9 DISCHARGE FOR BREACH OF CONTRACT

The contractual terms determine the performance obligations of the parties. Since a failure to comply in full with a performance obligation, without lawful excuse, is a breach of contract, it is vital to know the standard of performance required.

SECTION 1: ABSOLUTE AND QUALIFIED CONTRACTUAL OBLIGATIONS

If a contractual obligation is strict, non-compliance will be a breach of contract irrespective of fault, e.g., the obligations imposed on sellers in sale of goods contracts by the Sale of Goods Act 1979, ss. 13–15, are strict.

Contractual obligations which are qualified impose a duty to take reasonable care. For example, in *Liverpool City Council* v *Irwin* [1977] AC 239, the House of Lords held that the local authority owed a duty to take reasonable care to ensure that the common parts of a block of flats were in reasonable repair and in use. Since the local authority had taken reasonable care there was no breach. Similarly, a surgeon owes a duty to exercise reasonable care and skill in the performance of an operation but cannot guarantee the result (*Thake* v *Maurice* [1986] 1 All ER 497). A further example of a qualified obligation is s. 13 of the Supply of Goods and Services Act 1982.

Supply of Goods and Services Act 1982

13. Implied term about care and skill.

In a contract for the supply of a service where the supplier is acting in the course of a business, there is an implied term that the supplier will carry out the service with reasonable care and skill.

Note

On standards of performance, see Treitel, *The Law of Contract*, 9th edn, pp. 751–55.

SECTION 2: CONSEQUENCES OF BREACH

Subject to an enforceable exemption clause, a breach of contract entitles the injured party to damages to compensate for the loss suffered as a result of the breach.

Photo Production Ltd v *Securicor Transport Ltd* [1980] AC 827 (HL)

The facts of this case appear at page 312. Lord Diplock explained the effects of a breach of a contractual obligation.

LORD DIPLOCK: . . . [B]reaches of primary obligations give rise to substituted or secondary obligations on the part of the party in default, and, in some cases, may entitle the other party to be relieved from further performance of his own primary obligations. . . .

Every failure to perform a primary obligation is a breach of contract. The secondary obligation on the part of the contract breaker to which it gives rise by implication of the common law is to pay monetary compensation to the other party for the loss sustained by him in consequence of the breach; but, with two exceptions, the primary obligations of both parties so far as they have not yet been fully performed remain unchanged. This secondary obligation to pay compensation (damages) for non-performance of primary obligations I will call the 'general secondary obligation.' It applies in the cases of the two exceptions as well.

The exceptions are: (1) Where the event resulting from the failure by one party to perform a primary obligation has the effect of depriving the other party of substantially the whole benefit which it was the intention of the parties that he should obtain from the contract, the party not in default may elect to put an end to all primary obligations of both parties remaining unperformed. [If the expression 'fundamental breach' is to be retained, it should, in the interests of clarity, be confined to this exception.) (2) Where the contracting parties have agreed, whether by express words or by implication of law, that *any* failure by one party to perform a particular primary obligation ('condition' in the nomenclature of the Sale of Goods Act 1893), irrespective of the gravity of the event that has in fact resulted from the breach, shall entitle the other party to elect to put an end to all primary obligations of both parties remaining unperformed. (In the interests of clarity, the nomenclature of the Sale of Goods Act 1893, 'breach of condition' should be reserved for this exception.)

Where such an election is made (a) there is substituted by implication of law for the primary obligations of the party in default which remain unperformed a secondary obligation to pay monetary compensation to the other party for the loss sustained by him in consequence of their non-performance in the future and (b) the unperformed primary obligations of that other party are discharged. This secondary obligation is additional to the general secondary obligation; I will call it 'the anticipatory secondary obligation.'

Notes

1. The primary obligations are the performance obligations in the contract. Breaches of these obligations give rise to secondary obligations to pay damages.

