerations, however, apply where there is no illegal intention at the time the contract is entered into, but one party subsequently performs the contract in an illegal manner. Normally that party will be precluded from enforcing any claim which requires reliance on its own illegal performance.[349] But this is not necessarily the case. As we have seen, if a statutory offence is committed in the course of performing a contract, the intention of the statute may simply be to impose a penalty, and not to prevent the party in default from asserting civil

[346] See *post*, p. 386.

[347] (1824) 3 B. & C. 232 (the defendant in this case could not have sued: *Fennell* v. *Ridler* (1826) 5 B. & C. 406). See also *Shaw* v. *Shaw* [1954] 2 Q.B. 429; *Bank für Gemeinwirtschaft* v. *City of London Garages Ltd.* [1971] 1 W.L.R. 149; *Fuji Finance Inc.* v. *Aetna Life Insurance Co. Ltd.* [1994] 4 All E.R. 1025 (on appeal to the House of Lords) and the cases cited *ante*, p. 335. Contrast *Phoenix General Insurance Co. of Greece S.A.* v. *Halvanon Insurance Co. Ltd.* [1988] 1 Q.B. 216 (effect reversed by the Financial Services Act 1986, s. 132).

[348] (1856) 1 H. & N. 73. Cf. *Taylor* v. *Bhail* [1996] C.L.C. 377, at p. 383 (no such remuneration for guilty party) and *Aratra Potato Co.* v. *Taylor Johnson Garrett* [1995] 4 All E.R. 695, at pp. 709–10 (no *quantum meruit* for work done under champertous agreement).

[349] *Anderson Ltd.* v. *Daniel* [1924] 1 K.B. 138; *B. & B. Viennese Fashions* v. *Losane* [1952] 1 All E.R. 909.

remedies.[350] There may also be other situations where public policy does not require that the commission of an unlawful or immoral act in the course of performance should deprive the 'guilty' party of recourse to the Courts.[351] In any event, the normal contractual remedies are available to the innocent party. In *Archbold's (Freightage) Ltd.* v. *Spanglett Ltd.*:[352]

S agreed with A to carry a consignment of whisky from Leeds to London docks in one of its vans. Unknown to A, the vehicle to be used for this purpose did not possess an 'A' licence entitling it to carry the goods of other persons for reward. Owing to the driver's negligence, the whisky was stolen *en route* and A claimed damages for its loss. S contended that it was not liable as the contract was illegal.

The Court of Appeal refused to accept this contention. The contract was not one prohibited by statute; and it was not rendered illegal merely by the fact that one of the parties (i.e. S) had performed it in an unlawful manner. Thus, even though S might not have been able to enforce the contract, A was ignorant of the illegality and was entitled to damages.

Ignorance of law generally no defence

There is, however, an important qualification which must be made to the principles stated above. A party to a contract who has full knowledge of the facts which constitute the illegality, but yet is ignorant of the law will not be held to be innocent, for *ignorantia juris haud excusat*. In *J. M. Allan (Merchandising) Ltd.* v. *Cloke*[353] the plaintiff sued the defendant for rentals payable in respect of a roulette table hired to the defendant and designed for the playing of 'Roulette Royale', a game which was at that time unlawful by virtue of the Betting and Gaming Act 1960.[354] At the time the parties entered into the hiring agreement, neither knew that the game was illegal, and the plaintiff pleaded that it had no 'wicked intention to break the law'. The Court of Appeal rejected this plea and held that ignorance of the law was no answer to the charge of illegality so as to permit the plaintiff to enforce the agreement.

Ignorance of law a defence where performance lega

In *Cloke*'s case, the parties intended from the beginning that the subject-matter of the contract should be used for an unlawful purpose (the playing of 'Roulette Royale'), and this fact was held to render the contract illegal in its formation. On the other hand, in *Waugh* v. *Morris*:[355]

M chartered a ship belonging to W to take a cargo of hay from Trouville to London, the cargo to be unloaded alongside ship in the river. M subsequently instructed the master to land the hay at a wharf at Deptford Creek, and the master agreed to do so. Unknown to the parties an Order in Council (made before the charterparty was entered into) had forbidden the *landing* of French hay in order to prevent the spread of disease among animals. M, on hearing this, took the cargo from alongside the ship without landing it, and exported it, thus avoiding a breach of the Order in Council. The return of the vessel was delayed, and W sued for damages arising from the delay.

[350] See *ante*, p. 335.
[351] *Coral Leisure Group Ltd.* v. *Barnett* [1981] I.C.R. 521.
[352] [1961] 1 Q.B. 374. Contrast *Ashmore, Benson, Pease & Co. Ltd.* v. *A.* v. *Dawson Ltd.* [1973] 1 W.L.R. 828; *ante*, p. 335.
[353] [1963] 2 Q.B. 340. See also *Nash* v. *Stevenson Transport Ltd.* [1936] 2 K.B. 128; *Miller* v. *Karlinski* (1945) 62 T.L.R. 85. Contrast *Shelley* v. *Paddock* [1980] Q.B. 348.
[354] The Act has now been repealed.
[355] (1873) L.R. 8 Q.B. 202.

M pleaded as a defence that the charterparty contemplated an illegal act, the landing of French hay contrary to the Order in Council. This defence did not prevail. The charterparty itself merely provided that the hay should be taken and delivered alongside, but not landed; and the Court found as a fact that W never contemplated or believed that M would violate the law. In his judgment, however, Blackburn J. said:[356]

> Where a contract is to do a thing which cannot be performed without a violation of the law it is void, whether the parties knew the law or not. But we think, that in order to avoid a contract which can be legally performed, on the ground that there was an intention to perform it in an illegal manner, it is necessary to show that there was the wicked intention to break the law; and if this be so, the knowledge of what the law is becomes of great importance.

It is submitted that Blackburn J. did not intend, by these words, to lay down a general rule that, when a contract is not illegal in its formation, but the illegality resides only in its performance, a party may be excused by ignorance of the law. The principle is more narrow: that if one or both parties contemplate a method of performance which is, unknown to them, illegal, they will not be shut out from their contractual remedies if, on their discovering the illegality, the contract is lawfully performed.[357]

(b) Contracts Unlawful '*per se*'

Contracts *per se* illegal

If a contract is expressly or by implication forbidden by statute or by public policy, then it is void and unenforceable, though the parties may have been ignorant of the facts constituting the illegality and did not intend to break the law. Such contracts are unlawful *per se* and the intention of the parties is irrelevant.

An example of a contract forbidden by statute has been given in *Re Mahmoud and Ispahani*[358] where the plaintiff, who was ignorant of the fact that the defendant had no licence to purchase linseed oil, was unable to recover damages for non-acceptance in face of a statutory prohibition. An example of a contract forbidden by public policy is one which necessarily involves trading with an alien enemy in time of war. No rights of action will arise, even though one party at the time of the agreement is ignorant of the fact that war has broken out or that the other party has the status of an enemy.[359] The agreement itself is prohibited and cannot be enforced in any way.

It is clear that considerable difficulty may be experienced in deciding whether a particular statute or head of public policy renders the contract unlawful *per se* or merely prevents a guilty party from suing on it. But the modern tendency is to

[356] At p. 208.
[357] See also *Hindley & Co. Ltd.* v. *General Fibre Co. Ltd.* [1940] 2 K.B. 517. Cf. *Reynolds* v. *Kinsey* 1959 (4) S.A. 50 (South Africa).
[358] [1921] 2 K.B. 716, *ante*, p. 334; *Chai Sau Yin* v. *Liew Kwee Sam* [1962] A.C. 304; *Harse* v. *Pearl Life Assurance Co.* [1904] 1 K.B. 558.
[359] *Sovfracht (v/o)* v. *Van Udens Scheepvaart en Argentuur Maatschappij (N.V. Gebr.)* [1943] A.C. 203.

hold that a contracting party who has not participated in the unlawful intention cannot be cast from the seat of judgment. The state of mind of the parties is the crucial factor. Unless it is clear that the legislature intended, or public policy demands, that the contract be prohibited altogether, the innocent party can sue on the agreement.

Collateral remedies

Moreover, even if the contract is one which is unlawful *per se*, the innocent party is not necessarily without remedy. If the innocent party has been induced to enter into the contract by a misrepresentation or assurance by the other party, then damages can be recovered for breach of a collateral warranty if such has been given,[360] or for fraud if there is fraud,[361] provided that the conduct of the innocent party is not itself sufficiently culpable to bar that remedy.[362] So in *Strongman (1945) Ltd.* v. *Sincock*[363] a builder recovered damages for the breach of a collateral assurance by his client that he would obtain the necessary licences to enable the work to be carried out, even though a contract to build without a licence was absolutely prohibited by statute. And in *Shelley* v. *Paddock*[364] a woman who was fraudulently induced to agree to buy a house in Spain in ignorance of the fact that the purchase was in breach of the Exchange Control Act 1947 was held entitled to recover damages for the fraud.

(c) Benefit from Illegal Contracts

Fruits of illegality

It is sometimes said to be a rule of law that no person can take any benefit from a contract, either directly or through a personal representative, when that benefit results from the performance by *that person* of an illegal act.[365] In *Beresford* v. *Royal Insurance Co. Ltd.*:[366]

R insured his life with the defendant company for £50,000. A few minutes before the policy was due to lapse, he committed suicide. The policy contained a term avoiding it in the event of suicide within a year of its commencement, but the suicide occurred after the policy had run for some years.

The House of Lords held that the insurance company had agreed to pay in this event, but that the claim was contrary to public policy as the deceased's personal

[360] *Strongman (1945) Ltd.* v. *Sincock* [1955] 2 Q.B. 525, at pp. 536, 539; *Gregory* v. *Ford* [1951] 1 All E.R. 121.

[361] *Burrows* v. *Rhodes* [1899] 1 Q.B. 816; *Road Transport & General Insurance Co.* v. *Adams* [1955] C.L.Y. 2455; *Shelley* v. *Paddock* [1980] Q.B. 348. Rescission on the ground of fraud may also be available, see *Hughes* v. *Clewley (The Siben) (No 2)* [1996] 1 Lloyd's Rep. 35 (not available in that case), *ante*, pp. 248, 251.

[362] *Askey* v. *Golden Wine Co. Ltd.* [1948] 2 All E.R. 35.

[363] [1955] 2 Q.B. 525.

[364] [1980] Q.B. 348. See also *Hughes* v. *Clewley (The Siben) (No 2)* [1996] 1 Lloyd's Rep. 35, at p. 63 and *Saunders* v. *Edwards* [1987] 1 W.L.R. 1116, the result, but not the reasoning of which was said to be 'unassailable' by Lord Goff in *Tinsley* v. *Milligan* [1994] 1 A.C. 340, at p. 360.

[365] *Cleaver* v. *Mutual Reserve Fund Life Association* [1892] 1 Q.B. 147; *Re the Estate of Crippen* [1911] P. 108, at p. 112; *Archbolds (Freightage) Ltd.* v. *Spanglett Ltd.* [1961] 1 Q.B. 374, at p. 388; *Re Giles* [1971] Ch. 544; *Davitt* v. *Titcumb* [1990] 1 Ch. 110. But see the Forfeiture Act 1982; *Re K.* [1985] Ch. 85; *Re S.* [1996] 1 W.L.R. 235.

[366] [1938] A.C. 586. See also *Prince of Wales etc. Association* v. *Palmer* (1858) 25 Beav. 605. Cf. *White* v. *British Empire etc. Assurance Co.* (1868) L.R. 7 Eq. 394.

representatives could not obtain any benefit from the assured's illegal act. The case would certainly not be decided the same way at the present day, for suicide is no longer a crime,[367] and the rule itself is probably too widely stated. It is submitted that it will only apply where the statute or head of public policy is such as to require that the offender be deprived of the fruits of the illegal act.[368] Thus, although it has been held that no recovery would be allowed under a policy of insurance when the insured goods had been deliberately imported without payment of customs duty,[369] the same considerations would not apply in the case of unintentional importation or the innocent possession of uncustomed goods.[370] Similarly, in principle no renumeration in the form of a restitutionary *quantum meruit* will be given for work done pursuant to an illegal contract where that would amount to indirect enforcement of the contract.[371]

(d) Recovery of Money Paid or Property Transferred

Recovery of money or property

It is scarcely surprising that the Courts will refuse to enforce an illegal agreement at the suit of a person who is implicated in the illegality. But it is also a rule of English law that money paid or property transferred by such a person cannot be recovered. In the colourful words of Wilmot C.J.: 'All writers upon our law agree in this, no polluted hand shall touch the pure fountains of justice. Whoever is a party to an unlawful contract, if he hath once paid the money stipulated to be paid in pursuance thereof, he shall not have the help of a court to fetch it back again'.[372]

This principle is expressed in the maxim *in pari delicto potior est conditio defendentis* and it may be illustrated by the case of *Parkinson* v. *College of Ambulance Ltd.*:[373]

> The secretary of a charitable organization promised the plaintiff that he would secure for him a knighthood if he would make a sufficient donation to the organization's funds. In consideration of this promise, the plaintiff paid over £3,000 and promised more when he should receive the honour. The knighthood never materialized, and the plaintiff sued for the return of his money.
>
> Although, there was 'a total failure of consideration', which, but for the illegality, would have grounded a restitutionary claim for the return of the money, it was held that the action must fail as it was founded upon a transaction which was illegal at common law.

[367] Suicide Act 1961.
[368] *Marles* v. *Philip Trant & Sons Ltd.* [1954] 1 Q.B. 29, at p. 39; *St. John Shipping Cpn.* v. *Joseph Rank Ltd.* [1957] 1 Q.B. 267, at p. 292; *R.* v. *Chief National Insurance Commissioner* [1981] Q.B. 758, at p. 765; *Gardner* v. *Moore* [1984] 1 A.C. 548; *Thorne* v. *Silverleaf* [1994] 1 B.C.L.C. 637.
[369] *Geismar* v. *Sun Alliance and London Insurance Ltd.* [1978] Q.B. 383; *ante*, p. 350.
[370] *Ibid.*, at p. 395.
[371] *Aratra Potato Co.* v. *Taylor Johnson Garrett* [1995] 4 All E.R. 695, at pp. 709–10 (champertous agreement). But, in the case of statutory illegality, *quaere* whether the test is whether the statute bars restitution as well as enforcement of the executory contract; see by analogy *Scott* v. *Pattison* [1923] 2 K.B. 723; *Pavey & Matthews Pty. Ltd.* v. *Paul* (1986–87) 162 C.L.R. 221 (unenforceable contracts).
[372] *Collins* v. *Blantern* (1767) 2 Wilson 341, at p. 350.
[373] [1925] 2 K.B. 1. See also *Shaw* v. *Shaw* [1965] 1 W.L.R. 937. For a criticism of the maxim, see Grodecki (1955) 71 L.Q.R. 254.

But there are exceptional cases in which a person will be relieved of the consequences of an illegal contract which that person has entered—cases to which the maxim just quoted does not apply. They fall into three classes: (i) where the illegal purpose has not yet been carried into effect before it is sought to recover the money paid or goods delivered or other property transferred in furtherance of it; (ii) where the party seeking recovery is not *in pari delicto* with the party resisting recovery; (iii) where the plaintiff does not have to rely on the illegal contract to make out the claim, but can establish a claim based on a legal or equitable property right. We shall consider each of these exceptions in turn.

(i) Illegal purpose not yet carried into effect

Illegality not yet effected

The first exception relates to cases where money has been paid, or goods delivered, or other property transferred for an unlawful purpose which has not yet been carried into effect because the plaintiff withdrew in time.[374] The law is not quite satisfactorily settled on this point, and the authorities are difficult to reconcile, but its present condition would seem to demand that two conditions be satisfied. First, the party seeking to recover must withdraw from the transaction before the illegal purpose is executed in whole or in part. Secondly, the withdrawal must be voluntary and not be merely frustration by circumstances over which the party seeking to recover money paid or property transferred has no control.

Repudiation of illegal purpose

While the illegality is still completely executory, the parties are allowed an opportunity for repentance or change of mind, a *locus poenitentiae*. But some doubt exists as to when this privilege ceases. In *Taylor* v. *Bowers*[375] it was said by Mellish L.J. that:

> If money is paid or goods delivered for an illegal purpose, the person who had so paid the money or delivered the goods may recover them back *before the illegal purpose is carried out*; but if he waits till the illegal purpose is carried out, or if he seeks to enforce the illegal transaction, in neither case can he maintain an action.

The facts of the case to which these words applied were as follows:

> The plaintiff, a debtor, had made a fictitious assignment of his goods to one A in order to defraud his creditors. Two meetings of creditors were then called, but no composition was reached as only one creditor turned up. A had in the meantime, without the plaintiff's consent, parted with the goods under a bill of sale to the defendant, who was one of the creditors and knew of the fraudulent assignment. The plaintiff sued the defendant for the recovery of the goods.

It was held that he was entitled to succeed. It could be contended that, in this case, the illegal purpose was still entirely executory, for no creditor had actually been defrauded.[376] But it is difficult to see the fictitious assignment as anything but a

[374] See Beatson (1975) 91 L.Q.R. 313; Merkin (1981) 97 L.Q.R. 920.
[375] (1876) 1 Q.B.D. 291, at p. 300.
[376] *Tinsley* v. *Milligan* [1994] 1 A.C. 340, at p. 374; *Tribe* v. *Tribe* [1996] Ch. 107, at pp. 121–2, 124, 132–3. See also *Perpetual Executor & Trustees Assoc.* v. *Wright* (1917) 23 C.L.R. 185, at p. 193 (High Court of Australia).

part-performance of the illegal purpose, since at the two creditors' meetings the creditors would clearly have been less likely to have pressed their claims in view of the assignment. If this is so, then the facts in *Taylor* v. *Bowers* support the principle stated by Mellish L.J., that recovery is possible at any time before the illegal purpose is carried out, i.e. completed.[377]

Subsequent cases, however, do not endorse this formulation. In *Kearley* v. *Thomson*,[378] for instance:

> The defendants, a firm of solicitors acting for a petitioning creditor of one Clarke, a bankrupt, agreed with the plaintiff, a friend of Clarke, that in consideration of the payment of their costs they would not appear at the public examination of Clarke, nor oppose the order for his discharge. They carried out the first part of the agreement, but before any application was made for Clarke's discharge, the plaintiff changed his mind and sought to recover the money which he had paid.

His action failed. It was held that the agreement was illegal as tending to pervert the course of justice, and that recovery was precluded as the illegal purpose had already been partly executed. The principle as formulated by Mellish L.J. in *Taylor* v. *Bowers*, and even the case itself, might, said the Court, require reconsideration.[379] In any event, the case before the Court was distinguishable as there had been 'a partial carrying into effect of an illegal purpose in a substantial manner'.[380] Although the matter is not free from doubt,[381] the position now seems to be that money paid or goods delivered in pursuance of an illegal purpose cannot be recovered where that purpose has been executed in whole or in part.[382]

Withdrawal must be genuine

What the law allows in these cases is a *locus poenitentiae*, and therefore, whilst it will help one who repudiates, it will not help a person who has abandoned the illegal purpose only because that purpose has been frustrated by the failure of the other contracting party to fulfil his side of the illegal contract, or in some other way. So, in *Bigos* v. *Bousted*:[383]

> In breach of the provisions of the Exchange Control Act 1947, A entered into an agreement with B whereby B agreed to make available £150 worth of Italian currency to enable A's wife and daughter to travel in Italy. As security, A deposited with B a share certificate. The promised money was never forthcoming, and A sued B to recover the certificate.

It was pleaded on A's behalf that he was entitled to a *locus poenitentiae* as the illegal contract had not been performed, but this contention was rejected by Pritchard J. He held that there was no true withdrawal on A's part; the contract had merely been frustrated by B's failure to supply the money.

[377] See also *Singh* v. *Ali* [1960] A.C. 160, at p. 167.

[378] (1890) 24 Q.B.D. 742.

[379] See Millett L.J.'s doubts in *Tribe* v. *Tribe* (*supra*, n. 376) at p. 125. But the decision was cited without disapproval in *Tinsley* v. *Milligan* [1994] 1 A.C. 340, at p. 374.

[380] *Ibid.*, *per* Fry L.J. at p. 747. See also *Apthorp* v. *Neville & Co.* (1907) 23 T.L.R. 575; *Re National Benefit Assurance Co. Ltd.* [1931] 1 Ch. 46; *Parker (Harry) Ltd.* v. *Mason* [1940] 2 K.B. 590.

[381] Compare Lord Browne-Wilkinson's formulations (whether illegal purpose 'put into operation' and whether it was 'carried through') in *Tinsley* v. *Milligan* (*supra*, n. 379) at p. 374.

[382] *Tribe* v. *Tribe* (*supra*, n. 376) at pp. 122, 124, 133. Cf. at 134. For an alternative formulation, see Beatson (1975) 91 L.Q.R. 313, at pp. 314–16.

[383] [1951] 1 All E.R. 92. But see *Shelley* v. *Paddock* [1980] Q.B. 348.

But although the *withdrawal* must be genuine, it is not necessary that there be genuine repentance. Thus in *Tribe* v. *Tribe*:[384]

A father transferred shares to his son on trust so that they would not be the subject of claims made against him by creditors but the illegal purpose of defrauding the creditors was not carried out because the claims settled. The son refused to transfer the shares back to his father.

The Court of Appeal held that the father was entitled to the benefit of the *locus poenitentiae* doctrine. Millett L.J. stated that 'genuine repentance is not required . . . voluntary withdrawal from an illegal transaction when it has ceased to be needed is sufficient'.[385]

Marriage brokage contracts

Marriage brokage contracts, moreover, constitute an exception to the general rule. In *Hermann* v. *Charlesworth*,[386] a woman who had paid £52 to the proprietor of a newspaper, *The Matrimonial Post and Fashionable Marriage Advertiser*, with a view to obtaining by advertisement an offer of marriage, successfully recovered the money after advertisements had appeared, and several prospective suitors had been introduced, but before any marriage had been arranged.

No *locus poenitentiae* at all

At the other end of the scale, it seems highly unlikely that the Courts would allow any *locus poenitentiae* at all in the most serious cases of moral reprehensibility, as for example, where money is paid to another to commit murder.[387]

(ii) Parties not 'in pari delicto'

Parties not *'in pari delicto'*

Where the parties are not *in pari delicto* the less guilty party may be able to recover money paid, or property transferred, under the contract. This possibility may arise in two basic situations. The first is where the contract is rendered illegal by statute in order to protect a class of persons of whom the plaintiff is one. The second is where the nature of the restitutionary cause of action shows that the plaintiff was ignorant or innocent of the illegality.

Class protecting statutes

First, the case of a contract made illegal by statute in the interests of a particular class of persons of whom the plaintiff is one. As Lord Mansfield explained in *Browning* v. *Morris*:[388]

But, where contracts or transactions are prohibited by positive statutes, for the sake of protecting one set of men from another set of men; the one, from their situation and condition, being liable to be oppressed or imposed upon by the other; there, the parties are not *in pari delicto*; and in furtherance of these statutes, the person injured, after the transaction is finished and completed, may bring his action and defeat the contract.