2. A breach of contract will not necessarily terminate the contract, so that the primary obligation of both parties may continue. However, if there has been a repudiatory breach of contract, then the injured party has an option to terminate or affirm the contract. In order for the contract to be terminated, the injured party must have accepted the repudiatory breach as terminating the contract. See *Decro-Wall International SA* v *Practitioners in Marketing Ltd* [1971] 2 All ER 216: where Sachs LJ stated (at pp. 227–8):

> The general law as to the effect of repudiation has long been settled. The locus classicus for reference purposes is the statement in plain and simple terms in the speech of Viscount Simon LC in *Heyman* v *Darwins Ltd* [1942] AC 356 p.361:
>
> > . . . repudiation by one party standing alone does not terminate the contract. It takes two to end it, by repudiation, on the one side, and acceptance of the repudiation, on the other.
>
> Whether the other party accepts is a matter for his option; if he does not, the contract remains alive . . .

See *Vitol SA* v *Norelf Ltd, The Santa Clara* [1996] 3 All ER 193, page 359, on the question of what constitutes 'acceptance' of a repudiatory breach.

By termination, we mean that performance of future obligations under the contract is no longer required. It does not mean that the contract is treated as if it never existed. (Care should therefore be taken with the expression 'rescission for breach of contract'.)

In *Johnson v Agnew* [1980] AC 367, Lord Wilberforce stated (at pp. 392–3):

> . . . [I]t is important to dissipate a fertile source of confusion and to make clear that although the vendor is sometimes referred to in the above situation as 'rescinding' the contract, this so-called 'rescission' is quite different from rescission ab initio, such as may arise for example in cases of mistake, fraud or lack of consent. In those cases, the contract is treated in law as never having come into existence. . . . In the case of an accepted repudiatory breach the contract has come into existence but has been put an end to or discharged. Whatever contrary indications may be disinterred from old authorities, it is now quite clear, under the general law of contract, that acceptance of a repudiatory breach does not bring about 'rescission ab initio.' I need only quote one passage to establish these propositions.
>
> In *Heyman* v *Darwins Ltd* [1942] AC 356 Lord Porter said, at p. 399:
>
> > To say that the contract is rescinded or has come to an end or has ceased to exist may in individual cases convey the truth with sufficient accuracy, but the fuller expression that the injured party is thereby absolved from future performance of his obligations under the contract is a more exact description of the position. Strictly speaking, to say that on acceptance of the renunciation of a contract the contract is rescinded is incorrect. In such a case the injured party may accept the renunciation as a breach going to the root of the whole of the consideration. By that acceptance he is discharged from further performance and may bring an action for damages, but the contract itself is not rescinded.

3. Lord Diplock refers to two situations where the primary obligations which have not yet been performed are discharged. They correspond with breaches of conditions (page 268) and breaches of non-conditions which deprive the injured party of substantially the whole benefit of the contract (see *Hong Kong Fir Shipping* v *Kawasaki Kishen Kaisha* [1962] 2 QB 26, at page 276), i.e. repudiatory breaches.

In this situation there is a secondary obligation to pay damages for the breach (referred to as the 'general secondary obligation'), and the primary obligations which remain unperformed are replaced by a secondary obligation to pay damages for the loss resulting from non-performance of these primary obligations due in the future (referred to as 'the anticipatory secondary obligation').

SECTION 3: ANTICIPATORY BREACH

An anticipatory breach occurs where, before the time for performance, one party informs the other that they will not perform their contractual obligations. This type of breach will be repudiatory, since the contract is renounced or the party incapacitates himself from performing the obligations under the contract.

Renunciation of the contract in advance of the time for performance occurs where one party evinces an unconditional intention not to perform his contractual obligations or not to be bound by the contract.

Woodar Investment Development Ltd v *Wimpey Construction UK Ltd*
[1980] 1 WLR 277 (HL)

The full facts of this case appear at page 209. Wimpey sought to terminate the contract to purchase land on the ground that the Secretary of State for the Environment had commenced a compulsory acquisition procedure in respect of the land. The contract expressly reserved the right to terminate in these circumstances. Woodar, the vendors, claimed that Wimpey had repudiated the contract. Held: (Lord Salmon and Lord Russell of Killowen dissenting) in order to constitute a renunciation of the contract there had to be an intention to abandon the contract and instead of abandoning the contract Wimpey were relying on its terms as justifying their right to terminate.

LORD WILBERFORCE: . . . [I]t would be a regrettable development of the law of contract to hold that a party who bona fide relies upon an express stipulation in a contract in order to rescind or terminate a contract should, by that fact alone, be treated as having repudiated his contractual obligations if he turns out to be mistaken as to his rights. Repudiation is a drastic conclusion which should only be held to arise in clear cases of a refusal, in a matter going to the root of the contract, to perform contractual obligations. To uphold the respondents' contentions in this case would represent an undesirable extension of the doctrine.

As with all repudiatory breaches, the injured party has the option of affirming or terminating the contract.

A: AFFIRMATION

If the injured party chooses to affirm, the contract continues in force and the injured party awaits performance on the performance date. It is only if the guilty party still does not perform at that time that the injured party can accept the repudiatory breach as terminating the contract and seek damages.

Since the contract continues in force, this presents some risks to the injured party.

(a) Subsequent breach by the injured party

If the injured party subsequently breaches the contract, the injured party is liable to pay damages for his breach and cannot argue that the guilty party's anticipatory breach excused further performance of the contractual obligations.

Fercometal SARL* v *Mediterranean Shipping Co. SA, The Simona
[1988] 2 All ER 742 (HL)

Under a charterparty for the carriage of steel coils from Durban to Bilbao, the charterers were entitled to cancel if the vessel was not ready to load on or before 9 July. On 2 July the charterers committed an anticipatory repudiatory breach by chartering another vessel to carry the cargo when the owners had requested an extension to 13 July. The owners did not accept this repudiation and notified the charterers that the vessel would start loading on 8 July. This notice was invalid because the vessel was not in fact ready to load. Consequently, the owners were committing a breach of contract. The charterers sought to cancel the charterparty relying on the express cancellation provision. Held: if the injured party elects to affirm the contract following an anticipatory repudiatory breach, then that party is not absolved from tendering further performance of his obligations under the contract. The charterers therefore retained the right to cancel the charterparty. The House of Lords did state, however, that if the charterers had indicated that the owner was no longer required to perform, and the owner had relied upon that as excusing the performance, then the charterers would be estopped from relying on the breach and could not have cancelled the charterparty.

LORD ACKNER: . . . When A wrongfully repudiates his contractual obligations in anticipation of the time for their performance, he presents the innocent party, B, with two choices. He may either affirm the contract by treating it as still in force or he may treat it as finally and conclusively discharged. There is no third choice, as a sort of via media, to affirm the contract and yet be absolved from tendering further performance unless and until A gives reasonable notice that he is once again able and willing to perform. Such a choice would negate the contract being kept alive for the benefit of

both parties and would deny the party who unsuccessfully sought to rescind the right to take advantage of any supervening circumstance which would justify him in declining to complete.

. . . [I]n affirming the continued existence of the contract, the owners could only avoid the operation of the cancellation clause by tendering the vessel ready to load on time (which they failed to do), or by establishing (which they could not) that their failure was the result of the charterers' conduct in representing that they had given up their option, which representation the owners had acted on by not presenting the vessel on time . . .

(b) Frustration between affirmation and date for performance

If the contract is frustrated between the date of affirmation and the date fixed for performance, then the injured party will lose his right to remedies for the breach.

Avery v *Bowden*
(1855) 5 E & B 714; 119 ER 647 (QB)
affirmed Exchequer Chamber (1856) 6 E & B 953

A ship was required to load cargo at Odessa within 45 days. The ship's master was told before the expiry of these laydays that no cargo would be available. He elected to affirm the contract and remained in port hoping that a cargo would be provided. Before the expiry of the 45-day period the contract was frustrated by the outbreak of war, which made it illegal to load a cargo at an enemy port. Held: the shipowners could not recover damages for the anticipatory repudiatory breach in failing to provide a cargo since the master had affirmed. If the master had sailed away on receiving that information, then not only could another cargo have been loaded at a friendly port, but the shipowner would have had a right to claim damages for the loss caused by the breach.