The Rent Acts have furnished an illustration of this type of case. The Rent Act 1977 provides that, where under any agreement a premium is paid which could not lawfully be required or received, the premium is to be recoverable by the person by whom it is paid.[389] But even in the absence of any such express statutory

[384] [1996] Ch. 107.
[385] *Ibid.*, at p. 135.
[386] [1905] 2 K.B. 123. Cf. *ante*, p. 357 doubting that such contracts should be unenforceable.
[387] *Kearley* v. *Thomson* (1890) 24 Q.B.D. 742, at p. 747; *Tappenden* v. *Randall* (1801) 2 B. & P. 467.
[388] (1778) 2 Cowp. 790, at p. 792.
[389] Rent Act 1977, s. 125. See *Farrell* v. *Alexander* [1977] A.C. 59.

provision, it has been held that a tenant or assignee of a lease, though a willing party to the evasion of the Rent Acts, may recover an illegal premium paid, since the Acts were passed for the protection of such persons.[390]

The intention of the statute is one of prime importance. In *Green* v. *Portsmouth Stadium Ltd.*:[391]

The plaintiff, a bookmaker, alleged that, over a long period of time, he had been overcharged by the defendants for admission to a greyhound track run by them. The Betting and Lotteries Act 1934, section 13(1), allowed a charge to be made to bookmakers not exceeding five times the highest fee for the public at large, but the plaintiff had been compelled to pay considerably more. He claimed the excess from the defendants in an action for money had and received.

The Court of Appeal held that the action must fail. The Act was designed to regulate racecourses; it was not a bookmakers' charter. The statute was not passed 'to protect one set of men from another set of men', at any rate, not so as to give bookmakers the right to bring civil proceedings for the recovery of their money.

Fraud

Where the plaintiff has been induced to enter into the contract by fraud or strong pressure, recovery will be allowed. In *Hughes* v. *Liverpool Victoria Legal Friendly Society*:[392]

The plaintiff took up five insurance policies with the defendants on the lives of persons in which she had no insurable interest. She was induced to do so by a fraudulent misrepresentation on the part of the defendants' agent that the policies were valid and would be paid. They were in fact illegal and void.

It was held that she was entitled to recover the premiums which she had paid.

Oppression & duress

In *Atkinson* v. *Denby*:[393]

The plaintiff, a debtor, offered his creditors a composition of 5*s*. in the pound. The defendant, an influential creditor, refused to assent to the composition unless the plaintiff would make him an additional payment of £50 in fraud of the other creditors. This was done and the composition arrangement was carried out. The plaintiff then sued to recover the £50 on the ground that it was a payment made by him under oppression.

It was held that he could recover. The Court of Exchequer Chamber, affirming the judgment of the Court of Exchequer, observed:[394]

It is said that both parties are *in pari delicto*. It is true that both are *in delicto*, because the Act is a fraud upon the other creditors, but it is not *par delictum*, because one has the power to dictate, the other no alternative but to submit.

Mistake

In *Oom* v. *Bruce*[395] insurance premiums paid by the agent of a Russian in ignorance of the outbreak of war between the United Kingdom and Russia were held

[390] *Gray* v. *Southouse* [1949] 2 All E.R. 1019; *Kiriri Cotton Co. Ltd.* v. *Dewani* [1960] A.C. 192. See also *Ailion* v. *Spiekermann* [1976] Ch. 158.

[391] [1953] 2 Q.B. 190.

[392] [1916] 2 K.B. 482. Cf. *Harse* v. *Pearl Life Assurance Co.* [1904] 1 K.B. 558 where no fraud present. See also *Reynell* v. *Sprye* (1852) 1 De G. M. & G. 660. See also, *ante*, p. 387 (*damages* for fraud).

[393] (1861) 6 H. & N. 778, affirmed (1862) 7 H. & N. 934. On duress, see *ante*, p. 271.

[394] (1862) 7 H. & N. 934, at p. 936.

[395] (1810) 12 East 225.

to be recoverable. That case involved a mistake of fact, and in the present state of the law a mistake of law by the payer will not suffice unless the mistake was induced by the payee's fraud, oppression, undue influence, or breach of fiduciary duty, or the mistake concerned statutory provisions designed to protect persons in the payer's position; i.e. unless there is a right of recovery on some ground other than mistake. But the much criticized rule precluding recovery of payments made under a mistake of law has been said to be 'on the turn'[396] and, if it is abolished either by a decision of the House of Lords or legislatively, the bar to the suggestion made by Lord Denning in 1960,[397] that money paid under a mistake of law will be recoverable whenever there is something in the parties' conduct which shows that the responsibility for the mistake lies primarily on the payee, will be removed.

Fiduciary duty

Finally, there is some authority for the view that a person who is under a fiduciary duty to the plaintiff may not be allowed to retain property, or to refuse to account for moneys received, on the ground that the property or the moneys have come into his hands as the proceeds of an illegal transaction. In *Re Thomas*,[398] where a client sought to recover from his solicitor money paid in pursuance of a champertous agreement between them, it was held that he was entitled to do so. 'Is every rascally solicitor', said Lindley L.J.,[399] 'to invoke his own rascality as a ground of immunity from the jurisdiction of the Court?' It may also be that an agent who receives money from a third party under an illegal contract is bound to account to the principal for the proceeds.[400] But this exception is by no means clearly established, and it is probable that recovery will be denied where the agency is itself illegal.[401]

Balancing of merits

It will be seen from this discussion that there are only a limited number of situations in which one of the parties will be held not to be *in pari delicto* with the other. But, in view of the fact that most cases of illegality nowadays arise out of statutes, there is much to be said for the argument that the Courts should either take up Lord Denning's suggestion[402] and allow recovery to a party who made the payment under a mistake of law where the payee was primarily responsible for it, or to go further, and to apply a test similar to that in the *St. John Shipping Corp.* case in the context of enforcement of the contract,[403] to weigh up the comparative merits of the parties in the light of the statutory purposes and policies, and allow the recovery of money or property when to so so would not undermine them.[404]

[396] *Friends Provident Life Office* v. *Hillier Parker* [1997] Q.B. 85, *per* Auld L.J. at p. 97. See also *Woolwich Equitable B.S.* v. *I.R.C.* [1993] A.C. 70, at pp. 177, 192; Law Com. No. 227, *Mistakes of Law and Ultra Vires Public Authority Receipts and Payments*, (1994), §§ 3.7–3.12.

[397] *Kiriri Cotton Co. Ltd.* v. *Dewani* [1960] A.C. 192, at p. 204.

[398] [1894] 1 Q.B. 742. But contrast *Kearley* v. *Thomson* (1890) 24 Q.B.D. 742; *Palaniappa Chettiar* v. *Arunasalam Chettiar* [1962] A.C. 294.

[399] At p. 749.

[400] *Tenant* v. *Elliott* (1797) 1 B. & P. 3; *Farmer* v. *Russell* (1798) 1 B. & P. 296; *Bone* v. *Eckless* (1869) 5 H. & N. 925. See also *Bridger* v. *Savage* (1884) 15 Q.B.D. 363.

[401] *Parker (Harry) Ltd.* v. *Mason* [1940] 2 K.B. 590.

[402] *Kiriri Cotton Co. Ltd.* v. *Dewani* (*supra*, n. 397) at p. 204.

[403] [1957] 1 Q.B. 267, *ante*, pp. 335–6.

[404] See also *Nelson* v. *Nelson* (1995) 132 A.L.R. 133, *post*, p. 396.

(iii) Plaintiff not relying on the illegal contract

Passing of property

It is settled law that the ownership of property can pass under an illegal contract if the parties so intend, as in the case of goods sold to a buyer under an illegal contract of sale.[405]

Recovery where plaintiff does not rely on illegality

Where, however, only a limited interest is transferred, as under a contract of bailment or a lease, or a trust, it is equally well established that the owner of the property who is not forced to found the claim on the illegal contract,[406] but simply relies on his or her title to the property, can recover it from the bailee or lessee.

This principle is extremely difficult to apply since it is frequently hard to determine whether a plaintiff is relying upon title, or upon the contractual provisions of the illegal agreement. For example, it seems probable that a landlord can recover premises let to a tenant under an illegal agreement once the term of years has expired; but it is a matter of doubt whether the landlord could recover them in the meantime under a covenant which provided for forfeiture for non-payment of rent.[407] Would the landlord be relying on his independent right of ownership, or (more probably) upon the contractual provisions of the illegal lease?

In the case of chattels, it has been held that the termination of the bailment puts the bailor in the more favoured position. In *Bowmakers Ltd.* v. *Barnet Instruments Ltd.*:[408]

> The defendant entered into a contract whereby it agreed to hire-purchase from the plaintiff certain machine tools. Such an agreement was rendered illegal by a government order which prohibited the disposition of machine tools without a licence from the Ministry of Supply. The defendant failed to make the agreed payments for hire. It further sold some of the tools and refused to deliver up to the plaintiffs others still in its possession. The plaintiff sued for damages for conversion.
>
> It was contended on behalf of the defendant that since the contract of hire-purchase was illegal, the plaintiffs could have no remedy on it. It pointed to the case of *Taylor* v. *Chester*[409] where a man failed to recover half of a £50 bank note deposited by him to secure the payment of money for a night's debauch in a brothel. To this the plaintiff replied that it was not relying on the contract, but upon its paramount right of ownership, the bailment having come to an end. The case of *Taylor* v. *Chester* was distinguishable because the pledge had not been redeemed, whereas in the present case all possessory rights of the defendant had been extinguished. This latter argument was adopted by the Court of Appeal. Du Parcq L.J. said:[410]

[405] *Scarfe* v. *Morgan* (1838) 4 M. & W. 270, at p. 281; *Elder* v. *Kelly* [1919] 2 K.B. 179; *Singh* v. *Ali* [1960] A.C. 167; *Kingsley* v. *Sterling Industrial Securities Ltd.* [1967] 2 Q.B. 747, at pp. 782, 783; *Belvoir Finance Co. Ltd.* v. *Stapleton* [1971] 1 Q.B. 210; *Tinsley* v. *Milligan* [1994] 1 A.C. 340, *per* Lord Browne-Wilkinson at p. 374; *Aratra Potato Co.* v. *Taylor Johnson Garrett* [1995] 4 All E.R. 695, at p. 710. Contrast *Amar Singh* v. *Kulubya* [1964] A.C. 142 (transfer prohibited). See also Higgins (1962) 25 M.L.R. 149.

[406] *Amar Singh* v. *Kulubya* (*supra*, n. 405); *Tinsley* v. *Milligan* (*supra*, n. 405).

[407] *Jaijbhay* v. *Cassim* 1939 A.D. 537 (South Africa); *Gas Light & Coke Co.* v. *Turner* (1839) 5 Bing. N.C. 666, *per* Tindal C.J. at p. 677; *Alexander* v. *Rayson* [1936] 1 K.B. 169, *per curiam* at p. 186.

[408] [1945] K.B. 65. See also *Tinsley* v. *Milligan* [1994] 1 A.C. 340

[409] (1869) L.R. 4 Q.B. 309.

[410] [1945] K.B. 65, at p. 71.

In our opinion, a man's right to possess his own chattels will as a general rule be enforced against one who, without any claim of right, is detaining them, or has converted them to his own use, even though it may appear either from the pleadings, or in the course of the trial, that the chattels in question came into the defendant's possession by reason of an illegal contract between himself and the plaintiff, provided that the plaintiff does not seek, and is not forced, either to found his claim on the illegal contract or to plead its illegality in order to support his claim.

This case has been criticized[411] on the ground that, although the possessory rights of the defendants in the tools *sold* had come to an end,[412] this was not so in the case of the tools *retained*. In so far as the Court allowed the claim to these latter in pursuance of the terms of the agreement, it was in effect permitting the enforcement of the provisions of an illegal agreement. Nevertheless, the principle has been accepted,[413] even if its application is a matter of dispute.

It seems probable that, if the property were of such a kind that it would be absurd to encourage litigation concerning its ownership, such as housebreaking instruments or obscene books, the Court would not countenance recovery in any event.[414] But it is difficult to see how a principle that entitles parties to recover their property can properly make a distinction of this sort.[415]

Claims based on equitable interests

In *Tinsley* v. *Milligan*[416] the principle in the *Bowmakers* case was applied to a claim based upon an equitable interest.

T and M purchased a house with funds generated by a joint business venture on the understanding that they had equal interests in it, but registered it in T's name so that M was able to make fraudulent claims for benefit from the Department of Social Security. Later, after the parties had quarrelled, T asserted her legal title and M, who had confessed her wrongdoing and made amends to the Department, counterclaimed for a declaration that T held the house on trust for the parties in equal shares.

It is a rule of equity that (save in the case of certain dealings between spouses and parents and children) where two parties have provided the purchase money to buy property which is conveyed into the name of one alone, that party is presumed to hold the property on a resulting trust for both parties in shares proportionate to their contributions to the price. Such a resulting trust arose in the case of the purchase of the house by T and M, and a majority of the House of Lords[417] held that the counterclaim by M did not therefore rely on the illegality but on her equitable interest. Lord Goff and Lord Keith dissented on the ground that, as M did not

[411] Hamson (1949) 10 C.L.J. 249; Paton, *Bailment in the Common Law* (1952), p. 34; *Miles* v. *Watson* [1953] N.Z.L.R. 958. For wider criticism, see *Nelson* v. *Nelson* (1995) 132 A.L.R. 133, at pp. 176, 189–90, *post*, p. 396. The case is stoutly defended by Coote (1972) 35 M.L.R. 38.

[412] An act inconsistent with the bailment, such as pledging or selling the goods bailed, automatically determines the bailment and the immediate right to possession re-vests in the bailor.

[413] *Belvoir Finance Co. Ltd.* v. *Stapleton* [1971] 1 Q.B. 210. Cf. *Lewis & Hall* v. *McBurney* [1970] C.L.Y. 372.

[414] *Bowmakers Ltd.* v. *Barnet Instruments Ltd.* (*supra*, n. 408), at p. 72; *Taylor* v. *Chester* (*supra*, n. 409).

[415] *Tinsley* v. *Milligan* [1994] 1 A.C. 340, *per* Lord Goff at p. 362. See also *R.* v. *Lomas* (1913) 9 Cr. App. Rep. 220, as explained in *R.* v. *Bullock* [1955] 1 W.L.R. 1.

[416] [1994] 1 A.C. 340. See Buckley (1994) 110 L.Q.R. 3; Enonchong (1995) 111 L.Q.R. 134.

[417] Lord Browne-Wilkinson, Lord Jauncey, and Lord Lowry.

have 'clean hands' she could not assert an equitable interest, and the rule in the *Bowmakers* case is not applicable where equitable relief is sought.[418] But the majority thought that if the law is that a party is entitled to enforce a proprietary right acquired under an illegal transaction, the same rule ought to apply to any property right so acquired, whether such right is legal or equitable.

The limited scope and procedural nature of the decision in *Tinsley* v. *Milligan* can be illustrated by comparing the facts of that case with those in *Tribe* v. *Tribe*, considered above, where a father voluntarily transfered shares to his son, and the presumption of resulting trust did not apply. In such cases there is a presumption of advancement, i.e. equity presumes an intention to make a gift so that the person who has transferred property or allowed it to be registered in the name of another will have no equitable interest to assert unless the presumption is rebutted. Lord Browne-Wilkinson considered this would be difficult for the transferor to do without pleading or leading evidence that would reveal the illegal aspect of the transaction, so that the transferor's claim would fail.[419] In *Tribe* v. *Tribe* the Court of Appeal was troubled by this consequence of the decision of the House of Lords[420] but was able to avoid it because the father fell within the *locus poenitentiae* principle,[421] which M did not in *Tinsley* v. *Milligan* because the illegal purpose had been carried into effect. So, if T had been M's wife or child, so that the presumption of advancement applied, M's claim would have failed.

Critique of the proprietary-based appproach

The rule established in the *Bowmakers* case and extended to equitable interests in *Tinsley* v. *Milligan* is a manifestation of judicial concern, where there is no question of enforcing the *executory* provisions of an illegal contract or transaction, that people should not be unnecessarily precluded by illegality from enforcing rights already acquired under the completed provisions of such a contract or transaction.[422] But it is submitted that it is open to a number of objections. First, it avoids confronting the issue of illegality, the underlying policy issues, and the merits of the parties, and relies instead on the mechanical application of highly technical and procedural concepts. Secondly, to the extent that the parties can, in their illegal contract, determine who owns the property that is its subject-matter, parties who know that the contract is illegal and nevertheless enter into it may be able to insulate themselves from the consequences of the *in pari delicto* rule. Furthermore, where the illegality consists, as it often does in modern conditions, in the contravention of a statute, the property-based approach takes no account of the statutory purposes.

In *Nelson* v. *Nelson*,[423] where a mother provided the purchase money for a house that was transferred into the names of her two children to enable her unlawfully to obtain a subsidized advance from a governmental body on another property, the High Court of Australia disapproved of both the proprietary-based

[418] *Ibid*, at p. 362.

[419] [1994] 1 A.C. 340, at p. 372.

[420] [1996] Ch. 107, at pp. 118, 134. See also *Nelson* v. *Nelson* (1995) 123 A.L.R. 132, at pp. 148, 165–6 and Davies in Oakley ed., *Trends in Contemporary Trust Law* (1996), Ch. 2.

[421] *Ante*, p. 389.

[422] *Tinsley* v. *Milligan* [1994] 1 A.C. 340, *per* Lord Jauncey at p. 366. See also *Nelson* v. *Nelson* (1995) 132 A.L.R. 133, *per* Toohey J. at p. 176 (High Court of Australia).

[423] (1995) 132 A.L.R. 133.

approach of the majority in *Tinsley* v. *Milligan* and the unremitting application by the minority of the rule laid down in *Holman* v. *Johnson*.[424] It applied a similar test to that in the *St. John Shipping Corp.* case in the context of enforcement of the contract,[425] and asked whether the policy of the statute precluded the claim made. McHugh J. stated:[426]

> [T]he sanction imposed should be proportionate to the seriousness of the illegality involved . . . The statute must always be the reference point for determining the seriousness of the illegality; otherwise the courts would embark on an assessment of moral turpitude independently of and potentially in conflict with the assessment made by the legislature.
>
> Secondly, the imposition of the civil sanction must further the purpose of the statute and must not impose a further sanction for the unlawful conduct if parliament has indicated that the sanctions imposed by the statute are sufficient to deal with conduct that breaches or evades the operation of the statute and its policies.

The Court concluded that the policy of the statute did not preclude the claim made, and awarded the mother the relief sought on the condition that she made appropriate recompense to the body that had given her the subsidy.

(e) Collateral Transactions

Securities

A transaction which is collateral to an illegal agreement may also be affected by taint of illegality.[427] Any security given to secure payment under, or performance of, an illegal contract is itself illegal, even though not given in pursuance of the contract. Thus in *Fisher* v. *Bridges*[428] a deed executed to secure the payment of the price for land conveyed to the defendant for an illegal purpose was held to be illegal and unenforceable. Jervis C.J., said that the deed:[429]

> springs from, and is a creature of, the illegal agreement; and, as the law would not enforce the original illegal contract, so neither will it allow the parties to enforce a security for the purchase money, which by the original bargain was tainted with illegality.

Bills of exchange

Similarly, if a bill of exchange is made and given to secure payment of money due or about to become due upon an illegal agreement, the rule that a subsequent holder is presumed to be a holder in due course does not apply; the holder can only recover by proving that consideration has been given either by himself or some immediate holder, and without notice of the illegality.[430] Money knowingly lent for the purpose of financing an illegal agreement is also, in principle, irrecoverable.[431]

No tainting

But not all collateral transactions are necessarily tainted. We have seen that an innocent party may have an action for breach of a collateral warranty.[432] And

[424] (1775) 1 Cowp. 341, *ante*, pp. 381–2.
[425] [1957] 1 Q.B. 267, *ante*, p. 335.
[426] (1995) 132 A.L.R. 133, at p. 192. See also (*ibid.*) pp. 146, 149, 167 and McCamus (1987) 25 Osgoode H.L.J. 787.
[427] *Heald* v. *O'Connor* [1971] 1 W.L.R. 497 (guarantee).
[428] (1854) 3 E. & B. 642.
[429] At p. 649.
[430] Bills of Exchange Act 1882, s. 30(2); see *ante*, p. 344, *post*, p. 466.
[431] *Cannan* v. *Bryce* (1819) 3 B. & Ald. 179; *Spector* v. *Ageda* [1973] Ch. 30.
[432] See *ante*, p. 387.

securities given in respect of an agreement which is not strictly illegal, but merely nugatory and void, can be enforced if supported by independent consideration.[433]

V. Severance

Severance of illegal or void conditions

THE same contract may contain both legal and illegal terms, and in such a case we have to consider whether the illegal parts of the contract may be disregarded and the contract enforced, or whether the whole contract is bad.[434]

It has long been established that an illegal term, or an illegal part of a term, can in certain circumstances be 'severed', leaving the remainder of the contract in force.[435] In *Pickering* v. *Ilfracombe Railway Co.* Willes J. stated:[436]

> The general rule is that, where you cannot sever the illegal from the legal part of a covenant, the contract is altogether void; but, where you can sever them, whether the illegality be created by statute or by the common law, you may reject the bad part and retain the good.

Criteria for severance may change

Yet this *dictum* does not indicate the circumstances in which we may, or may not, sever the illegal from the legal parts of the contract; nor does it indicate that differing criteria have been adopted from time to time by the Courts. For example, in recent years the Courts have moved away from the nineteenth century requirement that an illegal promise could only be severed if it was supported by separate consideration.[437] Emphasis has now shifted to the nature of the illegality involved and whether it accords with public policy that severance should be allowed. Nevertheless, the Courts have to bear in mind that it is not their task to force on the parties an entirely different contract.[438] Before severance is permitted, certain conditions must be satisfied in order to ensure that the elimination of the offending clause still leaves substantially the same agreement.

(a) Public Policy

'Illegal' conditions

Where there are legal and illegal terms in a contract which are capable of severance, the jurisdiction to enforce the legal terms will only be exercised if the severance is in accordance with public policy. If a stipulation involves a serious element of moral turpitude—if, for example, it is one which has as its object the deliberate commission of a criminal offence—it will so infect the rest of the contract that the Courts will refuse to give any effect to the agreement,[439] at least at the suit of one

[433] See *ante*, p. 343.
[434] See Marsh (1948) 64 L.Q.R. 230, 347, and (1953) 69 L.Q.R. 111.
[435] *Henry Pigot's Case* (1614) 11 Co. Rep. 27b.
[436] (1868) L.R. 3 C.P. 235, at p. 250.
[437] *Waites* v. *Jones* (1835) 1 Bing. N.C. 646, at p. 662; *Hopkins* v. *Prescott* (1847) 4 C.B. 578; *Walrond* v. *Walrond* (1858) 28 L.J. Ch. 97; *Lound* v. *Grimwade* (1888) 39 Ch. D. 605; *Kearney* v. *Whitehaven Colliery Co.* [1893] 1 Q.B. 700; *Kuenigl* v. *Donnersmark* [1955] 1 Q.B. 515, at p. 537; *post*, p. 399.
[438] *Putsman* v. *Taylor* [1927] 1 K.B. 637, at p. 639.
[439] *Bennett* v. *Bennett* [1952] 1 K.B. 249, at p. 254.

who knew of or participated in the illegality. Thus in *Napier* v. *National Business Agency Ltd.*:[440]

> The plaintiff entered into a contract of service with the defendant by which it was agreed that he should be paid the sum of £13 a week as salary, and a further £6 per week for 'expenses'. In fact, his expenses were nowhere near that sum, and this further provision was merely a device to defraud the income tax authorities. He brought an action to recover his salary, abandoning his claim to the expense allowance.

The Court of Appeal held that the provision as to expenses was contrary to public policy. Its inclusion vitiated the whole agreement and no severance could be allowed. Similarly relief will be refused if severance would be inconsistent with the policy of the Courts or of Parliament to discourage contracts containing an illegal element of the type sought to be severed. See *Kuenigl* v. *Donnersmark*,[441] where McNair J. refused to sever certain clauses in an agreement which involved dealings with an alien enemy because *inter alia* there is no authority for the proposition that for the purpose of the matter under consideration severance can ever take place and no ground of public policy which requires such severance.[442]

> The decisions relating to severability of covenants in restraint of trade . . . seem to me to have no application at all in the present context. Secondly, that severance can only take place, if at all, if the part which it is sought to sever stands by itself supported by separate consideration. This is not the case here.