(c) Claiming the contract price as an alternative to damages

It has been held that the injured party can continue his performance of the contract and claim the contract price (as an action for a liquidated sum) rather than suing for damages for the breach. This is controversial, since the performance clearly is not required and the expenditure in performing is wasted.

White & Carter (Councils) Ltd v *McGregor*
[1962] AC 413 (HL)

The plaintiffs, advertising contractors, had contracted with the defendant garage proprietor to display advertisements for the garage on litter bins for a three-year period. On the same day the defendant requested that the agreement be cancelled, but the plaintiffs refused. The plaintiffs displayed the advertisements for 156 weeks and then claimed the contract price of £196 4s. Held: (Lords Morton and Keith dissenting) the plaintiffs were

entitled to carry out the contract and claim the full contract price. They were not bound to accept the repudiation and sue for the lost profit on the contract as their damages. The minority were of the opinion that there could be no recovery of unwanted wasted expenditure and that the plaintiffs should have mitigated (page 397).

LORD REID: . . . If one party to a contract repudiates it in the sense of making it clear to the other party that he refuses or will refuse to carry out his part of the contract, the other party, the innocent party, has an option. He may accept that repudiation and sue for damages for breach of contract, whether or not the time for performance has come; or he may if he chooses disregard or refuse to accept it and then the contract remains in full effect. . . .

I need not refer to the numerous authorities. They are not disputed by the respondent but he points out that in all of them the party who refused to accept the repudiation had no active duties under the contract. The innocent party's option is generally said to be to *wait* until the date of performance and then to claim damages estimated as at that date. There is no case in which it is said that he may, in face of the repudiation, go on and incur useless expense in performing the contract and then claim the contract price. The option, it is argued, is merely as to the date as at which damages are to be assessed.

Developing this argument, the respondent points out that in most cases the innocent party cannot complete the contract himself without the other party doing, allowing or accepting something, and that it is purely fortuitous that the appellants can do so in this case. In most cases by refusing co-operation the party in breach can compel the innocent party to restrict his claim to damages. Then it was said that, even where the innocent party can complete the contract without such co-operation, it is against the public interest that he should be allowed to do so. An example was developed in argument. A company might engage an expert to go abroad and prepare an elaborate report and then repudiate the contract before anything was done. To allow such an expert then to waste thousands of pounds in preparing the report cannot be right if a much smaller sum of damages would give him full compensation for his loss. It would merely enable the expert to extort a settlement giving him far more than reasonable compensation.

. . . It might be, but it never has been, the law that a person is only entitled to enforce his contractual rights in a reasonable way, and that a court will not support an attempt to enforce them in an unreasonable way. One reason why that is not the law is, no doubt, because it was thought that it would create too much uncertainty to require the court to decide whether it is reasonable or equitable to allow a party to enforce his full rights under a contract.

. . . It may well be that, if it can be shown that a person has no legitimate interest, financial or otherwise, in performing the contract rather than claiming damages, he ought not to be allowed to saddle the other party with an additional burden with no benefit to himself. If a party has no interest to enforce a stipulation, he cannot in general enforce it: so it might be said that, if a party has no interest to insist on a particular remedy, he ought not to be allowed to insist on it. And, just as a party is not allowed to enforce a penalty, so he ought not to be allowed to penalise the other party by taking one course when another is equally advantageous to him. If I may revert to the example which I gave of a company engaging an expert to prepare an elaborate report and then repudiating before anything was done, it might be that the company could show that the expert had no substantial or legitimate interest in