On the other hand, if a provision in a contract is illegal by virtue of a statute passed for the protection of a class of persons,[443] there is no ground of public policy to prevent the Court from severing the illegal provision and giving effect to the remainder of the contract in an action brought by a member of the protected class.[444] Further, public policy does not prevent the severance of provisions that are merely void or unenforceable,[445] and, in particular, of covenants in unreasonable restraint of trade or clauses which oust the jurisdiction of the Courts. Such stipulations are not illegal in the strict sense, and will not taint the entire agreement in which they are contained. Provided that certain requirements are satisfied, they may be severed from the rest of the agreement. As Denning L.J. pointed out in *Bennett* v. *Bennett*:[446]

> The presence of a void covenant of this kind does not render the deed totally ineffective. . . . The party who is entitled to the benefit of the void covenant, or rather who would have been entitled to the benefit of it if it had been valid, can sue upon the other covenants of the deed which are in his favour; and he can even sue upon the void covenant, if he can sever the good from the bad, even to the extent of getting full liquidated damages for a breach of the good part. So also the other party, that is, the party who gave the void

[440] [1951] 2 All E.R. 264. See also *Kenyon* v. *Darwen Manufacturing Co. Ltd.* [1936] 2 K.B. 193; *Miller* v. *Karlinski* (1945) 62 T.L.R. 85 and *Hyland* v. *J. H. Barker (North West) Ltd.* [1985] I.C.R. 861.

[441] [1955] 1 Q.B. 515. [442] At p. 537. [443] See *ante*, p. 391.

[444] *Ailion* v. *Spiekermann* [1976] 1 Ch. 158.

[445] *Bennett* v. *Bennett* [1952] 1 K.B. 249, at p. 254.

[446] [1952] 1 K.B. 249, at p. 260; *post*, p. 401.

covenant and is not bound by its restraints, can himself sue upon the covenants in his favour, save only when the void covenant forms the whole, or substantially the whole, consideration for the deed.

There is no clear delimitation of the types of illegal stipulation which can be severed in this way, but whether or not a particular stipulation can be severed will depend upon considerations of public policy.

Employer–employee covenants

Public policy may also affect the extent of the severance to be allowed. As we have already seen, the law dislikes employer-employee covenants in restraint of trade and will be jealous to see that freedom of contract is not abused. The question, therefore, arises whether an employer should be permitted to bluff (whether intentionally or not) the employee into accepting a covenant which is unreasonably wide, and, then, when the bluff is called, to make use of the principle of severance to carve out of that void covenant the maximum of what might validly have been required. In *Mason* v. *Provident Clothing and Supply Co. Ltd.*,[447] Lord Moulton expressed the view that, in such cases, the excess which it is sought to delete must be 'merely trivial'. More recently, however, in *T. Lucas & Co. Ltd.* v. *Mitchell*,[448] the Court of Appeal held that an unreasonable restraint, if it can be regarded as intended by the parties to be separate and separable from a valid restraint,[449] is capable of being severed notwithstanding that it is contained in an agreement between employer and employee. It may be that, in modern times, an employee needs less protection than formerly. But as Lord Moulton pointed out:[450] 'It must be remembered that the real sanction at the back of these covenants is the terror and expense of litigation, in which the servant is at a great disadvantage, in view of the longer purse of his master'.

(b) Requirements

Requirements for severance

Assuming that severance of the contract is in accord with public policy, certain requirements must still be satisfied. It must, however, be stated that the formulation of these requirements has been the subject of much speculation and contradiction. At present, the situation would appear to be as follows.

(i) The 'blue pencil' rule

In the first place, the illegal portion of the contract must be capable at least of being verbally separated from the remainder of the agreement. This is generally known as the 'blue pencil' rule, that is, 'severance can be effected when the part severed can be removed by running a blue pencil through it'[451] without affecting the meaning of the part remaining. The rule in practice can be seen in *Goldsoll* v. *Goldman*:[452]

[447] [1913] A.C. 724, at p. 745. See also *Attwood* v. *Lamont* [1920] 3 K.B. 571, at p. 593. Cf. *Nevanas & Co.* v. *Walker* [1914] 1 Ch. 413; *Putsman* v. *Taylor* [1927] 1 K.B. 637.

[448] [1974] Ch. 129. See also *Scorer* v. *Seymour Jones* [1966] 1 W.L.R. 1419.

[449] See *post*, p. 402.

[450] [1913] A.C. 724, at p. 745. A similar concern also affects the construction of such clauses: *J. A. Mont (U.K.) Ltd.* v. *Mills* [1993] I.R.L.R. 173, *ante*, p. 369.

[451] *Attwood* v. *Lamont* [1920] 3 K.B. 571, *per* Lord Sterndale M.R. at p. 578. See also *Business Seating (Renovations) Ltd.* v. *Broad* [1989] I.C.R. 729 at p. 734 and *Ginsberg* v. *Parker* [1988] I.R.L.R. 483.

[452] [1915] 1 Ch. 292. See also *Putsman* v. *Taylor* [1927] 1 K.B. 637; *Ronbar Enterprises Ltd.* v. *Green* [1954] 1 W.L.R. 815.

The defendant sold his jeweller's business in New Bond Street, London to the plaintiff, who was also a jeweller, and covenanted that he would not for the period of 2 years 'either solely or jointly . . . carry on the business of a vendor of or dealer in real or imitation jewellery in the county of London, England, Scotland, Ireland, Wales, or any part of the United Kingdom . . . or in France, the United States of America, Russia, or Spain, or within twenty-five miles of Potsdamerstrasse, Berlin, or St. Stefans Kirche, Vienna'. The defendant joined a rival firm of jewellers in New Bond Street, and the plaintiff sought an injunction to restrain breach of the covenant.

The Court of Appeal held that, as the plaintiff's business was chiefly confined to imitation jewellery, the covenant was unreasonably wide, and that it was also too wide in area. But it was possible to excise the words 'real or' and also the references to foreign countries, and so to limit the covenant to dealing in imitation jewellery within the United Kingdom. In this form the covenant was unexceptionable and could be enforced. The reason for this somewhat technical rule is that the Court is not prepared to rewrite the agreement for the parties.

(ii) Illegal promise must not form main consideration

Secondly, the illegal promise must not form the whole or the main consideration for the contract. It must go only to a part, and a subsidiary part, of the consideration provided.[453] Otherwise one party would be compelled to perform a promise, the consideration for which would be far less than was ever contemplated when the promise was made. In *Bennett* v. *Bennett*:[454]

A wife entered into a deed with her husband by which she covenanted not to apply to the Court for maintenance for herself or for her children, to maintain the younger herself, and to indemnify her husband against any legal expenses arising out of the deed. The husband in his turn undertook to pay his wife and son an annuity, and to convey to her certain property. The husband failed to make the promised payments and was sued by his wife.

It was held that the covenant by the wife not to apply to the Court for maintenance was contrary to public policy and void. This, however, formed the main consideration for the contract, so that it could not be severed from the rest of the agreement. The wife was therefore unable to enforce her claim to the annuity since it was founded upon a consideration which was void. On the other hand, in *Goodinson* v. *Goodinson*:[455]

A husband promised to pay his wife a weekly sum if she would indemnify him against any debts incurred by her, not pledge his credit for necessaries, and forbear to bring any matrimonial proceedings against him.

He fell into arrears with the payments and was sued by her. It was held that there was ample consideration to support the agreement apart from the covenant not to sue, and so the husband was liable.

[453] See *Carney* v. *Herbert* [1985] 1 A.C. 301 (illegal ancilliary provision for the exclusive benefit of the plaintiff).

[454] [1952] 1 K.B. 249. This decision was effectively reversed by the Matrimonial Causes Act 1965, s. 23(1), now the Matrimonial Causes Act 1973, s. 34; *ante*, p. 359. See also *Triggs* v. *Staines U.D.C.* [1969] 1 Ch. 10.

[455] [1954] 2 Q.B. 118.

(iii) Must not alter agreement

Thirdly, the Court will not permit severance where the offending provisions are 'inextricably interwoven with the other promises in the agreement'[456] so that severance would 'alter entirely the scope and intention of the agreement'.[457] This is a sensible rule, for the mechanical deletion of an offending clause could affect the whole nature of the contract. Nevertheless, it is extraordinarily difficult to apply, and our understanding of its application is by no means increased by a study of its leading illustration. In *Attwood* v. *Lamont*:[458]

> A was the proprietor of a general outfitter's business. L had been employed as a tailor and cutter in one of A's departments. He was not concerned with any of the other departments. In his contract of service he had bound himself, after the termination of his employment, not to be concerned in the trade or business of a tailor, dressmaker, general draper, milliner, hatter, haberdasher, gentlemen's, ladies', or children's outfitter within 10 miles of his employer's place of business at Kidderminster.

The Court of Appeal held that this covenant was too wide. It attempted to protect against competition all departments of the employer's business, and not merely tailoring. The Divisional Court had found that the covenant was severable by striking out the other trades except that of tailor. The Court of Appeal reversed this finding. Both Lord Sterndale M.R. and Younger L.J. considered that severance was only permissible in a case where the covenant to be severed was 'not really a single covenant, but was in effect a combination of several distinct covenants',[459] and the latter said:[460]

> Now, here, I think, there is in truth but one covenant for the protection of the respondent's entire business, and not several covenants for the protection of his several businesses. The respondent is, on the evidence, not carrying on several businesses but one business, and, in my opinion, this covenant must stand or fall in its unaltered form.

It may be presumed that their Lordships intended simply to say that the deletion of the offending trades altered the *nature*, and not merely the *extent*, of the original covenant.[461] But the distinction drawn between 'single' and 'several' covenants is somewhat unprofitable, and cannot easily be applied to covenants such as that in *Goldsoll* v. *Goldman*.[462] It seems better to say that the question of altering the scope and intention of the agreement is one which depends upon the true construction of the covenant and agreement rather than upon this difficult and elusive distinction.

[456] *Kuenigl* v. *Donnersmark* [1955] 1 Q.B. 515, at p. 538; see *ante*, p. 399.
[457] *Attwood* v. *Lamont* [1920] 3 K.B. 571, *per* Lord Sterndale M.R. at p. 580. See also *British Reinforced Concrete Engineering Co. Ltd.* v. *Schelff* [1921] 2 Ch. 563; *Routh* v. *Jones* [1947] 1 All E.R. 179, 758; *Marshall* v. *N. M. Financial Management Ltd.* [1995] 1 W.L.R. 1461 (illegality of one of two conditional promises).
[458] [1920] 3 K.B. 571. Cf. *Putsman* v. *Taylor* [1927] 1 K.B. 637; *T. Lucas & Co. Ltd.* v. *Mitchell* [1974] Ch. 129 (reversing the decision of Pennycuick J. [1972] 1 W.L.R. 938).
[459] They differed, however, as to how this test should be applied.
[460] At p. 593.
[461] See Lord Sterndale M.R. at p. 578.
[462] See *ante*, p. 400.

(c) Effect of Severance

True severance

The effect of severance is not uniform in all cases. If the illegal and legal undertakings are distinct and separate, each being supported by its own consideration, the Court will strike out the offending conditions, together with the consideration, leaving the rest unimpaired.

Suppose that Government regulations prohibit building on a single property in excess of £1,000 without a licence. A builder undertakes to execute a number of unlicensed works on a single property on a 'cost plus' basis, i.e. the individual items being executed and paid for as required.[463]

Any work ordered or executed within the £1,000 limit will be legal and must be paid for. Work ordered in excess of this limit will be illegal, but it can be severed from the rest of the agreement. Neither a promise to do such work, nor a promise to pay for it, will be enforceable. The illegal part is truly and completely severed.

One-sided severance

On the other hand, the Court may strike out one or more of the promises on one side, while leaving the consideration on the other side unaffected. *Goldsoll* v. *Goldman*[464] and *Goodinson* v. *Goodinson*,[465] are examples of 'one-sided' severance.[466] The Court excised the offending provisions, but did not interfere with the consideration given for them. The severance was on one side only.

Restitutio in integrum

If severance would substantially alter the nature of the contract, and neither party is willing to accept the contract in its severed form, there is authority for the view that the Court may order *restitutio in integrum* of benefits obtained under the contract.[467] In *South Western Mineral Water Co. Ltd.* v. *Ashmore*:[468]

The defendant wished to purchase from the plaintiffs a controlling interest in a company. It was agreed that he should pay £6,000 and be given an option to purchase the assets of the company for £36,500 to be secured by a debenture over the assets. He was let into possession of the company's premises and took delivery of all the assets. It was subsequently realized that the proposed debenture was illegal as it infringed a provision of the Companies Act 1948.

Cross J. held that the stipulation for an illegal debenture did not render the whole agreement void. The agreement could be enforced by the plaintiffs if they waived the security or by the defendant if he tendered immediate payment. But as neither party was willing to accept an agreement in these terms, the plaintiffs were to return the £6,000 and the defendant was to give up possession of the premises and restore the assets received.

[463] *Frank W. Clifford Ltd.* v. *Garth* [1956] 1 W.L.R. 570.
[464] See *ante*, p. 400.
[465] See *ante*, p. 401.
[466] A term suggested by Somervell L.J. in *Bennett* v. *Bennett* [1952] 1 K.B. 249, at p. 260.
[467] Provided that recovery is not precluded by the maxim *in pari delicto potior est conditio defendentis* (see *ante*, p. 388) if the contract as a whole is tainted.
[468] [1967] 1 W.L.R. 1110.

PART 3

Limits of the Contractual Obligation

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Privity of Contract

Scope of the obligation

We come now to deal with the effects of a valid contract when formed, and to ask, to whom does the obligation extend? This question must be considered under two separate headings: (1) the acquisition of rights by a third party, and (2) the imposition of liabilities upon a third party. We shall see that the general rule of the common law is that no-one but the parties to a contract can be entitled under it, or bound by it. This principle is known as that of *privity of contract*.

I. The Acquisition of Contractual Rights by Third Parties[1]

(a) The Development of the General Rule

The development of the general rule

If A and B make a contract in which B promises to do something or to refrain from doing something for the benefit of TP, all three may be willing that TP should have all the rights of an actual contracting party. Thus, B may promise to pay a sum of money[2] to, or perform a service for,[3] TP. Alternatively, B may promise not to sue TP either at all[4] or in circumstances covered by an exclusion or limitation clause in the contract between A and B.[5] Many systems of law give effect to the intentions of those concerned but the rule of the English common law is that a person who is not a party to a contract can neither sue on nor rely on defences based on that contract.

A relative latecomer

This rule was a relative latecomer to English law and was not clearly established until the middle of the nineteenth century. There are earlier decisions permitting the third party, often a relative of the promisee[6] but not always,[7] to enforce the

[1] See generally Law Com. No. 242, *Privity of Contract: Contracts for the Benefit of Third Parties* (1996), Parts I–II; Dowrick (1956) 19 M.L.R. 374.

[2] *Price* v. *Easton* (1833) 4 B. & Ad. 433; *Beswick* v. *Beswick* [1968] A.C. 58, *post*, p. 414.

[3] *Jackson* v. *Horizon Holidays Ltd.* [1975] 1 W.L.R. 1548, *post*, p. 412 (provision of holiday accommodation).

[4] *Snelling* v. *John Snelling Ltd.* [1973] Q.B. 87.

[5] *Scruttons* v. *Midland Silicones Ltd.* [1962] A.C. 446.

[6] *Bourne* v. *Mason* (1699) 1 Ventr. 6; *Dutton* v. *Poole* (1672) 2 Lev. 210. Contrast the comments of Denning L.J. in *Drive Yourself Hire Co. (London) Ltd.* v. *Strutt* [1954] 1 Q.B. 250, at p. 272 and Windeyer J. in *Coulls* v. *Bagot's Executor and Trust Co. Ltd.* [1967] A.L.R. 385, 407–9 (the true explanation of *Dutton* v. *Poole* turned on the expansive views of consideration then held).

[7] *Marchington* v. *Vernon* (1787) 1 Bos. & P. 101n. (doubted in *Phillipps* v. *Bateman* (1812) 16 East 356); *Carnegie* v. *Waugh* (1823) 1 L.J.(O.S.) 89.

promise. The development of the rule of privity of contract was linked with that of the doctrine of consideration and the early cases used both strands of reasoning. In *Price* v. *Easton*:[8]

WP owed Price £13. He promised to work for Easton, and in return Easton undertook to discharge the debt to Price. The work was done by WP, but Easton did not pay the money to Price. Price sued Easton.

It was held that Price could not recover because he was not a party to the contract. However, the reasoning of the judges differed. Lord Denman C.J. said that the plaintiff did not 'shew any consideration for the promise moving from him to the defendant',[9] while Littledale J. said, 'No privity is shewn between the plaintiff and the defendant';[10] and Patteson J. that there was 'no promise to the plaintiff alleged'.[11]

In *Tweddle* v. *Atkinson*,[12] it was also held that no action could be brought by a non-party:

H and W married. After the marriage, X and Y, their respective fathers, made a contract by which they undertook that each should pay a sum of money to H, and that H should have power to sue for such sums. After the death of X and Y, H sued the executors of Y for the money promised to him.

Wightman J. said:[13]

Some of the old decisions appear to support the proposition that a stranger to the consideration of a contract may maintain an action upon it, . . . But there is no modern case in which the proposition has been supported. On the contrary, it is now established *that no stranger to the consideration can take advantage of a contract, although made for his benefit.*

The modern rule is based on Lord Haldane's formulation in *Dunlop Pneumatic Tyre Co. Ltd.* v. *Selfridge & Co. Ltd.*:[14]

[I]n the law of England certain principles are fundamental. One is that only a person who is a party to a contract can sue on it. Our law knows nothing of a *jus quaesitum tertio* arising by way of contract. Such a right may be conferred on a stranger to a contract as a right to enforce the contract *in personam.*

This case arose out of a resale price maintenance agreement:

The appellants were manufacturers of motor-car tyres. They sold to Messrs. Dew & Co. a number of tyres on the understanding that they should not be sold under a certain price. The respondents bought some of these tyres from Dew & Co. and, in the contract of sale, (a) bound themselves to observe the conditions as to price; and (b) promised that they would pay £5 by way of damages to the appellants for every tyre sold, or offered for sale, in breach of this undertaking. They sold some of the tyres for sums below the stipulated price.

[8] (1833) 4 B. & Ad. 433. [9] At p. 434. [10] At p. 434. [11] At p. 435.
[12] (1861) 1 B. & S. 393; *ante*, p. 95. Lord Denning M.R. in *Beswick* v. *Beswick* [1966] Ch. 538, at p. 553 said that the action failed because H's father had not done his part under the contract.
[13] At pp. 397–8. [14] [1915] A.C. 847, at p. 853.

The appellants, faced with the fact that they were strangers to the contract between the respondents and Dew & Co. and thus could not take any benefit under it, sought to establish that Dew & Co. had entered into the contract as their agents and on their behalf. But the House of Lords held that, even if the terms of the contract were consistent with that construction, the appellants would still be unable to enforce it, since no consideration had moved from them to the respondents.

(b) Relationship with Doctrine of Consideration

Distinct from doctrine of consideration

These cases might seem to rest solely on the rule that consideration must move from the promisee and it has been argued that the privity rule is really no more than an application of the doctrine of consideration.[15] However, in *Dunlop Pneumatic Tyre Co. Ltd.* v. *Selfridge & Co. Ltd.* Lord Haldane[16] clearly distinguished the two and the balance of authority supports the existence of two distinct rules of consideration and privity.[17] The two rules reflect two logically separate issues of policy.[18] The first, primarily associated with the privity doctrine, relates to who can enforce a contract. The second, primarily associated with consideration, concerns the types of promises that can be enforced.

(c) Present Status of the General Rule

We shall see that the desirability of the rule as a matter of policy has been questioned by judges, law reform bodies, and commentators.[19] The pedigree of the rule has also been criticized on the ground that it was doubtful that the nineteenth century cases cited above in fact established its existence and that it was only a rule of procedure.[20] Despite these criticisms, it has been reaffirmed on several occasions by the House of Lords in the last 40 years, notably in 1968 in *Beswick* v. *Beswick*:[21]

[15] Furmston (1960) 23 M.L.R. 373; Smith, *The Law of Contract*, 2nd edn. (1993), p. 94.

[16] [1915] A.C. 847, at p. 853.

[17] *Vandepitte* v. *Preferred Accident Insurance Corp of New York* [1933] A.C. 70, 79; *Scruttons Ltd.* v. *Midland Silicones Ltd.* [1962] A.C. 446; *Kepong Prospecting Ltd.* v. *Schmidt* [1968] A.C. 810, at p. 826. See also Atiyah, *Essays on Contract* (1986), p. 220; *Coulls* v. *Bagot's Executor and Trustee Co. Ltd.* (1967) 119 C.L.R. 460, at pp. 478, 486, 493; *Trident General Insurance Co. Ltd.* v. *McNiece Bros Pty. Ltd.* (1988) 165 C.L.R. 107, at p. 164 (High Court of Australia); *K. H. Enterprise* v. *Pioneer Container* [1994] 2 A.C. 324, at p. 355; *White* v. *Jones* [1995] 2 A.C. 207, at pp. 262–3; *London Drugs Ltd.* v. *Kuehene & Nagel International Ltd.* [1992] 3 S.C.R. 299, at p. 417 (Supreme Court of Canada).

[18] Law Revision Committee, Sixth Interim Report 1937 (Cmnd. 5449), para. 37; Law Commission C.P. No. 121, *Privity of Contract: Contracts for the Benefit of Third Parties* (1991), § 2.9 and see (albeit more equivocally) Law Com. No. 242 (1996) Part VI.

[19] *Post*, pp. 426–7.

[20] *Drive Yourself Hire Co. (London) Ltd.* v. *Strutt* [1954] 1 Q.B. 250, at p. 273; *Beswick* v. *Beswick* [1968] Ch. 538, 553–4, 557 (*per* Lord Denning M.R., a particularly vigorous critic). See also *Smith and Snipes Hall Farm Ltd.* v. *River Douglas Catchment Board* [1949] 2 K.B. 500, at p. 514; *Scruttons Ltd.* v. *Midland Silicones Ltd.* [1962] A.C. 446, at p. 483.

[21] [1968] A.C. 58, at pp. 72, 78, 83, 92, 95, 105 discussed further *post*, pp. 410, 414. See also *Scruttons Ltd.* v. *Midland Silicones Ltd.* [1962] A.C. 446; *The Eurymedon* [1975] A.C. 154; *Woodar Investment Development Ltd.* v. *Wimpey Construction (U.K.) Ltd.* [1980] 1 W.L.R. 277, at pp. 284,

Peter Beswick, a coal merchant, agreed to transfer the business to his nephew in return for a promise by the nephew to employ him as 'consultant' during his lifetime, and, after his death, to pay an annuity of £5 a week to his widow. On Peter Beswick's death, the nephew failed to pay the money to the widow. She brought an action against him in her personal capacity as the beneficiary of the contract, and also in her capacity as administratrix of her deceased husband's estate.

The House of Lords held that she was not entitled to enforce the obligation in her personal capacity, but she was able to sue as administratrix of the estate, i.e. as her deceased husband's personal representative. As we shall see, this case also shows that, although a contract for the benefit for a third party binds the parties to it, even where the promisee seeks a remedy, there are certain difficulties.

Case for the general rule

The case for the general rule rests on a number of factors. First, although consideration has been provided for the promise, it has not been provided by the third party. Secondly, it is unjust that a person could sue on a contract but not be sued upon the contract.[22] Thirdly, if third parties could enforce contracts made for their benefit, the rights of the contracting parties to vary or terminate such contracts would be affected. Finally, it is undesirable for the promisor to be liable to two actions from both the promisor and the third party, and the privity rule limits the potential liability of a contracting party to a wide range of possible third party plaintiffs.[23]

The general rule is, however, not absolute and the Courts and the legislature have created exceptions to avoid perceived injustice. It must also be remembered that the rule only precludes the third party from proceeding *in contract*. Where it is possible to base a claim on some other cause of action, for instance in tort or based on a property right, proceedings may succeed. Proceedings may also succeed if the court can discern a collateral contract between the third party and the promisee under the main contract for the benefit of the third party. We shall first consider the remedies available to the promisee and then the exceptions and qualifications to the general rule.

(d) Remedies of the Promisee

Remedies of the promisee

Notwithstanding the fact that the third party cannot personally enforce the contract, the contract is nevertheless binding between the parties to it. Let us first consider what remedies may be available to the promisee if the promisor fails to perform the promise. These are only relevant where the promisee is able and willing to enforce the contract for the benefit of the third party: the widow in *Beswick*

291, 297, 300; *J. H. Rayner (Mincing Lane) Ltd.* v. *D.T.I.* [1990] 2 A.C. 418, at pp. 479, 506; *White* v. *Jones* [1995] 2 A.C. 207, at pp. 262–3, 266.

[22] *Tweddle* v. *Atkinson* (1861) 1 B. & S. 393, at p. 398; *London Drugs Ltd.* v. *Kuehene & Nagel International Ltd.* [1992] 3 S.C.R. 299, at pp. 418, 440. But see *ante*, p. 29 for the position in the case of unilateral contracts.

[23] *Trident General Insurance Co. Ltd.* v. *McNiece Bros Pty. Ltd.* (1988) 165 C.L.R. 107, at p. 121–2. The Law Commission did not regard any of these explanations as convincing justifications of the rule: *Privity of Contract: Contracts for the Benefit of Third Parties*, Law Com. C.P. No. 121 (1991), § 4.4; Law Com. No. 242 § 39 n.1. For a critique of the doctrine, see *post*, p. 426.

v. *Beswick* would not have been able to obtain her annuity had Peter Beswick appointed his nephew the executor of his estate instead of his widow. At present, there appears to be no procedure by which an unwilling or unco-operative promisee can be compelled to institute proceedings for specific performance on behalf of the third party.[24] The existence of a right of action in the promisee does not, in consequence, necessarily ensure that the third party will obtain the performance promised in the contract.

(i) Damages for loss sustained by the promisee

Damages for promisee's loss

The general rule is that damages are for loss suffered by the plaintiff. Therefore, where the breach of contract consists of failure to perform in favour of the third party, the damages will, in principle, be nominal only.[25] Thus, in *Beswick* v. *Beswick*,[26] the promisee's estate suffered no loss because the promisee 'died without any assets save and except the agreement which he hoped would keep him and then his widow [the third party] for their lives'.[27] In some situations, however, including many commercial transactions, the promisee will suffer loss by reason of the breach, either because an obligation of the promisee to the third party is not discharged, as in *Price* v. *Easton*,[28] or where the consequence is that the promisee comes under a legal obligation to the third party. In such cases substantial damages will, in principle,[29] be recoverable.[30]

In principle the promisee should also be able to recover substantial damages if, by reason of the breach of contract, the promisee (1) comes under a moral obligation to compensate the third party, though under no legal obligation to do so,[31] or, (2) voluntarily incurs expense in making good the default.[32] Thus, if a vicar hires a coach for an outing for the choir, and the coach operator leaves the choir stranded half-way, the vicar might recover substantial damages in respect of the taxi fares incurred in getting the choir home, whether the choir paid their own

[24] But see the suggestion that the third party be joined as a party to the action made by Lord Denning in *Beswick* v. *Beswick* [1966] Ch. 538, at p. 554, and (in a different context) *Snelling* v. *John Snelling Ltd.* [1973] Q.B. 87 (*post*, p. 415). Contrast *Gurtner* v. *Circuit* [1968] 2 Q.B. 587, at pp. 599, 606; *White* v. *Jones* [1995] 2 A.C. 207, at p. 267.

[25] For exceptions, see *post*, p. 413. See also Coote's argument [1997] C.L.J. 537, at p. 549 ff. that Courts have confused loss of the enjoyments of the fruits of performance (which the promisee *has not* lost) and loss of the bargained-for contractual rights (which the promisee *has* lost).

[26] [1968] A.C. 58. For the facts, see *ante*, p. 410.

[27] *Ibid.*, at p. 102 (Lord Upjohn). See also pp. 72, 78, 101. Cf. Lord Pearce, at p. 88. Had there been other assets the loss to the estate could have been liability to provide for the widow under the statutory precursor of the Inheritance (Provision for Family and Dependants) Act 1975 or a voluntary payment made under a moral obligation, on which see *post*, n. 34.

[28] (1833) 4 B. & Ad. 433, *ante*, p. 408.

[29] i.e., subject to the ordinary rules, including those concerning remoteness and mitigation on which see *post*, pp. 568 and 582.

[30] *Jackson* v. *Watson* [1909] 2 K.B. 193; *Radford* v. *de Froberville* [1977] 1 W.L.R. 1262.

[31] It may be reasonable to make a voluntary payment; *Banco de Portugal* v. *Waterlow & Sons Ltd.* [1932] A.C. 452, *post*, p. 583 (mitigation of damages). See also *Admiralty Commissioners* v. *S.S. Amerika* [1917] A.C. 38, at p. 61.

[32] *Post*, p. 575.

fares (in which case the vicar would recompense the choir from the damages recovered) or the vicar paid their fares for them.[33]

There may also be certain cases of contracts for the benefit of a third party where what might at first sight appear to be the third party's loss can in fact be analysed as the promisee's. One example, discussed below, is where the promisee contracts for a family holiday.[34]

(ii) Damages for loss sustained by the third party

Damages for third party's loss generally irrecoverable

The principle that as a general rule substantial damages can only be given for loss suffered by the plaintiff, applied by the House of Lords in *Beswick* v. *Beswick*,[35] was affirmed in *Woodar Investment Development Ltd.* v. *Wimpey Construction U.K. Ltd.*,[36] *Linden Gardens Trust Ltd.* v. *Lenesta Sludge Disposals Ltd.*, and *St Martins Property Corporation Ltd.* v. *Sir Robert McAlpine Ltd.*[37] In *Woodar*'s case:

> The defendants contracted to buy land from the plaintiffs for £850,000. It was agreed that on completion £150,000 was to be paid by the defendants to a third party. The plaintiffs claimed damages for breach and repudiation of the contract.

A majority of the House of Lords held that the defendants had not repudiated the contract. But their Lordships agreed that, if the contract had been repudiated, the plaintiffs could not, without showing that they had themselves suffered loss or were agents or trustees for the third party, have recovered damages for non-payment of the £150,000.

In *Jackson* v. *Horizon Holidays Ltd.*[38] Lord Denning M.R., with whom Orr L.J. agreed, had stated that whenever a contract was made for the benefit of a third party and the third party suffered loss as a result of the failure of the promisor to perform the contract, the promisee could recover damages in respect of the loss sustained by the third party, holding the damages as money had and received to the use of the third party and paying them over. In that case:

> The plaintiff contracted with a travel company for the provision by the company of holiday accommodation for himself, his wife, and two children. The accommodation provided fell below the standard required by the contract and the whole family suffered discomfort, vexation, inconvenience, and distress. The trial judge awarded the plaintiff £1,100 damages including £500 for the plaintiff's mental distress.

The Court of Appeal upheld the award. James L.J. appeared to agree with the trial judge. Lord Denning M.R. said that, if regarded as only for the distress of the plaintiff himself, the award was excessive but held that the plaintiff could recover both for his loss and that of his family.

[33] An example given by Lord Denning M.R. in *Jackson* v. *Horizon Holidays Ltd.* [1975] 1 W.L.R. 1468, at pp. 1472–3.

[34] *Jackson* v. *Horizon Holidays Ltd.* [1975] 1 W.L.R. 1468. Cf. in tort, where voluntary payments to a victim's carer are analysed as the carer's loss: *Cunningham* v. *Harrison* [1973] Q.B. 454; *Hunt* v. *Severs* [1994] A.C. 350, at p. 363, and held on trust for the carer rather than as victim's 'need'; *Donnelly* v. *Joyce* [1974] Q.B. 454; *Housecroft* v. *Burnett* [1986] 1 All E.R. 332, 343.

[35] [1968] A.C. 58, at pp. 72, 78, 101, *ante*, pp. 408–9.

[36] [1980] 1 W.L.R. 277, at pp. 283–4, 291, 293, 297, 300.

[37] [1994] A.C. 85, varying (1992) 57 B.L.R. 57 (C.A.).

[38] [1975] 1 W.L.R. 1468.

In *Woodar*'s case the House of Lords disapproved of this view[39] but it was said that the decision in *Jackson*'s case could be supported either on the ground that the plaintiff there was recovering damages in consequence of the loss which he had himself sustained[40] or as a case which called for 'special treatment'.[41] In view of its decision on the repudiation point it was not necessary for the House to make a decision on the damages point and it did not state any rule of law regarding the recovery of damages for the benefit of third parties. Nevertheless certain members of the House of Lords were strongly critical of the result produced by the combined effect of these two aspects of the privity of contract principle; neither the third party for whom the benefit was intended nor the promisee who contracted for it could recover damages for that which the promisor had agreed, but failed, to provide. The hope was expressed that the House would soon have the opportunity of reconsidering this matter[42] but when the question came before the House in the *Linden Gardens* and *St Martins Property* cases,[43] the opportunity was not taken. Although there was support for a radical reformulation of the general rule so that damages for breach of a supply contract would be quantified solely by reference to the difference in value between that which was contracted for and that which is in fact supplied,[44] the decision was that the case fell within the rationale of the exceptions to the general rule.[45]

Exceptions to general rule

What then are the exceptions to the general rule? A trustee-promisee may recover in respect of the beneficiary's loss,[46] an agent may recover in respect of the undisclosed principal's loss[47] and a person with a limited interest in property who has taken out full insurance may recover the full amount of loss or damage.[48] Again, in a contract for the carriage of goods by sea, a consignor may recover substantial damages even where it has sold the goods and they are not at its risk

[39] Lord Denning had relied on a statement of Lush L.J. in *Lloyd's* v. *Harper* (1880) 16 Ch. D. 290, at p. 321 which was made in the context of the 'trust of a promise' exception to the general rule; see *post*, at p. 417 and *Beswick* v. *Beswick* [1968] A.C. 58, at p. 101; *Woodar Investment Development Ltd.* v. *Wimpey Construction U.K. Ltd.* [1980] 1 W.L.R. 277, at pp. 283, 293–4, 297. The Package Travel, Package Holidays and Package Tours Regulations 1992 (S.I. 1992 No. 3288), *post* p. 422 now gives the beneficiaries of package holidays a direct right of action.

[40] At pp. 293, 297; *Jackson* v. *Horizon Holidays Ltd.* (*supra*, n. 38), at p. 1474 (James L.J.).

[41] At pp. 283, 291, 293. See also *Calebar Properties Ltd.* v. *Sticher* [1984] 1 W.L.R. 287, at p. 290 (tenant's damages included sum in respect of spouse's ill health).

[42] At pp. 291, 297–8, 300–1.

[43] [1994] A.C. 85.

[44] *Ibid.*, at pp. 95, 112, *per* Lord Keith and Lord Browne-Wilkinson, with whom Lord Bridge and Lord Ackner agreed. Only Lord Griffiths (pp. 96–8) decided the case on this ground. See also *Darlington B.C.* v. *Wiltshier Northern Ltd.* [1995] 1 W.L.R. 68, at p. 80, *per* Steyn L.J. See also Cartwright (1996) 10 J.C.L. 244; Palmer and Tolhurst (1997) 12 J.C.L. 1 and 97; Coote [1997] C.L.J. 537, at p. 549 ff. On quantification of damages, see generally *post*, pp. 564, 577.

[45] *Ibid.*, at p. 114.

[46] *Lloyd's* v. *Harper* (1880) 16 Ch. D. 290, at p. 331 on which see *ante*, n. 39, *post*, p. 417. See also *St. Alban's City and District Council* v. *International Computers Ltd.* [1996] 4 All E.R. 481, at p. 489 (local authority recovered in respect of chargepayers' loss).

[47] *Allen* v. *F. O'Hearn & Co.* [1937] A.C. 213, at p. 218, *post*, p. 652.

[48] *Waters* v. *Monarch Fire and Life Assurance Co.* (1856) 5 E. & B. 870; *Hepburn* v. *Tomlinson (A.) (Hauliers) Ltd.* [1966] A.C. 451. Marine Insurance Act 1906, s. 26(3). See also the right of the bailee, albeit in tort, *The Winkfield* [1902] P. 42 and the analagous fact situation in *Bovis International Inc.* v. *The Circle Limited Partnership* (1995) 49 Con. L.R. 12.

provided it is not contemplated that the carrier would also be put into a direct contractual relationship with whomsoever might become the owner of the goods.[49] The last two exceptions concern commercial contracts about goods where the parties contemplate that the proprietary interests in the goods may be transferred after the contract has been entered into but before the breach which causes loss or damage to the goods. This principle has been held to apply to a contract for the development of land where it was contemplated that the land was going to be occupied, and possibly purchased, by third parties.[50] In such a case, where the third party owner or occupier has no direct right to sue for breach of contract, the contracting party can recover substantial damages as representing the third party's loss. It is arguable that a more general principle could be distilled from these exceptions, particularly because the ability of the promisee in these cases to recover in respect of the loss sustained by the third party was linked to the unavailability of a contractual action by the third party.[51]

(iii) Specific performance

Specific performance may be granted

The promisee may be able to obtain an order for specific performance against the promisor to compel him to carry out the promise in favour of the third party. Thus, in *Beswick* v. *Beswick*, which we have already considered,[52] the House of Lords held that the widow, in her capacity as personal representative of Peter Beswick (the promisee), could obtain specific performance of the promise in favour of herself as third party. As Lord Pearce explained: 'The estate (though not the widow personally) can enforce it'.[53]

Specific performance is, as we shall see later in this book,[54] a discretionary equitable remedy which is not available as a matter of course. As a general rule, an order for specific performance will not be made against a defendant in any case where damages are an adequate and appropriate remedy,[55] where, had the positions been reversed, the plaintiff's undertaking could not have been specifically enforced, so 'mutuality' was lacking,[56] or where the contract has been discharged and is no longer in existence.[57] Not all contractual undertakings, particularly those to perform services or to build, are sufficiently precisely defined to be enforced specifically.[58]

[49] This might be by the operation of the Carriage of Goods by Sea Act 1992 *post*, p. 468, or by making a separate contract. See the discussion of the exceptions in *The Albazero* [1977] A.C. 774, at pp. 846–7.

[50] *Linden Gardens Trust Ltd.* v. *Lenesta Sludge Disposals Ltd.* and *St Martins Property Corporation Ltd.* v. *Sir Robert McAlpine Ltd.* [1994] A.C. 85, at pp. 114–15 (contracting party owner of land); *Darlington B.C.* v. *Wiltshier Northern Ltd.* [1995] 1 W.L.R. 68; *Alfred McAlpine Construction Ltd* v. *Panatown Ltd.*, *The Times*, 11 February 1998, (contracting party had no proprietary interest).

[51] See Law Com. No. 242 (1996), § 2.46. Cf. *Alfred McAlpine Construction Ltd.* v. *Panatown Ltd.*, *The Times*, 11 February 1998 (promisee's ability to recover unaffected by existence of contractual action by third party).

[52] [1968] A.C. 58, *ante*, p. 410.

[53] *Ibid.*, at p. 89.

[54] See *post*, pp. 595–600.

[55] See *post*, p. 596.

[56] See *post*, p. 598.

[57] *Woodar Investment Development Ltd.* v. *Wimpey Construction U.K. Ltd.* [1980] 1 W.L.R. 277, at p. 300.

[58] *Forster* v. *Silvermere Gold and Equestrian Centre* (1981) 125 Sol. J. 397, *post*, p. 429.

In *Beswick* v. *Beswick* an award of damages was considered inadequate and specific performance appropriate for a number of reasons. First, damages would not have taken account of the loss to the third party and would have been purely nominal.[59] Secondly, the defaulting promisor had received the full benefit of the contract by the completed transfer of the business.[60] Thirdly, had the business not been transferred, the defaulting promisor could have obtained specific performance of the promise.[61] Fourthly, specific performance was more appropriate for a promise to make a series of regular payments than a succession of actions for damages which would have had to have been brought as each payment fell due. It does not therefore follow that specific performance will necessarily be ordered in all cases where performance is to be made to a third party.

(iv) Action for the agreed sum

Action for the agreed sum

The contracting party to whom the promise is made has normally no claim whatsoever to the money or other performance properly due to the third party.[62]

(v) Recovery of money paid

Recovery of money paid

Where a contract is made for the benefit of a third party and the promisee has paid money to the promisor in consideration of a promise which the promisor has totally failed to perform, the promisee will be entitled to recover the money as paid on a consideration which has totally failed.[63] This remedy, which might be less advantageous than damages or specific performance, would not be available in the present state of the law if the promisor had partly performed the promise, as there would then be no total failure of consideration.[64]

(vi) Promise not to sue

Promise not to sue

The sixth remedy of the promisee arises where the promisor, either expressly or by necessary implication, promises not to sue a third party. Such a promise may be made in a variety of commercial contexts. The third party, as a stranger to the contract, cannot rely directly on the terms of the contract as a defence to any action brought by the promisor.[65] But the promisee may obtain a declaration that the promise is binding on the promisor, and thus effectively prevent the promisor from suing the third party. In *Snelling* v. *John Snelling Ltd.*:[66]

Three brothers were shareholders and directors of a family company which owed each of them considerable sums of money. Differences arose between them, and, as part of an effort to settle these, they made a contract, agreeing *inter alia* that, in the event of any director resigning, he would immediately forfeit all moneys due to him from the company.

[59] *Ante*, p. 410. This factor alone would not necessarily be conclusive; see *ante*, p. 324 *post*, p. 597 (inadequacy of consideration); *Co-operative Insurance Society Ltd.* v. *Argyll Stores (Holdings) Ltd.* [1997] 2 W.L.R. 898, at p. 909, on which see *post*, p. 596 n. 29.

[60] [1968] A.C. 58, at pp. 83, 89, 97.

[61] *Ibid.*, at p. 89 (Lord Pearce).

[62] *Re Stapleton-Bretherton* [1941] Ch. 482; *Re Schebsman* [1944] Ch. 83; *Coulls* v. *Bagot's Executor and Trustee Co. Ltd.* (1967) 119 C.L.R. 460, at p. 502; *Beswick* v. *Beswick* [1968] A.C. 58, at pp. 94, 96. Cf. *Re Sinclair's Life Policy* [1938] Ch. 799.

[63] See *post*, p. 605.

[64] *Ibid.*

[65] See *post*, p. 439 (exemption clauses).

[66] [1973] Q.B. 87.

Subsequently, the plaintiff resigned his directorship and brought an action against the company for payment of the money owed to him. His two brothers applied to be, and were, joined as co-defendants to the action, and they counterclaimed for a declaration that the sums due to the plaintiff from the company had been forfeited.

The question arose whether the company, which was not a party to the agreement, could rely on it. In principle it could not do so, and so the plaintiff would be entitled to judgment on his claim. The two brothers would, however, also be entitled to a declaration that the provisions of the agreement were binding on the plaintiff. In the view of Ormrod J. the resulting situation was absurd, and he held that the proper order to make was to dismiss the plaintiff's claim. The reality of the situation was that the plaintiff's claim had failed since the two brothers had succeeded in their counterclaim, and the order of the court should reflect that fact. It would therefore seem that, where all parties are before the court, the court may stay[67] or dismiss a claim brought by a contracting party against a third party whom the other contracting party has promised not to sue.

It has been said that for the court to exercise its power to stay or dismiss a claim, the promisee must have a sufficient interest,[68] such as a legal or equitable right to protect[69] and must be able to show a real possibility of prejudice to himself, for example by being exposed to an action by the third party.[70] In *Snelling*'s case the promisees were not subject to this kind of 'legal' prejudice since they would not have been exposed to an action by the company. However, they would have been commercially and financially prejudiced by any deterioration in the company's financial position, as would have occurred had the plaintiff's action succeeded.

(e) Exceptions and Circumventions[71]

Exceptions & circumventions

In this section we shall consider a number of situations in which the rule preventing a third party from suing does not apply. In some, particularly those based on statute, the third party rule is simply overridden. In others the third party claimant does not need to rely on the contract but is able to have recourse to other areas of the law and to rely on a property right, a possessory right, or is able to sue in tort. Alternatively, as we have seen, the third party may be able to establish a collateral contract with the promisor.[72] Other exceptions to and circumventions of the rule may be seen in assignment,[73] agency (including the doctrine of the undisclosed principal),[74] transfer on death,[75] and bankruptcy.[76] These will be dealt with later and in greater detail.

[67] This power is now in Supreme Court Act 1981, s. 49(2). But contrast *Gore* v. *Van der Lann* [1967] 2 Q.B. 31.

[68] *Gore* v. *Van der Lann* [1967] 2 Q.B. 31.

[69] *European Asian Bank* v. *Punjab & Sind Bank* [1982] 2 Lloyd's Rep. 356, 369.

[70] *The Elbe Maru* [1978] 1 Lloyd's Rep. 206. Cf. *The Chevalier Roze* [1983] 2 Lloyd's Rep. 438, at p. 443.

[71] See in general Law Commission No. 242 (1996), §§ 2.8–2.62.

[72] See generally, *ante*, p. 129 and, on exemption clauses and third parties, *post*, p. 439.

[73] See *post*, p. 447. [74] See *post*, p. 497. [75] See *post*, p. 469.

[76] See *post*, p. 470.

(i) Trusts of contractual rights

Trusts of contractual rights

Equity allows a third party to enforce a contract where it can be construed as creating a completely constituted trust of the contractual right, also known as a trust of the promise. However, as Lord Haldane stated in the passage already cited from *Dunlop* v. *Selfridge*,[77] the rights do not arise by way of contract but are based on the third party's equitable proprietary interest in its subject-matter and the right of the equitable owner to enforce the trust in his favour. Property may be tangible or intangible[78] and certain rights under a contract, 'choses in action', constitute an important example of intangible property.[79]

Thus, a promisee under a contract, either at the time when the contract is made or thereafter, may constitute a trust of the right to which he is entitled in favour of a third party which is enforceable in equity.[80] The subject of the trust, the contractual right to money or property,[81] is at law vested in the trustee, that is to say, in the promisee under the contract.

As with the enforcement of equitable rights in general, the person having the legal right in the thing demanded, in this case the contracting party who has thus become a trustee, must in general be a party to the action. 'The trustee then can take steps to enforce performance to the beneficiary by the other contracting party as in the case of other equitable rights. The action should be in the name of the trustee; if, however, he refuses to sue, the beneficiary can sue, joining the trustee as defendant.'[82] A trustee who sues on behalf of the third party, may recover not merely nominal damages representing the trustee's own meagre interest in the performance of the contract, but the whole loss suffered by the beneficiary.[83]

Although this equitable principle was first enunciated in the eighteenth century by Lord Hardwicke,[84] the important developments occurred in the nineteenth century. Thus, in *Lloyd's* v. *Harper*:[85]

> A father whose son was about to be elected a member of Lloyd's wrote to the committee guaranteeing his son's solvency. When the son became insolvent, Lloyd's claimed against the father on behalf of members who had suffered thereby, and also on behalf of some outsiders.
>
> It was held that the creditors were entitled to the benefit of the contract made, since the committee had entered into it as trustee for all those who had suffered by the insolvency of the son.

[77] [1915] A.C. 847; *ante*, p. 408.
[78] Lawson and Rudden, *The Law of Property*, 2nd edn. (1982), ch. 2.
[79] *Ibid.*, pp. 26–8. *Post*, p. 447.
[80] Williston (1902) 15 Harvard L.R. 767; Corbin (1930) 46 L.Q.R. 12; Glanville Williams (1944) 7 M.L.R. 123.
[81] Cf. *Southern Water Authority* v. *Carey* [1985] 2 All E.R. 1077, at p. 1083 (no trust of the benefit of an exemption clause).
[82] *Vandepitte* v. *Preferred Accident Insurance Corporation of New York* [1933] A.C. 70, at p. 79.
[83] *Lloyd's* v. *Harper* (1880) 16 Ch. D. 290, *infra*.
[84] *Tomlinson* v. *Gill* (1756) Amb. 330.
[85] (1880) 16 Ch. D. 290. See also *Gregory* v. *Williams* (1817) 3 Mer. 582; *Fletcher* v. *Fletcher* (1844) 4 Hare 67. See further the cases cited *post*, p. 419 n. 98.

It was applied by the House of Lords in *Les Affréteurs Réunis Société Anonyme* v. *Leopold Walford (London) Ltd.*:[86]

In a charterparty made between the appellant, the owner of a steamship, and a firm of charterers, the appellant promised to pay a commission of 3% on the gross amount of hire to the respondent, the broker who had negotiated the contract of charterparty. The appellant failed to pay, and the respondent sued to obtain its commission.

The respondent was not a party to the contract. Although it would not normally be entitled to any rights under it, it was the practice for a charterer, if necessary, to sue the shipowner for the amount of a broker's commission *as trustee for the broker*. Here the action had been brought by the brokers themselves, but by consent it was treated as brought by the charterers as trustees for them. The House of Lords recognized the practice and gave judgment in the brokers' favour.

Intention to create trust

To establish a trust of the promise it is necessary to establish that the promisee intended to enter the contract as trustee but, in the absence of express words,[87] there is no satisfactory test to determine whether the requisite intention exists. The consequence is uncertainty.[88]

The different judicial approaches to the question at different stages of the doctrine have led to a complicated body of case law which is not possible to reconcile. *Lloyd's* v. *Harper* and *Walford*'s case may suggest that it is possible to infer an intention to create a trust solely from the intention to benefit the third party and, as such, the device of a trust could be fictionally employed as a way round the privity rule.[89] However, the approach of the Courts in more recent times has been stricter. It is said that the intention to constitute the trust must be affirmatively proved by substantial evidence[90] in part because the presence of a trust renders the contract immutable where the parties might otherwise wish to be free to vary it.[91] Thus, it will be more difficult to establish a trust where the intention to benefit the third party is not irrevocable,[92] where the contract consists of a complex package of benefits and burdens,[93] or where the third party may not need the benefit.[94]

An example of the differences of approach is provided by the contrast between *Re Flavell*[95] and *Re Schebsman*.[96] In *Re Flavell*:

[86] [1919] A.C. 801.

[87] *Fletcher* v. *Fletcher* (1844) 4 Hare 67.

[88] Glanville Williams (1944) 7 M.L.R. 123.

[89] Corbin (1930) 46 L.Q.R. 12, at p. 17; Lord Wright (1939) 55 L.Q.R. 189, at p. 208 (a 'cumbrous fiction').

[90] *Vandepitte* v. *Preferred Accident Insurance Corp of New York* [1933] A.C. 70, at p. 80.

[91] *Re Schebsman* [1944] Ch. 83, at p. 104, *post*, p. 419; *Green* v. *Russell* [1959] 2 Q.B. 226, at p. 241.

[92] *Re Sinclair's Life Policy* [1938] Ch. 799. Note, however, that it is possible to have a revocable trust; *Wilson* v. *Darling Island Stevedoring and Lighterage Co.* (1956) 95 C.L.R. 43, at p. 67 (Fullagar J.).

[93] *Vandepitte* v. *Preferred Accident Insurance Corp of New York* [1933] A.C. 70, at p. 81; *Swain* v. *The Law Society* [1983] 1 A.C. 598, at p. 612; *Southern Water Authority* v. *Carey* [1985] 2 All E.R. 1077, at p. 1083.

[94] *Vandepitte* v. *Preferred Accident Insurance Corp of New York*, (*supra*, n. 93), at p. 80 (contracting party liable for infant third party's torts); *Swain* v. *The Law Society* [1983] 1 A.C. 598, at pp. 612, 621 (third party beneficiary accorded direct action against promisor by statute), *post*, p. 421.

[95] (1883) 25 Ch. D. 89.

[96] [1944] Ch. 83.

Partnership articles provided that, in the event of the death of one of the partners, an annuity out of the firm's net profits each year was to be paid to his widow or children as he should appoint and, in default of appointment, to his widow.

It was held that the executors of the deceased partner were trustees for the widow under this contract, and that she was entitled to be paid the promised sums. But in *Re Schebsman*:

In 1940 S's employment was terminated, and, in consideration of his retirement, the company agreed to pay him the sum of £5,500 by instalments. If he died before the completion of the payments to him, they were to be paid to his widow and daughter. S later became bankrupt, and then died. His trustee in bankruptcy claimed to intercept the sums being paid to his widow, on the ground that S himself could have intercepted them, and so they were available for his creditors.

The Court refused to hold that the contract created a trust in favour of the widow and daughter; they had therefore no enforceable right to the money. But the company was free to perform its obligation if it so wished, and, if it did so, neither S. nor his trustee in bankruptcy could intercept the money and put it in his own pocket. Accordingly the claim failed. Du Parcq L.J. said:[97]

It is true that, by the use possibly of unguarded language, a person may create a trust, as Monsieur Jourdain talked prose, without knowing it, but unless an intention to create a trust is clearly to be collected from the language used and the circumstances of the case, I think that the Court ought not to be astute to discover indications of such an intention. I have little doubt that in the present case both parties (and certainly the debtor) intended to keep alive their common law right to vary consensually the terms of the obligation undertaken by the company, and if circumstances had changed in the debtor's life-time injustice might have been done by holding that a trust had been created and that those terms were accordingly unalterable.

Similar contrasts can be found in the approach of the Courts to contracts of insurance. Thus, while in some cases such contracts have been held to create a trust in favour of third parties,[98] in others they have not.[99] In this context too it would appear that English courts no longer favour the device of a trust of a contractual right. It has been stated in Australian decisions that this may be too cautious and that there is 'considerable scope for the development of trusts' particularly in the context of insurance policies for the benefit of third persons.[100] There are also indications that English courts may be less hostile to the trust of a

[97] [1944] Ch. 83, at p. 104.

[98] *Royal Exchange Assurance* v. *Hope* [1928] Ch. 179; *Re Webb* [1941] Ch. 225; *Re Foster's Policy* [1966] 1 W.L.R. 222. See also *Williams* v. *Baltic Insurance Association of London Ltd.* [1924] 2 K.B. 282.

[99] *Re Englebach's Estate* [1924] 2 Ch. 348; *Clay's Policy of Assurance* [1937] 2 All E.R. 548; *Re Sinclair's Life Policy* [1938] Ch. 799; *Green* v. *Russell* [1959] 2 Q.B. 226; *Swain* v. *The Law Society* [1983] 1 A.C. 598; *McCamley* v. *Cammell Laird Shipbuilders Ltd.* [1990] 1 W.L.R. 963, at p. 969.

[100] *Trident General Insurance Co. Ltd.* v. *NcNiece Bros. Pty. Ltd.* (1988) 165 C.L.R. 107, at p. 166 (Toohey J.). See also *ibid.*, at pp. 120–1, 146–51, 156; *Wilson* v. *Darling Island Stevedoring and Lighterage Co.* (1956) 95 C.L.R. 43, at p. 67.

promise.[101] However, the dominant approach of English courts is exemplified by the decision of the Judicial Committee of the Privy Council in *Vandepitte* v. *Preferred Accident Insurance Corporation of New York*[102] on appeal from British Columbia:

> B insured his car with the respondent. The contract of insurance was stated to cover not only B himself, but all persons driving the car with his consent. B's daughter, while driving it with his consent, knocked down and injured the appellant, Vandepitte. She was successfully sued in negligence by Vandepitte, but the judgment was unsatisfied. By the British Columbia Insurance Act, an injured person could, in such circumstances, avail himself of any rights possessed by the driver of the vehicle against the insurance company. Vandepitte therefore brought an action against the respondent under this Act.
>
> In order to succeed, he had to establish that the daughter had some rights against the company under the policy, and he could only do this by showing that a trust had been created for her benefit. The Judicial Committee were not satisfied that such was B's intention. First, as British Columbia law provided that a father was liable for the torts of his minor children living with the family, B would 'naturally expect' any claim to be against him.[103] Secondly, a trust was not appropriate for a contract, such as insurance which imposes 'serious duties and obligations . . . on any person claiming to be insured, which necessarily involve consent and privity of contract'.[104]

The strict and possibly overcautious approach to the requirement of intention means that the trust of a contractual right does not now constitute a major qualification to the doctrine of privity of contract.

(ii) Contracts of insurance

Contracts of insurance

Contracts of insurance made for the benefit of third parties cannot in principle be enforced by them, unless a trust is created in their favour.[105] The general principle is, however, subject to a number of important statutory exceptions.

Road Traffic

Under the Road Traffic Act 1988, section 148(7), the person issuing a policy of insurance against death or bodily injury to third parties in accordance with the requirements of the Act is made liable to indemnify not only the persons taking out the policy, but 'the person or classes of persons specified in the policy in respect of any liability which the policy purports to cover'. This means that the driver of a motor vehicle is entitled to the benefit of an insurance policy made with an insurance company by the owner of the vehicle and which purports to cover the driver.[106] The Act also permits an injured third party to proceed directly against the insurance company on obtaining judgment against the assured.[107]

[101] *Darlington BC* v. *Wiltshier (Northern) Ltd* [1995] 1 WLR 68, at pp. 75, 81 (a constructive trust). The Law Commission (Law Com. No. 242 (1996) § 2.9) does not consider a change of approach is heralded, noting that this was only an alternative ground for the decision; for the primary ground see *ante*, p. 414 n. 50.

[102] [1933] A.C. 70. Cf. *Williams* v. *Baltic Insurance Association of London Ltd.* [1924] 2 K.B. 282; Road Traffic Act 1988, s. 148(7).

[103] *Ibid.*, at p. 80. [104] *Ibid.*, at p. 81. [105] See *ante*, p. 419, nn. 98 and 99.

[106] *Tattersall* v. *Drysdale* [1935] 2 K.B. 174.

[107] Road Traffic Act 1988, ss. 151–3. See also the Third Parties (Rights against Insurers) Act 1930.

Victims of road accidents are also protected by two agreements entered into in 1972 between the Secretary of State for the Environment and the Motor Insurers' Bureau. These are designed to compensate those injured by untraced ('hit and run') drivers and by uninsured drivers. Where the victim claims against the Bureau in respect of injuries sustained, as it is the policy of the Bureau not to raise the defence that the victim is not a party to the agreement between it and the Secretary of State,[108] the victim may proceed and even obtain judgment.[109]

Liability and indemnity insurance

Under the Third Parties (Rights against Insurers) Act 1930 a third party who has a claim against a defendant who has taken out insurance against liability to third parties will be able to claim against the insurer where the defendant has become *inter alia* insolvent either before or after incurring the liability to the third party.[110] Third party rights may also be created by administrative rules made by a regulatory body operating in the public law sphere. Thus, a contract to provide indemnity insurance for solicitors made between the Law Society and insurers as part of a compulsory insurance scheme can be directly enforced by solicitors.[111]

Husband and wife

The Married Women's Property Act 1882, section 11,[112] allows a husband to effect an insurance on his life for the benefit of his wife and children. A wife, too, may effect an insurance on her own life for the benefit of her husband and children. Such an insurance creates a trust in favour of the objects of the policy, and does not form part of the assured's estate.

Limited interests

Persons with limited interests in property may also be given the right to sue even though not parties to the contract of insurance. In contracts of marine insurance, when several persons have an interest in the merchandise conveyed, any such person 'may insure on behalf and for the benefit of other persons interested as well as for his own benefit'.[113] Similarly in the case of sales of land, if A contracts to sell land to B and property on the land is damaged or destroyed before the completion of the sale, any insurance moneys received by A must be held by A in trust for B.[114] And a tenant can claim under the landlord's fire insurance policy, and vice versa.[115]

(iii) Commercial practice

Commercial practice

Certain exceptions have been introduced into the doctrine of privity of contract as concessions to commercial practice. Some of these are the result of statutory

[108] *Hardy* v. *Motor Insurers' Bureau* [1964] 2 Q.B. 745, at p. 757; *Gurtner* v. *Circuit* [1968] 2 Q.B. 587, at p. 599.

[109] But see the criticism voiced by Lord Dilhorne in *Albert* v. *Motor Insurers' Bureau* [1972] A.C. 301, at p. 320.

[110] For the limitations of the 1930 Act, see *Bradley* v. *Eagle Star Insurance Co. Ltd.* [1989] A.C. 957 (cf. Companies Act 1989, s. 141); *The Fanti* and *The Padre Island* [1991] 2 A.C. 1; *Cox* v. *Bankside Members Agency Ltd.* [1995] 2 Lloyd's Rep. 437; Law Com. C.P. No. 152 (1998).

[111] *Swain* v. *Law Society* [1983] 1 A.C. 598.

[112] The Law Revision Committee's Sixth Interim Report (Cmd. 5449), § 49 proposed that this be extended to all life, endowment, and education policies which name a beneficiary but the Law Commission considered that this would only be sensible as part of a general review of insurance: Law Com. No. 242 (1996) § 12.26.

[113] Marine Insurance Act 1906, s. 14(2).

[114] Law of Property Act 1925, s. 47(1).

[115] Fires Prevention (Metropolis) Act 1774, s. 83.

provisions; others arise out of the agreed practices of merchants as recognized by the Courts. Negotiable instruments and bills of lading provide important illustrations of statutory exceptions, but since these are dealt with in the section devoted to them later in this book,[116] it is not necessary to elaborate their effect here.

Package holidays

Where a consumer makes a contract for the provision of the package holiday, the beneficiaries of that contract (for example family members and others who go on the holiday) are given direct contractual rights against the organizer and the retailer even where they are not parties to the contract.[117]

Letters of credit

The operation of the device known as the irrevocable letter of credit has often been said to be an example of an exception to privity of contract.[118] It is based on trade practice. Its purpose is to finance contracts for the sale of goods between buyers and sellers in different countries, and particularly where the delay between despatch from the place of manufacture and arrival at the destination is a considerable one. It enables short-term credit facilities to be made available, guarantees payment to the seller, and safeguards the parties against currency fluctuations.

There are three stages in the transaction. First, a term is inserted in the contract of sale made between the buyer and the seller whereby the buyer undertakes to furnish an irrevocable letter of credit in favour of the seller.[119] Secondly, the buyer approaches its own banker (usually described as the issuing banker) and instructs it to issue an irrevocable letter of credit, giving the banker details of the transaction. This constitutes a contract between the buyer and the banker. Thirdly, the banker advises the seller that an irrevocable letter of credit has been opened in its favour, that is to say, the banker gives an irrevocable undertaking to pay the seller, or to accept bills of exchange drawn on it, provided the seller tenders the required shipping documents in compliance with the terms of the letter of credit.[120] The seller can then ship the goods in the secure knowledge that it will be paid for them. The shipping documents represent the goods themselves,[121] and they are usually retained by the banker as security against its right to be reimbursed by the buyer.

The irrevocable letter of credit does not fit easily into the common law. If the transaction is regarded simply as a contract between the buyer and its banker, the seller is a third party to this contract and technically would be unable to sue should the banker revoke the letter of credit or for some reason fail to make payment.[122] Nevertheless, it has been established that the banker is legally under an

[116] See *post*, pp. 462, 468.

[117] Package Travel, Package Holidays and Package Tours Regulations 1992 (S.I. 1992 No. 3288), regs 2 and 15, implementing EEC Council Directive 90/314, 1990 O.J. L158/59. See also *Jackson* v. *Horizon Holidays Ltd.* [1975] 1 W.L.R. 1468 *ante*, p. 412.

[118] See *The Uniform Customs and Practice for Documentary Credits* (1993); Jack, *Documentary Letters of Credit*, 2nd edn. (1993).

[119] For the effect of a failure to furnish the letter of credit, see *ante*, p. 134, *post*, p. 498.

[120] An irrevocable letter of credit may also be 'confirmed' by a banker operating in the seller's country (known as the correspondent banker) who, by confirming the credit, adds to the promise of the issuing banker his own undertaking to ensure payment.

[121] See *post*, p. 468.

[122] In the Sixth Interim Report of the Law Revision Committee (Cmd. 5449, 1937), § 45, it was pointed out that the liquidator of a bank might be compelled to rely on the defence of privity.

absolute obligation to pay, irrespective of any dispute there may be between the buyer and seller.[123] It has therefore been argued that the irrevocable letter of credit forms an 'exception' to the doctrine of privity of contract; but it seems better to regard the promise of payment given by the banker to the seller as an autonomous undertaking, independent of any other contract. Thus the irrevocable letter of credit is not an exception to privity of contract but to the doctrine of consideration. It is either an irrevocable offer by the banker to the seller (which is accepted by the seller tendering the shipping documents) or a unilateral contract between the banker and the seller to pay on tender of the shipping documents.[124]

(iv) Contracts concerning land

Contracts concerning land

The benefit of covenants in a lease which touch and concern the land demised will run upon an assignment of the lease or of the reversion.[125] Also, under the rule in *Tulk* v. *Moxhay*,[126] a vendor of freehold land may attach to the land sold restrictive covenants as to its future use (for example, that no buildings shall be erected on the land). Provided that the covenant was imposed for the benefit of neighbouring land, any subsequent owner of that land may enforce the covenant if he shows that the benefit of the covenant has become annexed to his land,[127] has been assigned to him or that its benefit has passed to him under a building scheme.[128] Third parties may thus acquire rights under a covenant to which they were not privy.[129] These rules, however, are simply rules applicable to rights over land.

Law of Property Act 1925, s. 56(1)

A more controversial exception is provided by section 56(1) of the Law of Property Act 1925, which states:

> A person may take an immediate or other interest in land or other property, or the benefit of any condition, right of entry, covenant or agreement over or respecting land or other property, although he may not be named as a party to the conveyance or other instrument.

The word 'property' is defined in the Act, unless the context otherwise requires, as including 'any thing in action, and any interest in real or personal property'.[130]

The scope of this sub-section has long been problematical.[131] In the view of

[123] *Urquhart, Lindsay & Co. Ltd.* v. *Eastern Bank Ltd.* [1922] 1 K.B. 318, at pp. 321, 322; *Donald H. Scott & Co. Ltd.* v. *Barclays Bank Ltd.* [1923] 2 K.B. 1, at p. 13; *Trans-Trust S.P.R.L.* v. *Danubian Trading Co. Ltd.* [1952] 2 Q.B. 297, at pp. 304–5; *Midland Bank Ltd.* v. *Seymour* [1955] 2 Lloyd's Rep. 147, at p. 166; *Hamzeh Malas & Sons* v. *British Imex Industries Ltd.* [1958] 2 Q.B. 127, at p. 129.

[124] Ellinger (1962) 4 Malaya L.R. 307. The problem in either case is how, and at what time, consideration for the undertaking is furnished by the seller, so as to render it binding. In *Urquhart*'s case (*supra*, n. 123), at p. 321, Rowlatt J. thought that the banker's undertaking took effect once the seller acted on it, e.g. by commencing performance of their contract with the buyer. Cf. *Dexters Ltd.* v. *Schenker & Co.* (1932) 14 Ll. L.R. 586, at p. 588 (when letter of credit received). The latter is correct.

[125] *Spencer*'s case (1583) 5 Co. Rep. 16a.

[126] (1848) 2 Ph. 774; see *post*, p. 431.

[127] In *Federated Homes Ltd.* v. *Mill Lodge Properties Ltd.* [1980] 1 W.L.R. 594 Brightman L.J. indicated this could take place automatically without express words.

[128] Gray, *Elements of Land Law*, 2nd edn. (1993), pp. 1159–64.

[129] See the Law of Property Act 1925, ss. 78(1) and 79(1) and also *Smith and Snipes Hall Farm Ltd.* v. *River Douglas Catchment Board* [1949] 2 K.B. 500.

[130] Law of Property Act 1925, s. 205(1)(xx).

[131] See Elliott (1956) 20 Conv. (N.S.) 43, 114; Andrews (1959) 23 Conv. (N.S.) 179; Furmston (1960) 23 M.L.R. 373, 380–5; Ellinger (1963) 26 M.L.R. 396; Wade [1964] C.L.J. 66.

some it is merely a conveyancing provision and applies only to land; but others have interpreted it much more widely.[132] There has also been considerable doubt as to who can properly rely on it. In its terms the sub-section is wide enough to comprehend any person who might conceive it of 'benefit' to take advantage of a covenant or agreement made by others, but such could scarcely have been the intention of the legislature. Accordingly the Courts have construed it in a more limited fashion. In *White* v. *Bijou Mansions Ltd.* Simonds J. said that the only person who could rely on section 56 is one who, although not expressly named, the instrument purports to grant something to, or covenant with.[133]

This, which we may call the orthodox meaning, however, does not assist a person who is not a party to a contract but wishes to sue on that contract. The agreement is not 'made with him', nor does it 'grant something to him' since the sub-section does not give to the non-party a right to the performance of a contract if, apart from the sub-section, that person has no such right.[134] The sub-section did not create any fresh rights to sue under a contract, but only assisted the protection of rights shown to exist.

The Court of Appeal in *Beswick* v. *Beswick*[135] held that section 56(1) had abolished the doctrine of privity of contract in relation to written contracts. In the view of the Court, the history of the sub-section,[136] and the definition of 'property' contained in the Act, showed that it was not confined to land, but extended to 'any thing in action', e.g. to a right under a contract. Moreover, the Court considered the orthodox meaning given to the sub-section to be erroneous, for it clearly said that a person not a party could take the benefit of a contract.

In the House of Lords[137] their Lordships held unanimously that such a far-reaching and substantial alteration of the fundamental rule of privity was never intended by Parliament. They were agreed that the context of section 56(1) required that a limited interpretation should be given to the word 'property', but there was no agreement as to what that interpretation should be. Lord Guest thought that it meant land,[138] but Lord Upjohn did not accept that the word was limited to an interest in real property.[139] There was similar disagreement about the orthodox meaning of the scope of the sub-section.[140] And Lord Upjohn expressed the view, based on historical grounds, that the words 'conveyance or

[132] In particular Lord Denning. See *Smith and Snipes Hall Farm Ltd.* v. *River Douglas Catchment Board* [1949] 2 K.B. 500, at p. 517; *Drive Yourself Hire Co. (London) Ltd.* v. *Strutt* [1954] 1 Q.B. 250, at p. 274.

[133] [1937] Ch. 610, at p. 625. See also *ibid.* (on appeal) [1938] Ch. 351, at p. 365; *Re Ecclesiastical Commissioners for England's Conveyance* [1936] Ch. 430; *Amsprop Trading Ltd.* v. *Harris Distribution Ltd.* [1997] 1 W.L.R. 1025. Contrast *Stromdale and Ball Ltd.* v. *Burden* [1952] Ch. 223.

[134] *Re Miller's Agreement* [1947] Ch. 615. See also *Re Foster* [1938] 3 All E.R. 357; *Re Sinclair's Life Policy* [1938] Ch. 799; *Green* v. *Russell* [1959] 2 Q.B. 226; *Scruttons Ltd.* v. *Midland Silicones Ltd.* [1962] A.C. 446.

[135] [1966] Ch. 538 (Lord Denning M.R. and Danckwerts L.J.).

[136] It substantially replaced the Real Property Act 1845, s. 5 but enlarged the scope of that section in its actual wording. Cf. *Beswick* v. *Beswick* [1968] A.C. 58, at pp. 93, 104–5.

[137] [1968] A.C. 58.

[138] At p. 87.

[139] At p. 105, with whom Lord Pearce agreed (at p. 94).

[140] At pp. 74–5, 81, 87, 94, 106.

other instrument' were confined to documents *inter partes* and under seal.[141] These differences of opinion have yet to be resolved,[142] but it is clear that section 56(1) does not apply to a simple promise by A to B to pay a sum of money to C.

(v) Contracts giving rise to tortious duties of care to third parties[143]

Tortious duty to third party beneficiary

A contract between A and B may, in addition to creating obligations between the contracting parties, lead to the creation of a tortious duty of care by one of them towards a third party. For instance, a contract made by an occupier of land may subject him or her to liability in tort to third party visitors,[144] and professionals such as surveyors and solicitors have been held liable in tort to third parties who have suffered loss by reason of their misrepresentation[145] or defective performance of the contract. For instance, in the two cases of *Smith* v. *Eric S. Bush (a firm)* and *Harris* v. *Wyre Forest District Council*:[146]

> S and H applied to borrow money on mortgage to enable them to buy a house. In each case the lender contracted with surveyors to value the house and S and H then bought their respective houses in reliance on the valuations, which had in fact been carried out negligently. Although not party to any contract with the surveyors, S and H successfully sued them in tort; the surveyors knew that they would rely on the valuation and had paid the lenders for a valuation.

Intended legatees

Again, in *Ross* v. *Caunters*[147] and *White* v. *Jones*[148] solicitors, who had contracted with a testator to draw up wills benefiting third parties, were held liable in tort to the third parties where, as a result of their negligence, in the first case, the will was executed in such a way as to invalidate the gift and in the second case it was never drawn up. In these cases the relationship created by the contract gives rise to a duty of care to a third party who is thus able to sue the contracting party in tort, at least where no loss is suffered by the testator's estate.[149] It is submitted that these cases are best analysed as torts; although the intended legatee is expressly designated as a beneficiary, the contract is not one in which the solicitor promises to confer a benefit on the third party, the legatee, but one by which the solicitor is to enable the client to do so.[150]

A third party who is sued by a party to a contract, may also be able to rely on its terms to show that it was under no duty of care, perhaps because the party to

[141] At p. 107, with whom Lord Pearce agreed (at p. 94). See also Lord Reid at pp. 76–7.
[142] In *Lynus* v. *Prowsa* [1982] 1 W.L.R. 1044, at p. 1049 and *Amsprop Trading Ltd.* v. *Harris Distribution Ltd.* [1997] 1 W.L.R. 1025, the orthodox meaning was considered correct.
[143] Reynolds (1985) 11 N.Z.U.L.R. 215, at pp. 220–6.
[144] Occupiers Liability Act 1957, s. 3; Defective Premises Act 1972, ss. 1(1)(b) and 4.
[145] *Hedley Byrne & Co. Ltd.* v. *Heller & Partners Ltd.* [1964] A.C. 465, *ante*, at p. 242.
[146] [1990] 1 A.C. 831. See *ante*, at p. 185.
[147] [1980] Ch. 287.
[148] [1995] 2 A.C. 207. See Weir (1995) 111 L.Q.R. 357. See further *Hill* v. *Van Erp* (1997) 142 A.L.R. 687 (Australia).
[149] *Carr-Glyn* v. *Frearsons* [1997] 2 All E.R. 614, at pp. 623–4, 628.
[150] *White* v. *Jones* [1995] 2 A.C. 207, at pp. 262–3, 273; *Gartside* v. *Sheffield, Young & Ellis* [1983] N.Z.L.R. 37, at pp. 42, 49. See also Law Com. No. 242, *Privity of Contract: Contracts for the Benefit of Third Parties* (1996), §§ 7.19–7.25; Barker (1994) 14 O.J.L.S. 137. Cf. Markesinis (1987) 103 L.Q.R. 354.

the contract had agreed to bear the risk.[151] This is discussed below[152] when the special problems of exemption clauses and third parties are considered.

Tort liability not based on contractual intention to benefit third party

The exceptions and qualifications to the privity principle we have already considered are based on an intention by the contracting parties to benefit the third party. Tort liability is not, and there may be such liability where there could be no question of a contractual action. Although the contract is a relevant factor in determining whether a duty of care is owed to or by a third party, the criteria for liability in tort reflect wider considerations than the intentions of the contracting parties and include 'proximity', the type of loss suffered (liability in tort for economic loss is very narrow), assumption of responsibility by the defendant, and whether the plaintiff has reasonably relied on something said or done by the defendant.

The potential width of tort liability can be demonstrated by *Junior Books Co. Ltd.* v. *Veitchi Co. Ltd.*,[153] a decision of the House of Lords on appeal from Scotland:

> The owner of property had contracted for the erection of a factory. The contract entitled the owner to nominate sub-contractors and the head contractor made a contract with a nominated flooring sub-contractor. The floor was defective and the owner successfully sued the sub-contractor in tort in respect of the economic loss suffered. It was not known to the Court whether this circumvented an exemption clause in the contract between the sub-contractor and the head contractor.[154]

Although Scottish law recognizes that third parties may acquire rights under a contract, the owner did not seek to argue that it could sue in contract.[155] However, Courts have been increasingly reluctant to impose liability in tort for pure economic loss, particularly where this would cut across the contractual structure governing dealings between the defendant and others. Personal injury or damage to property is normally necessary and the reasoning in the *Junior Books* case has been substantially undermined.[156] Detailed discussion of this topic will be found in works on the law of tort.[157]

(f) Appraisal of the General Rule

Critique of general rule

The principle that a third party cannot acquire rights under a contract has been the subject of considerable criticism both in the Courts[158] and by commenta-

[151] *Southern Water Authority* v. *Carey* [1985] 2 All E.R. 1077; *Norwich City Council* v. *Harvey* [1989] 1 W.L.R. 828, at p. 837, *post*, p. 445. See also, *post*, p. 434 (bailment).

[152] *Post*, p. 439. [153] [1983] 1 A.C. 520. [154] *Ibid.*, at p. 538 (Lord Roskill).

[155] It is not clear whether the requirements for a contractual action by the third party had been satisfied. On these, see McBryde, *The Law of Contract in Scotland* (1987), p. 412 ff.

[156] See *D. & F. Estates* v. *Church Commissioners for England* [1989] A.C. 177, 202; *Caparo Industries plc* v. *Dickman* [1990] 2 A.C. 605; *Murphy* v. *Brentwood D.C.* [1991] 1 A.C. 398; *Henderson* v. *Merrett Syndicates Ltd.* [1995] 2 A.C. 145.

[157] Cane, *Tort Law and Economic Interests*, 2nd edn. (1996), Markesinis and Deakin, *Tort Law*, 3rd edn. (1994), p. 83 ff.

[158] *Scruttons Ltd.* v. *Midland Silicones Ltd.* [1962] A.C. 446, at pp. 467–8; *Beswick* v. *Beswick* [1968] A.C. 58, at p. 72; *Woodar Investment Development Ltd.* v. *Wimpey Construction U.K. Ltd.* [1980] 1 W.L.R. 277, 291, 297–8, 300 (H.L.); *Forster* v. *Silvermere Golf and Equestrian Centre* (1981) 125

tors.[159] It is said that it serves only to defeat the legitimate expectations of the parties and the third party who often organize their affairs on the faith of the contract, that it undermines the social interest of the community in the security of bargains, and that it is commercially inconvenient.[160] Above all it defeats the intentions of the parties to the contract. Although, as we have seen, it may be possible to circumvent the rule by a variety of legal devices, these are complicated and not always available and their technicality has led to artificiality and uncertainty.

The right of a third party to sue on a contract made for its benefit is recognized by the law of Scotland and the legal systems of the USA. It has also been introduced by statute in several Commonwealth jurisdictions[161] while in others the privity doctrine has been modified judicially.[162] In England, the Courts, while criticizing the principle that a third party cannot acquire rights under a contract, have indicated that a radical change in the common law, such as abrogation of the principle, should be introduced by legislation.[163]

Proposals for statutory reform

In 1937 the Law Revision Committee recommended that where a contract by its express terms purports to confer a benefit directly on a third party, the third party shall be entitled to enforce the provision in its own name.[164] Although it was widely supported and has influenced developments in other Commonwealth jurisdictions, the recommendation has not been implemented, and the Law Commission has recently returned to the subject. The Law Commission has recommended that the privity rule should be reformed so as to enable contracting parties to confer a right to enforce the contract on a third party.[165]

While the simple recognition of some form of third party right might be uncontroversial, the determination of its precise extent is not. The most important difficulties concern the test of enforceable benefit, the validity of defences that would

Sol. J. 397 (C.A.); *Swain* v. *The Law Society* [1983] 1 A.C. 598, at p. 611; *Darlington B.C.* v. *Wiltshier Northern Ltd.* [1995] 1 W.L.R. 68, at pp. 73, 76.

[159] Corbin (1930) 46 L.Q.R. 12; Furmston (1960) 23 M.L.R. 373; Flannigan (1987) 103 L.Q.R. 564; Andrews (1988) 8 L.S. 14; Kincaid [1989] C.L.J. 243; Adams and Brownsword (1990) 10 L.S. 12. For a summary of the arguments against the rule, see Law Com. No. 242, *Privity of Contract: Contracts for the Benefit of Third Parties* (1996), Part III and for a summary of those for the rule see Law Com. C.P. No. 121 (1991) § 4.3.

[160] For difficulties in construction and insurance contracts, see Law Com. No. 242 (1996), §§ 3.10–3.27.

[161] Western Australia, Queensland and New Zealand. For a summary of this legislation see Law Com. No. 242 (1996), Appendix B and for a summary of the position in other legal systems, including Scotland, the USA, France, and Germany, see the Appendix to Law Com. C.P. No. 121 (1991).

[162] *London Drugs Ltd.* v. *Kuehene & Nagel International Ltd.* [1992] 3 S.C.R. 299, (Canada) *post*, p. 445 (exemption clauses); *Trident General Insurance Co. Ltd.* v. *McNiece Bros. Pty. Ltd.* (1988) 165 C.L.R. 107 (Australia).

[163] *Scruttons Ltd.* v. *Midland Silicones Ltd.* [1962] A.C. 446, at pp. 467–8; *Beswick* v. *Beswick* [1968] A.C. 58, at p. 72; *Woodar Investment Development Ltd.* v. *Wimpey Construction U.K. Ltd.* [1980] 1 W.L.R. 277, at pp. 291, 297–8, 300. But cf. *K. H. Enterprise* v. *Pioneer Container* [1994] 2 A.C. 324, at p. 335; *Darlington B.C.* v. *Wiltshier Northern Ltd.* [1995] 1 W.L.R. 68. Cf. *The Mahkutai* [1996] A.C. 650, at p. 665. See further Beatson (1992) 44 C.L.P. 1.

[164] Sixth Interim Report (Cmd. 5449), para. 48.

[165] Law Com. No. 242 (1996), § 3.29. This includes the right to rely on clauses limiting or excluding the third party's liability to a contracting party; *ibid.*, § 3.32; Draft Bill, clause 1(5).

have been available had the promisee sued, and whether the contracting parties should have power to vary or cancel the contract.

The test of enforceable benefit

The Law Revision Committee recommended that a third party should acquire an enforceable right only if the contract contained an express provision to that effect. The requirement of express contractual designation means that the intentions of contracting parties (including those reflected in trade practice)[166] will not always be recognized. Nor would it cover the facts of cases such as *Beswick* v. *Beswick*.[167] The Law Commission's recommendation is wider and provides for a rebuttable presumption in favour of there being a third party right where a contractual provision purports to confer a benefit on a third party identified by name, class, or description.[168] The presumption would be rebutted where, on the proper construction of the contract,[169] the parties did not intend the third party to have a right to enforce it.[170]

Intended and incidental beneficiaries

The Commission's approach should avoid a problem which has arisen in the USA where only the 'intention to benefit' test has been used. That test has led to difficult distinctions between the 'intended beneficiary' and the 'incidental beneficiary', the third party who benefits *incidentally* by the performance of a contract by others.[171] Where A contracts with B to construct a new road on B's land, C, whose adjoining land would be enhanced in value by the building of the road, while deriving a factual benefit from the performance of the contract made between A and B, is merely an incidental beneficiary of the contract. Moreover, while the road may be intended for the benefit of all road-users, it is unlikely that the parties intend that road-users should have a right of action in the event of a delay in construction.

Defences

The Law Commission is of the view that the rights of the third party should be subject to the entitlement of the promisor to raise any defence, such as fraud or mistake, which arise out of or in connection with the contract and which would have been available against the promisee.[172] The third party is therefore placed in a similar position to that of an assignee of a contractual right.[173]

Variation and cancellation

Variation and cancellation is perhaps the most difficult question and one that has not been satisfactorily solved in certain jurisdictions which recognize third party rights.[174] The Law Revision Committee considered that third party rights

[166] See *ante*, pp. 421–3.

[167] [1968] A.C. 58. See Law Com. No. 242 (1996) § 7.11.

[168] Law Com. No. 242 (1996) §§ 7.6, 7.17; Draft Bill, clauses 1(1) and 1(2). For the reasons given *ante*, p. 425, the Commission is of the view that an intended legatee who suffers loss from a solicitor's negligent will-drafting has no presumed right to enforce the contract despite being designated as a beneficiary in it.

[169] See *ante*, at p. 156.

[170] The Commission considers facts such as those in *Junior Books Ltd* v. *Veitchi & Co. Ltd.* [1983] 1 A.C. 520, *ante*, p. 426, to be an example of such rebuttal: Law Com. No. 242 (1996) §§ 7.47 and 7.18. *Sed quaere.*

[171] *Restatement of Contracts* (1932), §§ 133(1) and 147; *Restatement of Contracts* (2d) (1981), § 302. See Prince (1985) 25 Boston College L. Rev. 919, 934–7, 979.

[172] Law Com. No. 242 (1996), § 10.12 and Draft Bill clause 3(2). Cf. Law Revision Committee, Cmd. 5449, § 47.

[173] See *post*, p. 447.

[174] In Scotland, while *Carmichael* v. *Carmichael's Executrix* 1920 S.C. (H.L.) 195 suggests the right becomes irrevocable when brought to the notice of the third party, the position is unclear; McCormick [1970] Jur. Rev. 228, 236; Scot. Law Com. Memorandum No. 38 (1977).

should be subject to cancellation of the contract by the contracting parties at any time before the third party had adopted the contract either expressly or by conduct.

It has, however, been said that the notion of 'adoption' lacks precision and may, as in the USA, lead to Courts presuming that there had been acceptance.[175] In New Zealand variation is allowed until the third party has materially altered his position in reliance on the contract[176] and there may be advantages in utilizing this familiar concept in this context. In certain cases, such as contracts of insurance[177] and possibly other contracts which expressly name a third party, it is arguable that the third party's rights should not be subject to cancellation unless the contract expressly provides for this. Where, however, as the Law Commission has proposed, the intention to grant the third party the right to sue is based on identification as a beneficiary rather than express provision, also to presume irrevocability may lead to unfairness.[178] The Commission has recommended that the contracting parties' right to vary or cancel the contract should be lost in two situations. First, where the third party has relied on the contract and the promisor is aware of such reliance or could reasonably have foreseen that the third party would rely on it.[179] Secondly, the right to cancel should be lost where the third party has communicated its acceptance of the contract to the promisor.[180]

These recommendations, which have been accepted by government[180a] would provide a workable basis for a new rule as to third party rights. Amendment is desirable because the principle of privity of contract, as at present applied, is highly inconvenient. It is true that equitable remedies may be available, that the more obvious difficulties, such as those concerning insurance, have been largely provided for by statute, and that commercial practice has, as we have seen, gone a long way to mitigate the rigours of the doctrine in that sphere. Nevertheless, it does no credit to the law to countenance 'an unconscionable breach of faith'[181] and the third party should not be denied a remedy in its own right. Moreover, the present rule that the promisee cannot in general recover damages for loss sustained by the third party, coupled with the principle that the third party itself cannot sue, produces a result that has rightly been described as 'a blot on our laws and most unjust'.[182] It is to be hoped that, if the legislature is not prepared to enact the necessary reform, the House of Lords will take the opportunity to correct this anomaly.

[175] Law Com. C.P. No. 121 (1991), §§ 4.32, 5.31; Law Com. No. 242 (1996), § 9.17.
[176] New Zealand Contracts (Privity) Act 1982, s. 5, set out in Appendix B to Law Com. No. 242 (1996). See also *Restatement of Contracts* (2d), § 311.
[177] As in the case of of the Married Woman's Property Act 1882, s. 11, *ante*, p. 421.
[178] Law Com. No. 242 (1996) §§ 12.24–12.26.
[179] Law Com. No. 242 (1996), §§ 9.26–9.27, Draft Bill, clause 2(1).
[180] *Ibid.*, § 9.20, 9.26, Draft Bill, clause 2(2).
[180a] H.C. Deb. 19 March 1998 W.A. col. 709.
[181] *Beswick* v. *Beswick* [1968] A.C. 58, *per* Lord Pearce, at p. 83.
[182] *Forster* v. *Silvermere Gold and Equestrian Centre* (1981) 125 Sol. J. 397 *per* Dillon J.

II. The Imposition of Contractual Liabilities upon Third Parties

Generally no imposition of burdens on third parties

As a general rule, two persons cannot, by any contract into which they may enter, thereby impose contractual liabilities upon a third party.

This principle may be illustrated by reference to building contracts, where a person (the employer) engages a contractor to carry out certain building work. The contractor frequently sub-contracts parts of the work to sub-contractors. A sub-contractor has no cause of action against the employer for work done or materials supplied under the sub-contract, since the employer is not a party to that contract.[183] Even if the employer has nominated the sub-contractor and taken the benefit of the sub-contractor's work, it will not be liable to the sub-contractor for the price, as there is no privity of contract between them. Conversely the employer has no claim in contract[184] against the sub-contractor,[185] since the sub-contractor is not a party to the main contract between the employer and the contractor.

Further, the principle of privity of contract normally prevents a person from being bound by an exemption clause contained in a contract to which it is not a party. This rule, and its exceptions and circumventions, are considered later in this chapter.[186]

Exceptions

Nevertheless, there are certain situations where contractual liabilities may affect third parties. First, a contract concerning property may impose liabilities on third parties who subsequently acquire the property with notice of the contract. The property may be tangible, as where a contract is made concerning land or goods, or it may be intangible, as where the contract concerns intellectual property such as a patent or copyright. A similar principle may apply where information subject to a contractual obligation of confidentiality comes to the knowledge of a third party with notice of the contract,[187] although confidential information does not have all the attributes of a property interest, and it is not generally treated as such.[188] A second situation arises under the law of bailment. Where the owner of goods transfers possession to another (i.e. bails the goods), and the bailee then sub-bails them to another, the owner may be bound by exemption clauses contained in the contract of sub-bailment although not a party to it. Thirdly, the land law doctrine of restrictive covenants has been said to apply to chattels but, although there is some support in the cases, this approach has been much criticized. Fourthly, a person who knowingly interferes with contractual rights without justification will be liable in tort and may be restrained from doing so by an injunction.

[183] *Hampton* v. *Glamorgan County Council* [1917] A.C. 13. See also *Schmaling* v. *Tomlinson* (1815) 6 Taunt. 147 (principal and sub-agent).

[184] But a claim may lie in tort: *Junior Books Ltd.* v. *Veitchi Co. Ltd.* [1983] 1 A.C. 520: see *ante*, p. 426.

[185] Unless there is a collateral warranty: see *ante*, p. 128.

[186] *Post*, p. 439.

[187] See Gurry, *Breach of Confidence* (1984), pp. 271–82; Cornish, *Intellectual Property*, 3rd. edn. (1996), pp. 274–5.

[188] *Boardman* v. *Phipps* [1967] 2 A.C. 46, at pp. 127–8; Cornish, (*supra*, n. 187), pp. 281, 289–90. Cf. Gurry, (*supra*, n. 187), pp. 46–56.

(a) Contracts Concerning Land

Contracts concerning land

A contract for the sale of land creates an equitable proprietary interest in the land which can be enforced against a subsequent purchaser with notice.[189] Certain kinds of covenants concerning land are enforceable against third parties whether or not there is notice. If A leases land to B, there is privity of contract between them. But covenants in a lease which have reference to the subject-matter of the lease will be enforceable, not only between A and B, but against assignees of the lease or of the reversion.[190]

Restrictive covenants

Also, under an equitable principle known as the rule in *Tulk* v. *Moxhay*,[191] the burden of covenants restricting the use to which land may be put can 'run with the land'. In that case:

> The plaintiff, who owned houses in Leicester Square, sold the garden in the centre of the square to E. E covenanted to maintain the land sold as a garden and not to build on it. The land was sold several times before being purchased by the defendant with notice of the covenant. The defendant proposed to build on the land and the plaintiff sought an injunction to restrain him.

The injunction was granted. The defendant was not permitted to use the land in a manner inconsistent with the covenant entered into by E. The ground for the decision was the defendant's *notice* of the covenant at the time of the purchase.[192] But in subsequent cases the principle in *Tulk* v. *Moxhay* has undergone a considerable change. The person seeking to enforce the covenant must now show that it was imposed for the benefit of neighbouring land owned by it and that the benefit of the covenant has passed to it.[193] The right of a person entitled to the benefit of the covenant to prevent the inconsistent use has taken on a proprietary quality, an 'equitable interest'[194] in the land burdened by the covenant. A subsequent purchaser of that land buys it subject to the equitable interest and with the burden of the interest attached.[195]

Similar principles are also applied to certain other interests in land such as easements and options to purchase.

(b) Contracts Concerning Chattels and Other Personal Property[196]

Contracts concerning chattels

English law has always drawn a distinction between the principles applicable to real and personal property. The general rule set out above is subject to statutory

[189] *London & South West Ry.* v. *Gomm* (1882) 20 Ch. D. 562. See Megarry and Wade, *The Law of Real Property*, 5th edn. (1984), ch. 14; Meagher, Gummow, and Lehane, *Equitable Doctrines and Remedies*, 3rd edn. (1992), pp. 525–6.

[190] *Spencer*'s case (1583) 5 Co. Rep. 16a; Law of Property Act 1925, ss. 141, 142.

[191] (1848) 2 Ph. 774.

[192] Such covenants must now be registered under the Land Charges Act 1972.

[193] *London County Council* v. *Allen* [1914] 3 K.B. 642; see *ante*, p. 423.

[194] *Re Nisbet and Potts' Contract* [1905] 1 Ch. 391, at p. 398; [1906] 1 Ch. 386, at pp. 403, 405.

[195] *Rogers* v. *Hosegood* [1900] 2 Ch. 388, at p. 407.

[196] See Cohen-Grabelsky (1982) 45 M.L.R. 241; Gardner (1982) 98 L.Q.R. 279; Tettenborn [1982] C.L.J. 58.

exceptions. It does not apply where a contract or an option to transfer a chattel or an intangible interest creates an equitable interest in property or a possessory interest in the transferee, and the courts may protect this interest against a third party.[197]

It has also been said that:

> Reason and justice seem to prescribe that, at least as a general rule, where a man, by gift or purchase, acquires property from another, with knowledge of a previous contract, lawfully and for valuable consideration made by him with a third person, to use and employ the property for a particular purpose in a specified manner, the acquiror shall not, to the material damage of the third person, in opposition to the contract and inconsistently with it, use and employ the property in a manner not allowable to the giver or seller.[198]

Although the generalization in this *dictum* has been influential, it will be seen that there are formidable difficulties in regarding it as sound in principle.[199] It is also not entirely clear why it applies to some types of contract (time charters) but not to others (resale price maintenance agreements).[200]

(i) Resale price maintenance

Resale price maintenance

Manufacturers who contract with wholesalers may try to prevent price-cutting by imposing a condition that the goods are not to be re-sold at less than a fixed or minimum price, thus attempting to bind retailers and others with whom they have no contractual relationship. At common law such conditions were ineffective against subsequent purchasers who did not take subject to the price maintenance conditions even where notice of the conditions was attached to the goods.[201]

The matter is now governed by the Resale Prices Act 1976.[202] Although this provides that any term or condition of a contract for the sale of goods by a supplier to a dealer, or of any agreement relating thereto, which establishes resale price maintenance is void, an application may, however, be made to the Restrictive Practices Court for an order that goods of a particular class be exempted from this provision. The Court will not grant such an exemption unless it is proved that the scheme of resale price maintenance applicable to the goods can pass through one of the five 'gateways' contained in the Act, and is not otherwise detrimental to the public.[203] If no application is made, or if the application is dismissed by the Court, then it is unlawful to give effect to resale price maintenance, whether directly or indirectly, e.g. by withholding supplies from dealers

[197] *Falcke* v. *Grey* (1859) 4 Drew 651; *Erskine Macdonald Ltd.* v. *Eyles* [1921] 1 Ch. 631, 641. See also *Swiss Bank Corp.* v. *Lloyd's Bank Ltd.* [1982] A.C. 584, at pp. 598, 613 (contract did not create charge over property).

[198] *De Mattos* v. *Gibson* (1858) 4 De G. & J. 276, *per* Knight Bruce L.J. at p. 282.

[199] *Post*, p. 435.

[200] *Law Debenture Trust Cpn.* v. *Ural Caspian Oil Cpn. Ltd.* [1993] 1 W.L.R. 138, *per* Hoffmann L.J., at p. 144, reversed on other grounds [1995] Ch. 152.

[201] *McGruther* v. *Pitcher* [1904] 2 Ch. 306. See also *Taddy* v. *Sterious & Co.* [1904] 1 Ch. 354.

[202] Re-enacting the Resale Prices Act 1964. Resale price maintenance may also be unlawful under Article 85(1) of the European Community Treaty if it tends to isolate a national market: see *ante*, p. 373. Note that it is proposed to replace the United Kingdom legislation by prohibitions closely based on those in Article 85(1): Competition Bill 1997, clause 2.

[203] Resale Prices Act 1976, s. 14.

who undercut the stipulated price. But if an exemption order is obtained, then any resale price maintenance contract or agreement between a supplier and a dealer relating to those goods is valid and binding. Moreover, section 26(2) of the Act enacts, in respect of a condition which is not unlawful under the Act as to the price at which goods may be resold:

> Where goods are sold by a supplier subject to such a condition either generally or by or to a specified class or person, that condition may be enforced by the supplier against *any person who is not party to the sale* and who subsequently acquires the goods with notice of the condition, as if that person had been a party to the sale.

Thus a person who acquires goods for the purpose of resale in the course of business with notice of a valid price maintenance condition will be bound by it.[204] Failure to observe the condition may be restrained at the suit of the supplier in addition to any further relief to which the supplier may be entitled.[205]

(ii) Intellectual property

Patents

A patentee has by statute the sole right to make, use, exercise, and vend an invention; and no other person has the right to sell the patented article except under licence from the patentee, and subject to any conditions attached to the licence.[206] But section 10 of the Resale Prices Act 1976 has substantially curtailed the rights of a patentee to attach resale price maintenance conditions to goods. Certain other restrictive conditions, in agreements for sales by a direct licensee or assignee, for instance 'tie-in' clauses providing that the patented article is only to be used for manufacture with supplies purchased from the patentee, are rendered void by section 44 of the Patent Act 1977 unless the patentee is willing to supply or license the patented article on reasonable terms and without any such condition.[207] Of perhaps greater significance in practice are the requirements of European Community law to which patent licences and licensing agreements are subject. Licence agreements or assignments containing such restrictive conditions which may affect trade between Member States may be void under Article 85 of the European Community Treaty.[208]

Copyright

The owner of the copyright in literary, dramatic, musical, or artistic works has a statutory right to prevent it being copied, published, broadcasted, or infringed in certain other ways by any unauthorized person.[209] A signed agreement to transfer the copyright in a work not yet in existence will vest legal ownership in the transferee as soon as the work is created if there is no other person with a

[204] *County Laboratories Ltd.* v. *J. Mindel Ltd.* [1957] Ch. 295; *Goodyear Tyre & Rubber Co. (Great Britain) Ltd.* v. *Lancashire Batteries Ltd.* [1958] 1 W.L.R. 857.

[205] Resale Prices Act 1976, s. 26(5).

[206] *Columbia Graphophone Ltd.* v. *Murray* (1922) 39 R.P.C. 239; *Dunlop Rubber Co. Ltd.* v. *Long Life Battery Depot* [1958] 1 W.L.R. 1033.

[207] The person supplied or licensee may relieve himself of liability by payment of reasonable compensation: s. 44(4).

[208] For discussion of this and the exceptions under Article 85(3), see Whish, *Competition Law*, 3rd edn. (1993), pp. 240, 631–69 and see *ante*, p. 377.

[209] Copyright, Designs and Patents Act 1988. See generally Cornish, *Intellectual Property*, 3rd edn. (1996), Part IV.

superior equity.[210] It has been held that a publisher who is granted a contractual option in respect of the future work of an author may restrain another publisher who, although not a party to the contract, with knowledge of the circumstances subsequently contracts with the author to publish the work.[211]

(iii) Bailment

Bailment

Bailment involves the transfer of possession (or an agreement to transfer possession) of goods to a person (the 'bailee') who holds (or agrees to hold) the goods either for or at the direction of the bailor, to whom they will be returned.[212] The hirer of a car is a bailee as is the dry cleaning firm which takes in a customer's clothes for cleaning. In many situations there will be a series of bailments and the question is whether, if the ultimate sub-bailee loses or damages the goods and is sued by the bailor either in tort or for breach of duties arising from the bailment,[213] it can rely on the terms of the contract it made with its immediate bailor as a defence. In *Morris* v. *C. W. Martin & Sons Ltd.*:[214]

The plaintiff sent a mink stole to a furrier to be cleaned. The furrier did not clean furs himself, so, with the plaintiff's consent, he delivered it for cleaning to the defendant, one of whose servants later stole it. The contract between the furrier and the defendant contained an exemption clause, on which the defendant sought to rely.

Express or implied consent to conditions

On the facts the exemption clause was held not to apply, but Lord Denning M.R. said that, had it applied, in principle the defendant could have relied on it. The plaintiff would be bound by the conditions if she had expressly or impliedly consented to the furrier making a sub-bailment containing those conditions. Since she had agreed that the furrier should send the stole to the defendant, she impliedly consented to his making a contract for cleaning on the terms current in the trade.[215]

In *K. H. Enterprise* v. *Pioneer Container*[216] this principle was applied to a contract for the carriage of goods by sea:

The plaintiff contracted for the carriage of goods from Taiwan to Hong Kong. The carrier was permitted to sub-contract 'on any terms' and did so to the defendant who took possession of the goods under bills of lading providing that any dispute was exclusively to be determined in Taiwan. The goods were lost and the plaintiff sued in Hong Kong, contending that it was not bound by the exclusive jurisdiction clause because there was no contract between it and the defendants.

The Judicial Committee of the Privy Council stated that a person who voluntarily takes another person's goods into its custody holds them as bailee of that person (the owner) even if he does so without the owner's consent but can only

[210] *Intellectual Property*, 3rd edn. (1996), Part IV, s. 91.
[211] *Erskine Macdonald Ltd.* v. *Eyles* [1921] 1 Ch. 631.
[212] *Palmer on Bailment*, 2nd edn. (1991); *Chitty on Contracts*, 27th edn. (1994), para. 32-001 ff.
[213] For instance, only to deal with the goods in the manner authorized.
[214] [1966] 1 Q.B. 716.
[215] *Ibid.*, at p. 729. See also Salmon L.J. at p. 741. See also *Singer Co. (U.K.) Ltd.* v. *Tees and Hartlepool Port Authority* [1988] 2 Lloyd's Rep. 164; *The Captain Gregos (No. 2)* [1990] 2 Lloyd's Rep. 395, at p. 405.
[216] [1994] 2 A.C. 324.

invoke the terms of the sub-bailment under which he received the goods from an intermediate bailee (here the carrier) as qualifying his responsibility if the owner consented to them.[217] It held that consent to sub-contract and therefore to sub-bail 'on any terms' was wide enough to be express consent to the clause and the plaintiff was bound by it.

(iv) Ships under charterparty

In *Lord Strathcona Steamship Co. Ltd.* v. *Dominion Coal Co. Ltd.*:[218]

Restrictions on the use of chartered ships

The D Co. had a long-term time charterparty of a ship. The owners sold the ship, which eventually came into the possession of the LS Co., who took it with notice of the charterparty and on the understanding that the agreement should be honoured. They did not honour the agreement, and, when sued by the charterers, D Co. pleaded that they were not bound by the charterparty as there was no privity of contract between them.

The Judicial Committee of the Privy Council upheld the decision of the Courts in Nova Scotia granting the charterers an injunction restraining the LS Co. from using the ship inconsistently with the charterparty. The Board relied upon the *dictum* of Knight Bruce L.J. in *De Mattos* v. *Gibson* quoted *supra*.[219] The case was said to fall under the rule in *Tulk* v. *Moxhay* relating to the use of land: whether the subject-matter was land or a chattel, the principle is the same: 'the remedy is a remedy in equity by way of injunction against acts inconsistent with the covenant, with notice of which the land was acquired'.[220]

Criticism of reasoning in *Strathcona* case

This reasoning has, however, been the subject of considerable criticism,[221] and it has been said that the case was wrongly decided.[222] In the first place, it is argued that reliance should not have been placed on the *dictum* of Knight Bruce L.J. In *De Mattos* v. *Gibson* an interlocutory injunction was granted to restrain the mortgagee of a ship, who had acquired his mortgage with knowledge of an existing voyage charterparty, from interfering with the performance of the charter. Knight Bruce L.J.'s reasoning did not, however, form part of the concurring judgment of Turner L.J. and has been doubted.[223] When the case came before Lord Chelmsford L.C.,[224] a final injunction was refused.[225] Although the Lord Chancellor expressed the opinion that the mortgagee was bound to abstain from any act which would have the immediate effect of preventing performance of the charter, he appeared to do so on the ground that any right to an injunction was based on an extension of the principle whereby a person who knowingly induces

[217] *Ibid.*, at p. 342 disapproving *Johnson Matthey & Co. Ltd.* v. *Constantine Terminals Ltd.* [1976] 2 Lloyd's Rep. 215. The principles in *'The Pioneer Container'* were applied in *Somcare International Ltd.* v. *East Anglia Freight Terminal Ltd.* [1997] 2 Lloyd's Rep. 48 and *Spectra International plc* v. *Hayesoak Ltd.* [1997] 1 Lloyd's Rep. 153.

[218] [1926] A.C. 108.

[219] *Ante*, p. 432.

[220] [1926] A.C. 108, at p. 119.

[221] *Greenhalgh* v. *Mallard* [1943] 2 All E.R. 234, at p. 239.

[222] *Port Line Ltd.* v. *Ben Line Steamers Ltd.* [1958] 2 Q.B. 146, at p. 168.

[223] *London County Council* v. *Allen* [1914] 3 K.B. 642, at p. 658; *Barker* v. *Stickney* [1919] 1 K.B. 121, at p. 132.

[224] (1859) 4 De G. & J. 288.

[225] On the ground that the mortgagee had not interfered with performance of the charter until it was evident that the shipowner was wholly unable to perform it (at pp. 299–300).

one party to break its contract with another is liable to that other in tort in respect of any loss which may have been suffered by the breach.[226]

Secondly, in so far as the Judicial Committee in the *Strathcona* case drew an analogy with the rule in *Tulk* v. *Moxhay*, this too will not bear examination. We have seen that the *Tulk* v. *Moxhay* rule is not now dependent upon notice of the restrictive covenant alone, but upon the ownership of neighbouring land for the benefit of which the covenant was imposed: the person seeking to enforce the covenant must have a continuing proprietary interest in its enforcement.[227] But a charterer under a voyage or time charterparty (even if of long duration) only has a personal right that the shipowner should continue to use the ship to perform the services which he has covenanted to perform. The charterer has no proprietary interest in the subject-matter of the contract, the ship.[228]

Although the principle stated by Knight Bruce L.J. in *De Mattos* v. *Gibson* has subsequently been applied in cases of the mortgage of ships subject to a charterparty[229] these are open to the same criticisms. The better view is that any right of the charterer to an injunction to restrain use of the ship inconsistently with his charterparty arises if, but only if, the conduct of the purchaser is such as to constitute the tort of knowing interference with the charterer's contractual rights.[230]

Alternative explanations

There may, moreover, be alternative explanations for the decision in the *Strathcona* case. One is that there was an implied contract between the third party and the charterers, or a 'novation' of the original agreement,[231] for the Board pointed out: 'This is not a mere case of notice of the existence of a covenant affecting the use of the property sold, but it is the case of the acceptance of their property expressly *sub conditione*'.[232] Alternatively, there is some ground for saying that the third party was in the position of a 'constructive trustee'[233] with obligations which a Court of Equity would not permit it to violate.[234]

Scope of the decision

With these reservations in mind, we have now to consider the scope of the decision. This was considered in *Port Line Ltd.* v. *Ben Line Steamers Ltd.*:[235]

[226] *Lumley* v. *Gye* (1853) 3 E. & B. 216. See also Wade (1926) 42 L.Q.R. 139; *The Lord Strathcona* [1925] P. 143; *post*, n. 230.

[227] See *ante*, p. 423.

[228] *Port Line Ltd.* v. *Ben Line Steamers Ltd.* [1958] 2 Q.B. 146, *per* Diplock J. at p. 166. Unless it is a charterparty by demise, when the charterer could be said to acquire a 'possessory interest' in the vessel: see *Baumwoll Manufacturer Von Carl Scheibler* v. *Furness* [1893] A.C. 8. See also *Lorentzen* v. *White Shipping Co. Ltd.* (1943) 74 Ll. L.R. 161.

[229] *Messageries Imperiales* v. *Baines* (1863) 7 L.T. 763; *The Celtic King* [1894] P. 175.

[230] *Lumley* v. *Wagner* (1852) 1 De G.M. & G. 604. See also *Torquay Hotel Co. Ltd.* v. *Cousins* [1969] 2 Ch. 106; *Acrow Ltd.* v. *Rex Chainbelt Inc.* [1971] 1 W.L.R. 1676; *Law Debenture Trust Cpn.* v. *Ural Caspian Oil Cpn. Ltd.* [1995] 152. In *Swiss Bank Cpn.* v. *Lloyd's Bank Ltd.* [1979] Ch. 548, at p. 573 (reversed [1982] A.C. 584), Browne-Wilkinson J. stated that the principle of Knight Bruce L.J. represented 'the counterpart in equity of the tort of knowing interference with contractual rights'. But although they may cover the same ground they are doctrinally distinct and subject to different requirements: see Cohen-Grabelsky (1982) 45 M.L.R. 241, at pp. 265–7; Gardner (1982) 98 L.Q.R. 279, at pp. 289–93; Tettenborn [1982] C.L.J. 58, at p. 82.

[231] See *post*, p. 462.

[232] [1926] A.C. 108, at p. 116.

[233] See *ante*, pp. 419–20.

[234] [1926] A.C. 108, at p. 125. See also *Swiss Bank Cpn.* v. *Lloyd's Bank Ltd.* [1979] Ch. 548, at p. 573 (reversed [1982] A.C. 584).

[235] [1958] 2 Q.B. 146.

The M.V. *Port Stephens* was chartered to the plaintiff by its owner, Silver Line Ltd., on a gross time charter for 30 months from March 1955. In February 1956, Silver Line sold the vessel to the defendant, it being agreed that the defendant should immediately charter the ship back to Silver Line by demise in order that it might fulfil its contract with the plaintiff. Unfortunately, this second charterparty contained the term that 'If the ship be requisitioned this charter shall thereupon cease', although no such clause appeared in the original time charterparty. The defendant was unaware of this disparity. In August 1956 the ship was requisitioned by the Crown, and as a result the plaintiff lost the use of the vessel. Its claim against Silver Line was settled, but it then brought an action against the defendant to recover the whole or part of the compensation received by the defendant from the Crown in respect of the period of requisition.

Diplock J. stated that the *Strathcona* case was wrongly decided, but held that even if it was correct the plaintiff could not bring its claim within its principles, as the defendant had no knowledge at the time of its purchase of the plaintiff's rights under the time charter. The principle in the *Strathcona* case thus only applies where there is actual knowledge by the subsequent purchaser at the time of the purchase of the charterer's rights.[236] Constructive notice is insufficient.[237] Moreover, Diplock J. considered that, even if notice had been shown, (1) the defendant was in no breach of duty to the plaintiff since it was by no act of its that the vessel during the period of requisition was used inconsistently with the terms of the plaintiff's charter—it was by act of the Crown by title paramount—and (2) the plaintiff was not entitled to any remedy against the defendant except an injunction to restrain the defendant from using the vessel in a manner inconsistent with the terms of the charter.[238]

The charterer cannot obtain specific performance of the contract,[239] nor, it seems, damages or monetary compensation.[240] It would also seem that the Court will not be prepared to grant an injunction if the situation is such that, in any case, the vendor was incapable of further performing the charterparty,[241] or if, in the case of the mortgage of a vessel, the charter is such as substantially to impair the security.[242]

(v) Restrictions on the use of other chattels

Restrictions on the use of other chattels

There is even more doubt as to whether the principle stated by Knight Bruce L.J. in *De Mattos* v. *Gibson*, and the decision in the *Strathcona* case, would apply to contracts under which the owner of a particular chattel, other than a ship,

[236] [1958] 2 Q.B. 146, at p. 168.

[237] The doctrine of constructive notice does not apply to chattels (*Joseph* v. *Lyons* (1884) 15 Q.B.D. 280, at p. 287) nor to the contents of documents in commercial transactions (*Manchester Trust* v. *Furness* [1895] 2 Q.B. 539, at p. 545).

[238] *Port Line Ltd.* v. *Ben Line Steamers Ltd.* [1958] 2 Q.B. 146, at p. 167.

[239] *De Mattos* v. *Gibson* (1858) 4 De G. & J. 277, at p. 297.

[240] Although the form of the order made in the *Strathcona* case would seem to indicate that damages could be awarded, cf. *Port Line Ltd.* v. *Ben Line Steamers Ltd.* (*supra*, n. 238), at p. 169; *Law Debenture Trust Cpn.* v. *Ural Caspian Oil Cpn. Ltd.* [1993] 1 W.L.R. 138, at pp. 144; reversed on another ground [1995] Ch. 152.

[241] *The Lord Strathcona* [1925] P. 143. See also *ante*, p. 435, n. 225.

[242] *The Celtic King* [1894] P. 175.

undertakes to use the chattel to perform its obligations to the other contracting party: for example, where the owner of a costly machine[243] agrees to use the machine to manufacture goods for the other party over a certain period. In *De Mattos* v. *Gibson* Lord Chelmsford L.C. stressed that 'a vessel engaged under a charterparty ought to be regarded as a chattel of peculiar value to the charterer',[244] and it has been said that the *Strathcona* decision may be confined to 'the very special case of a ship under charterparty'.[245] Nevertheless, there would seem to be no reason why the immediate purchaser of a chattel should not be restrained by injunction if it commits or threatens to commit the tort of knowing interference with such a contract.[246] The same would probably apply to any covenant by the owner of a chattel to use[247] or not to use[248] the chattel in a particular manner. But the relief granted against the third party purchaser would depend upon the fact of tortious interference, and not upon notice of any 'interest' in the chattel.

Moreover, it is highly unlikely that any covenant affecting the use of a chattel would be held to 'run with the goods', so as to bind all persons who subsequently purchased the chattel with notice of the covenant.[249] There are good reasons why land-owners should be entitled to prevent neighbouring land from being put to a use that would be prejudicial to their property. But no such reasons would justify the imposition of incumbrances on chattels.

(vi) Hire-purchase and hire

There is no authority as to whether a hire-purchase agreement, under which a chattel is bailed to the hirer with an option to purchase the chattel once all the instalments have been fully paid, will be binding on a third party purchaser of the chattel from its owner. But since such an agreement confers upon the hirer a possessory interest in the chattel and has been said to confer a proprietary interest,[250] the better view is that the purchaser is bound, at least if he or she has notice of the agreement but possibly where there is no such notice.[251] The same principle could possibly apply to a simple bailment for hire.

[243] *De Mattos* v. *Gibson* (1858) 4 De G. & J. 288, *per* Knight Bruce L.J. at p. 283.
[244] (1859) 4 De G. & J. 288, at p. 299.
[245] *Clore* v. *Theatrical Properties Ltd.* [1936] 3 All E.R. 483, *per* Lord Wright M.R. at p. 490.
[246] See Cohen-Grabelsky (1982) 45 M.L.R. 241; Gardner (1982) 98 L.Q.R. 279; Tettenborn [1982] C.L.J. 58.
[247] *Sefton* v. *Tophams Ltd.* [1965] Ch. 1140 (land). But see *Clarke* v. *Price* (1819) 2 Wils. Ch. 157; *Haywood* v. *Brunswick Permanent Benefit Building Socy.* (1876) 3 Ch. D. 694.
[248] *British Motor Trade Association* v. *Salvadori* [1949] Ch. 556 (covenant not to re-sell chattel). See also *Esso Petroleum Co. Ltd.* v. *Kingswood Motors (Addlestone) Ltd.* [1974] Q.B. 142 (land); *Law Debenture Trust Cpn.* v. *Ural Caspian Oil Cpn. Ltd.* [1995] Ch. 152 (shares).
[249] *Taddy* v. *Sterious & Co.* [1904] 1 Ch. 354; *McGruther* v. *Pitcher* [1904] 2 Ch. 306; *ante*, p. 431.
[250] *Whiteley Ltd.* v. *Hilt* [1918] 2 K.B. 808, at pp. 817, 818, 822.
[251] Goode, *Hire Purchase Law and Practice*, 2nd edn. (1975), p. 35.

III. Exemption Clauses and Third Parties[252]

(a) Benefit to Third Parties

Benefit to third parties

We have noted that problems arise where a contracting party (A) seeks exemption from liability to the other party to the contract (B) for persons who are not parties to the contract, for example, its employees or sub-contractors who participate in the performance of the contract. We have seen that A's employees and sub-contractors, although not in a contractual relationship with B, may nevertheless be under duties to B imposed by the law of tort or the law of bailment. If the employees or independent contractors are not able to rely on the exemption clause as a defence to an action by B, they in turn may have a right to be indemnified by A. Even where there is no right to be indemnified, A may, particularly in the case of employees, nevertheless agree to meet the damages awarded to B.[253] In both cases the risk is ultimately borne by A, thus defeating the purpose of the exemption clause. Whether or not it is A who ends up paying, permitting B to succeed against the employees or independent contractors will in many cases upset the allocation of risks and consequent pattern of insurance in the transaction, since A and its employees and independent contractors will have expected B to insure against the relevant loss and not done so themselves.[254] Nevertheless such attempts to rely on exemption clauses have encountered great difficulties, primarily because A's employees or sub-contractors are not parties to the contract, but also because they will normally have furnished no consideration for the promise.[255] The tension between the doctrine of privity of contract and the commercial expectations of those who take part in multiparty transactions has produced a very complicated body of law. At times the courts have applied the doctrine[256] and have prevented a defendant relying on an exemption clause. At other times, and particularly more recently, they have been willing to circumvent the doctrine and even to contemplate some form of modification or exception to it with regard to exemption clauses.

But first, the operation of the doctrine of privity in such cases. In *Cosgrove* v. *Horsfall*:[257]

[252] See Law Com. No. 242 *Privity of Contract: Contracts for the Benefit of Third Parties* (1996), §§ 2.19–2.35.

[253] *Adler* v. *Dickson* [1955] 1 Q.B. 158.

[254] For example where there is a limitation clause, the non-party performer would be expected to insure up to the limit and the contracting party (B) beyond that: see *Scruttons Ltd.* v. *Midland Silicones Ltd.* [1962] A.C. 446, *post*, p. 440, where the non-party stevedores only agreed to take out insurance in excess of a $500 limitation where that limitation did not apply, *per* Lord Denning at p. 482. See also *The Mahkutai* [1996] A.C. 650; *London Drugs Ltd.* v. *Kuehne & Nagel International Ltd.* [1992] 3 S.C.R. 299, *per* Iacobucci J. at p. 423.

[255] *Ante*, p. 95.

[256] If the true doctrine is as stated by Lord Haldane in *Dunlop Pneumatic Tyre Co. Ltd.* v. *Selfridge & Co. Ltd.* [1915] A.C. 847, at p. 853, *ante*, p. 408, that 'only a person who is a party to a contract can *sue on it*' (emphasis added), it is arguable that a defendant seeking to rely on an exemption clause, is not within the doctrine.

[257] (1945) 62 T.L.R. 140. See also *Adler* v. *Dickson* [1955] 1 Q.B. 158; *Genys* v. *Matthews* [1966] 1 W.L.R. 758. Cf. *Gore* v. *Van de Lann* [1967] 2 Q.B. 31; *Buckpitt* v. *Oates* [1968] 1 All E.R. 1145.

The plaintiff was employed by the London Passenger Transport Board. He was given a free pass by the Board to travel on their omnibuses free of charge, but the pass contained a condition that 'neither the Board *nor their servants* were to be liable to the holder for any injury however caused'. The plaintiff suffered personal injuries as the result of the negligence of the defendant, a bus driver and a servant of the Board. Having no remedy against the Board, he sued the defendant personally.

The Court of Appeal held that the defendant was liable. He could not claim the benefit of the exemption clause as he was not a party to the agreement.

Again, in *Scruttons Ltd.* v. *Midland Silicones Ltd.*:[258]

A drum of chemicals was shipped from New York to London, consigned to the respondents upon the terms of a bill of lading which exempted the carriers from liability in excess of $500 (£179) per package. The drum was damaged by the negligence of the appellants, a firm of stevedores employed by the carriers, and the damage amounted to £593. Although the appellants were not a party to the bill of lading, nor expressly mentioned therein, they claimed to be entitled to the benefit of the clause limiting liability.

In the House of Lords, Lord Denning considered that the appellants were protected by an accepted principle of the law of tort, that of voluntary assumption of risk, since the respondents had assented to the limitation of liability. But the majority of their Lordships unequivocally reasserted the doctrine of privity of contract. They held that the appellants could not claim the benefit of an exemption clause in a contract to which they were not a party.[259]

(b) Burden on Third Parties

Burden on third parties

A similar problem arises in relation to the burden of an exemption clause. It is a trite principle of law that a person who is not a party to a contract cannot be subjected to the burden of that contract. So, at common law, an exemption clause will, as a general rule, only operate so as to take away the rights of the contracting parties, and not those of third parties who suffer injury or damage. In *Haseldine* v. *C. A. Daw & Son Ltd.*:[260]

The owners of a block of flats employed the defendant engineers to repair a lift in the building. Owing to their negligence, the lift was badly repaired and the plaintiff, a visitor to the premises, was injured when the lift fell to the bottom of the lift-shaft.

The defendant was held liable in tort for negligence. Goddard L.J. said:[261]

[258] [1962] A.C. 446.

[259] Article IV *bis* (2) of the Hague Rules (as amended), contained in the Schedule to the Carriage of Goods by Sea Act 1971, now extends protection to the servants and agents (but not independent contractors) of the carrier in respect of loss or damage to goods covered by a contract of carriage of goods by sea to which the Rules apply.

[260] [1941] 2 K.B. 343. By the Occupiers Liability Act 1957, s. 3(1), a contract made by an occupier of premises may increase its liability to non-parties beyond the common duty of care but may not reduce it below that duty. Cf., at common law, *Fosbroke-Hobbes* v. *Airwork Ltd.* [1937] 1 All E.R. 108, at p. 112.

[261] At p. 379.

It is, however, argued that it is not right that a repairer who, as in the present case, has stipulated with the person who employs him that he shall not be liable for accidents, should none the less be made liable to a third person. The answer to this argument is that the duty to the third party does not arise out of the contract, but independently of it.

We have seen[262] that this reasoning is of special importance where a person bails goods to another in order that they may be carried or worked on by the bailee. In turn, the bailee may sub-contract the task of carrying the goods or working on them to a sub-bailee. If the contract between the bailee and sub-bailee contains exemption clauses which exonerate the sub-bailee from liability, the bailor will not automatically be bound. The sub-bailee will not be protected against the bailor, who is not a party to the contract, unless the bailor expressly or impliedly consented to the bailee making a sub-bailment containing those conditions.[263]

Avoidance of doctrine

At one time the proposition was advanced that where a contract contained an exemption clause, any employee or agent while performing the contract was entitled to the same immunity from liability as the employer or principal.[264] But this principle of 'vicarious immunity' was rejected by the House of Lords in *Scruttons Ltd.* v. *Midland Silicones*.[265] There are, however, a number of ways in which the doctrine of privity may be avoided. The willingness of the Courts to do so has varied. The application of the doctrine in some cases can be seen as part of the process by which Courts sought to alleviate the position of those affected by onerous terms,[266] for instance clauses seeking to exclude liability for personal injury resulting from negligence, now prohibited by statute.[267] The reluctance to save negligent people from the normal consequences of their fault, however, extended beyond such cases and may have influenced the decision in *Scruttons Ltd.* v. *Midland Silicones Ltd.*[268] Since that decision, however, the perceived need to support established commercial practice and to avoid redistributing the risks of transactions has led to greater judicial dissatisfaction with the operation of privity in such situations and a greater willingness to avoid the operation of the doctrine.

Promise not to sue

Where the contract containing the exemption clause can be construed as a promise by the plaintiff not to sue the third party defendant, if the contracting party intervenes in the proceedings to protect the defendant, the Court may stay or dismiss the plaintiff's claim.[269] Apart from this there are two methods of avoiding the privity doctrine; a contractual route and what can broadly be termed a tortious route. The contractual route involves the identification of a second contract between the plaintiff (B) and the person wishing to rely on the exemption clause.

[262] *Ante*, p. 434.

[263] *K. H. Enterprise* v. *Pioneer Container* [1994] 2 A.C. 324, *ante*, p. 434.

[264] *Elder Dempster & Co. Ltd.* v. *Paterson, Zochonis & Co. Ltd.* [1924] A.C. 522, *per* Viscount Cave at p. 534. See also p. 548 (Viscount Finlay) and [1923] 1 K.B. 436, at p. 441 (Scrutton L.J.).

[265] [1962] A.C. 446.

[266] *Ante*, pp. 165, 177.

[267] *Cosgrove* v. *Horsfall* (1945) 62 T.L.R. 140 and the cases cited *ante*, p. 439, n. 257 concerned such clauses. See now the Unfair Contract Terms Act 1977, s. 2, *post*, p. 186.

[268] See [1962] A.C. 446, at p. 472 (*per* Viscount Simonds), relying on *Wilson* v. *Darling Island Stevedoring & Lighterage Co. Ltd.* (1956) 95 C.L.R. 43, at p. 78 (*per* Fullagar J.). See also *The Mahkutai* [1996] A.C. 650, *per* Lord Goff at p. 660.

[269] See *ante*, p. 415.

The second route is based on the exemption clause showing that the plaintiff (B), in its contract with A, assumed the risk of damage or loss resulting from the negligence of the defendant so as to qualify or negate the defendant's tortious duty of care to it or, more narrowly, the duty created by virtue of the defendant being a bailee or sub-bailee of goods. In its wider form this was not favoured by the majority in *Scruttons Ltd.* v. *Midland Silicones Ltd.* but has since attracted some support.[270]

Agency

The Courts may be able to imply that a party (A) to a contract containing an exemption clause which is intended to benefit third parties such as its employees or sub-contractors was either acting as agent for the third parties or as agent for the other party to the contract (B) so as to create a direct contractual relationship between B and the employees or sub-contractors.

This device was first employed during the nineteenth century, when England was (as it is again) covered by a network of small railway companies and a contract made with one might entitle the holder of a ticket to travel on one or more of them. In such circumstances, the passenger was not allowed to say that only the company which was a party to the primary agreement was protected by the exemption clauses contained in it. The Courts were ready to find either that the contracting company was acting as agent for the other companies,[271] or that it was acting as agent for the passenger.[272] The passenger was thus brought into a direct contractual relationship with the other companies. In reliance on the principle of agency many enterprises have framed contractual clauses designed to protect their employees and sub-contractors from liability.

In *Scruttons Ltd.* v. *Midland Silicones Ltd.*,[273] the House of Lords left open the question whether the stevedores could have been protected if the carriers had contracted as agents on their behalf. Lord Reid said:[274]

> I can see a possibility of success of the agency argument if (first) the bill of lading makes it clear that the stevedore is intended to be protected by the provisions in it which limit liability, (secondly) the bill of lading makes it clear that the carrier, in addition to contracting for these provisions on his own behalf, is also contracting as agent for the stevedore that these provisions should apply to the stevedore, (thirdly) the carrier has authority to do that, or perhaps later ratification by the stevedore would suffice, and (fourthly) that any difficulties about consideration moving from the stevedore were overcome.

Contract by performing specified act

These four conditions were held to have been satisfied in *New Zealand Shipping Co. Ltd.* v. *A. M. Satterthwaite & Co. Ltd. (The Eurymedon)*,[275] where the bill of lading contained a clause by which the carrier, as agent of the stevedore, stipulated that both he and the stevedore should be entitled to the limitation of liability contained in the bill. The Judicial Committee of the Privy Council held that the stevedore had furnished consideration by unloading the goods under its con-

[270] See *Pacific Associates* v. *Baxter* [1990] 1 Q.B. 933, at p. 1011 (Purchas L.J.); *Norwich City Council* v. *Harvey* [1989] 1 W.L.R. 828; *Marc Rich & Co. AG* v. *Bishop Rock Marine Co. Ltd. (The Nicholas H)* [1996] A.C. 211 *per* Lord Steyn at pp. 239–40, *post* p. 445.

[271] *Hall* v. *N.E. Ry.* (1875) L.R. 10 Q.B. 437, at p. 442.

[272] *Ibid.*, at p. 443.

[273] [1962] A.C. 446; *ante*, p. 440.

[274] At p. 474.

[275] [1975] A.C. 154.

tract with the carrier.[276] The contract was, however, only established by somewhat artificially[277] identifying an offer to the stevedore in the contract between the carrier and the shipper,[278] and it will not be possible to do so in all cases. The carrier may not have authority to act as agent of the stevedore and, although in the majority of cases this may be solved by recourse to the principle of ratification,[279] this may not always be possible.[280] Again, the person seeking the benefit of the exemption clause will only be held to have furnished consideration where it is performing the contract containing the exemption clause.[281] More fundamentally, the exclusion clause may not refer to the employee or sub-contractor.[282] Although, in cases of the carriage of goods by sea it has been said that stevedores would normally be protected and that Courts should not search for 'fine distinctions' which would diminish this general position,[283] this approach has not been applied in other contexts.[284] It is, moreover, inevitable, even in carriage of goods by sea, 'so long as the principle continues to be understood to rest upon an enforceable contract as between the cargo owners and the stevedores entered into through the agency of the shipowner, . . . that technical points of contract and agency law will continue to be invoked'.[285]

Implied contract

Alternatively, privity questions may be avoided by the implication of a contract between the plaintiff and the third party. The circumstances surrounding the transaction may justify the inference of a collateral contract between them. Again, this brings a plaintiff into a direct contractual relationship with the third party so that the third party is entitled to the benefit of the exemption clause. In *Pyrene Co. Ltd.* v. *Scindia Navigaton Co. Ltd.*:[286]

> The plaintiff sold to I.S.D. in India certain fire-tenders 'f.o.b. London'. The defendant agreed with I.S.D. to carry the tenders to India. The contract of carriage contained a clause limiting the liability of the defendant to £200. Owing to the negligence of the defendant, a tender was damaged while being loaded. But since it had not yet crossed the ship's side, it was still at the plaintiff's risk. The plaintiff made good the damage and sued the defendant for the loss, which amounted to more than £900.

[276] See *ante*, p. 103.

[277] See Reynolds (1974) 90 L.Q.R. 301; Coote (1974) 37 M.L.R. 453; Battersby (1978) 28 U. of Tor. L.J. 75.

[278] The plaintiff was in fact the consignee not the shipper. The consignee would be party to the offer made by the shipper to the stevedore either by statute (then the Bills of Lading Act 1855, now the Carriage of Goods by Sea Act 1992, s. 2) or by presenting the bill of lading to the ship and requesting delivery of the goods thereunder: *Brandt* v. *Liverpool Brazil & River Plate Navigation Co. Ltd.* [1924] 1 K.B. 575.

[279] *The Mahkutai* [1996] A.C. 650.

[280] *The Suleyman Stalskiy* [1976] 2 Lloyd's Rep. 609 (Sup. Ct. of British Columbia); *Lummus Co. Ltd.* v. *East African Harbours Cpn.* [1978] 1 Lloyd's Rep. 317, at pp. 322–3 (High Ct. of Kenya).

[281] *Raymond Burke Motors Ltd.* v. *The Mersey Docks and Harbour Co.* [1986] 1 Lloyd's Rep. 155 (goods damaged while they were being stored and not during loading or unloading).

[282] e.g. in *London Drugs Ltd* v. *Kuehene & Nagel International Ltd.* [1992] 3 S.C.R 299 the clause did not refer to warehouseman's employees.

[283] *Port Jackson Stevedoring Pty. Ltd.* v. *Salmond and Spraggon (Australia) Pty. Ltd.* [1981] 1 W.L.R. 138, at p. 144 (Lord Wilberforce). See Reynolds (1979) 95 L.Q.R. 183; Coote [1981] C.L.J. 13.

[284] *Southern Water Authority* v. *Carey* [1985] 2 All E.R. 1077, at p. 1084 (construction); *Kendall* v. *Morgan*, *The Times*, 2 December 1980 (employment).

[285] *The Mahkutai* [1996] A.C. 650, *per* Lord Goff, at p. 664.

[286] [1954] 2 Q.B. 402.

Devlin J. held that the plaintiff was bound by the exemption clause. Although it was not a party to the contract of carriage, it was entitled to the benefits of the contract and had in consequence also to accept its liabilities. In the *Midland Silicones* case, however, it was stated that this decision could be supported 'only upon the facts of the case, which may well have justified the implication of a contract between the parties'.[287] It may therefore be an example of an implied contract, that is to say, all three parties intended the plaintiff to participate in the contract of affreightment.

Where the third party is brought into a direct contractual relationship with one of the parties to the contract by reason of the device of agency or of an implied contract, the exemption clause relied on will be controlled by statute, in particular the Unfair Contract Terms Act 1977,[288] unless the contract between them is one which is not subject to the control of the legislation.[289]

Assumption of risk; negation of duty

Turning to the non-contractual route, the majority in *Scruttons Ltd.* v. *Midland Silicones*[290] rejected Lord Denning's powerful reasoning based on the general defence to actions in tort where a plaintiff has voluntarily consented to take the risk of a loss or injury. But we have noted that in the case of bailment a similar principle may protect an employee or sub-contractor. Where a bailor bails goods to a bailee who in turn sub-bails them to third party who damages them, the third party may be able to rely on the terms on which the goods were sub-bailed to it as a defence to an action by the bailor, provided the bailor has expressly or impliedly consented to the bailee making the sub-bailment containing the exemption clause.[291] Where this is so the bailor is bound by an exemption clause in a contract to which it is not a party. A defendant who is sued in tort may also rely on an exclusion clause in a contract to which the plaintiff but not the defendant is a party as restricting or excluding the duty of care that it would otherwise owe to the plaintiff. Where this is so the defendant is taking the benefit of an exemption clause in a contract to which it is not a party. So, in *Pacific Associates Inc.* v. *Baxter*[292] a consultant engineer successfully defended a claim for negligence by the contractor by relying on a term of the contract between the employer and the contractor which provided that neither the engineer nor any of his staff 'shall be in any way personally liable for the acts or obligations under the contract . . .'.

[287] [1962] A.C. 466, *per* Viscount Simonds at p. 471, and see p. 470 where *Elder Dempster & Co. Ltd.* v. *Paterson, Zochonis & Co. Ltd.* [1924] A.C. 522 was similarly explained. See also *Hispanica de Petroleos S.A.* v. *Vencedora Oceanica S.A. (The Kapetan Markos N.L.) (No. 2)* [1987] 2 Lloyd's Rep. 321, at p. 331; *Comp. Portorafti Comm. S.A.* v. *Ultramar Panama Inc. (The Captain Gregos) (No. 2)* [1990] 2 Lloyd's Rep. 395, at pp. 401–3.

[288] See *ante*, p. 182.

[289] See *ante*, p. 183.

[290] [1962] A.C. 446. See also *Leigh & Sillavan Ltd.* v. *Aliakmon SS. Co. Ltd.* [1986] A.C. 785, *per* Lord Brandon at p. 817 but cf. Robert Goff L.J. [1985] Q.B. 350 at p. 399. Cf. also the cases considered *infra*.

[291] *K. H. Enterprise* v. *Pioneer Container* [1994] 2 A.C. 324 *ante*, p. 434. The position would appear to be the same whether or not the original bailment is a contract. Where it is a contract there may well be an implied contract between the bailor and the sub-bailee; *ante*, p. 443, but note that it has been said that the relationship between bailor and sub-bailee cannot aptly be described as depending on agreement: *Dresser U.K. Ltd.* v. *Falcongate Freight Management Ltd.* [1992] 1 Q.B. 502, *per* Bingham L.J. at p. 509.

[292] [1990] 1 Q.B. 933. See also *Southern Water Authority* v. *Carey* [1985] 2 All E.R. 1077.

Purchas L.J. stated that 'the presence of such an exclusion clause, while not directly binding between the parties, cannot be excluded from a general consideration of the contractual structure against which the contractor demonstrates reliance on, and the engineer accepts responsibility for, a duty in tort, if any, arising out of the proximity established between them by the existence of that very contract'. The contractual structure may be relevant even where there is no express provision seeking to exempt the third party. In *Norwich C.C.* v. *Harvey*:[293]

A building was damaged by fire as a result of the negligence of a roofing sub-contractor. The main contract provided that the building owner was to bear the risk of damage by fire and the sub-contractor contracted on the same terms and conditions as in the main contract. The owner of the building brought an action against the sub-contractor.

It was held that, although there was no direct contractual relationship between the owner and the sub-contractor, nevertheless they had both contracted with the main contractor on the basis that the owner had assumed the risk of damage by fire and the sub-contractor owed no duty in respect of the damage which occurred. It is not, however, necessary for the defendant's contract to contain the exemption clause; what is important is whether the recognition of a duty of care by the defendant would outflank the contractual structure governing dealings between the plaintiff and others.[294]

An exception to privity

The commercial inconvenience that results from the application of the doctrine of privity in the context of exemption clauses has led to the recognition in Canada of an exception whereby employees and sub-contractors acting in the course of their employment and performing the services provided for in the main contract can rely on an exemption clause in that contract which is intended to protect them.[295] There are indications that the artificiality and technical nature of the approach based on *New Zealand Shipping Co. Ltd.* v. *A. M. Satterthwaite (The Eurymedon)*[296] may incline the House of Lords to regard the development started in that decision as not yet complete and to recognize a fully-fledged exception to the doctrine of privity where a contract clearly provides that (for example) independent contractors such as stevedores are to have the benefit of exceptions and limitations contained in that contract.[297] It is hoped that this does occur. The

[293] [1989] 1 W.L.R. 828.

[294] *Marc Rich & Co. AG* v. *Bishop Rock Marine Co. Ltd. (The Nicholas H)* [1996] A.C. 211, *per* Lord Steyn at pp. 239–40 (if the cargo owner recovered from the defendant, a classification society, the cost of insuring against such claims would be passed on to shipowners and the contractual structure governing dealings between shipowners and cargo owners and the limitation of shipowners' liability would be destroyed). See also *Henderson* v. *Merrett Syndicates Ltd.* [1995] 2 A.C. 145, at p. 197.

[295] *London Drugs Ltd.* v. *Kuehene & Nagel International Ltd.* [1992] 3 S.C.R. 299. It may be more problematic to establish a clear intention to extend the protection of an exemption clause to an independent contractor than to an employee; *ibid.*, at p. 441.

[296] [1975] A.C. 154, *ante*, pp. 442–3.

[297] *The Mahkutai* [1996] A.C. 650, at p. 665 (but the exclusive jurisdiction clause was held not to be intended to benefit third parties). See also *Dresser U.K. Ltd.* v. *Falcongate Freight Management Ltd.* [1992] 1 Q.B. 502, *per* Bingham L.J. at p. 511 (describing the principle of bailment on terms as 'a pragmatic legal recognition of commercial reality'); *Privity of Contract: Contracts for the Benefit of Third Parties* Law Com. C.P. No. 121, (1991), §§ 4.8–4.12; Law Com. No. 242 (1996), § 2.19 ff.

reasons for and justifications of the privity doctrine do not, it is submitted, apply where a third party seeks to rely on a contractual provision as a defence; there is an identity of interest between the contracting party and the third party as far as the performance of the contracting party's contractual obligations is concerned, and it is commercially undesirable to allow a person to circumvent a contractual exclusion clause and thus redistribute the contractual allocation of risk by suing the employee or sub-contractor of the other party to the contract.[298]

[298] *London Drugs Ltd.* v. *Kuehene & Nagel International Ltd.* [1992] 3 S.C.R. 299, at pp. 440–7. For these reasons and justifications, see *ante*, pp. 179, 439 and *Privity of Contract: Contracts for the Benefit of Third Parties* Law Com. C.P. No. 121 (1991), § 4.3; Law Com. No. 242 (1996) §§ 2.33–2.35.