carrying out the work rather than accepting damages: I would think that the de minimis principle would apply in determining whether his interest was substantial, and that he might have a legitimate interest other than an immediate financial interest. But if the expert had no such interest then that might be regarded as a proper case for the exercise of the general equitable jurisdiction of the court. But that is not this case. Here the respondent did not set out to prove that the appellants had no legitimate interest in completing the contract and claiming the contract price rather than claiming damages; there is nothing in the findings of fact to support such a case, and it seems improbable that any such case could have been proved. It is, in my judgment, impossible to say that the appellants should be deprived of their right to claim the contract price merely because the benefit to them, as against claiming damages and re-letting their advertising space, might be small in comparison with the loss to the respondent: that is the most that could be said in favour of the respondent. Parliament has on many occasions relieved parties from certain kinds of improvident or oppressive contracts, but the common law can only do that in very limited circumstances.

LORD HODSON: In *Howard* v *Pickford Tool Co. Ltd* [1951] 1 KB 417 Asquith LJ said: 'An unaccepted repudiation is a thing writ in water and of no value to anybody: it confers no legal rights of any sort or kind.'

It follows that, if, as here, there was no acceptance, the contract remains alive for the benefit of both parties and the party who has repudiated can change his mind but it does not follow that the party at the receiving end of the proffered repudiation is bound to accept it before the time for performance and is left to his remedy in damages for breach.

[Counsel] for the respondent, did not seek to dispute the general proposition of law to which I have referred but sought to argue that if at the date of performance by the innocent party the guilty party maintains his refusal to accept performance and the innocent party does not accept the repudiation, although the contract still survives, it does not survive so far as the right of the innocent party to perform it is concerned but survives only for the purpose of enforcing remedies open to him by way of damages or specific implement.

This produces an impossible result; if the innocent party is deprived of some of his rights it involves putting an end to the contract except in cases, unlike this, where, in the exercise of the court's discretion, the remedy of specific implement is available.

The true position is that the contract survives and does so not only where specific implement is available. When the assistance of the court is not required the innocent party can choose whether he will accept repudiation and sue for damages for anticipatory breach or await the date of performance by the guilty party. Then, if there is failure in performance, his rights are preserved.

It may be unfortunate that the appellants have saddled themselves with an unwanted contract causing an apparent waste of time and money. No doubt this aspect impressed the Court of Session but there is no equity which can assist the respondent. It is trite that equity will not rewrite an improvident contract where there is no disability on either side. There is no duty laid upon a party to a subsisting contract to vary it at the behest of the other party so as to deprive himself of the benefit given to him by the contract. To hold otherwise would be to introduce a novel equitable doctrine that a party was not to be held to his contract unless the court in a given instance thought it reasonable so to do. In this case it would make an action for debt a claim for a discretionary remedy. . . .

LORD MORTON OF HENRYTON *dissenting*: My Lords, I think that this is a case of great importance, although the claim is for a comparatively small sum. If the

appellants are right, strange consequences follow in any case in which, under a repudiated contract, services are to be performed by the party who has not repudiated it, so long as he is able to perform these services without the co-operation of the repudiating party. Many examples of such contracts could be given. One, given in the course of the argument and already mentioned by my noble and learned friend, Lord Reid, is the engagement of an expert to go abroad and write a report on some subject for a substantial fee plus his expenses. If the appellants succeed in the present case, it must follow that the expert is entided to incur the expense of going abroad, to write his unwanted report, and then to recover the fee and expenses, even if the other party has plainly repudiated the contract before any expense has been incurred.

It is well established that repudiation by one party does not put an end to a contract. The other party can say 'I hold you to your contract, which still remains in force.' What then is his remedy if the repudiating party persists in his repudiation and refuses to carry out his part of the contract? The contract has been broken. The innocent party is entitled to be compensated by damages for any loss which he has suffered by reason of the breach, and in a limited class of cases the court will decree specific implement. The law of Scotland provides no other remedy for a breach of contract, and there is no reported case which decides that the innocent party may act as the appellants have acted. The present case is one in which specific implement could not be decreed, since the only obligation of the respondent under the contract was to pay a sum of money for services to be rendered by the appellants. Yet the appellants are claiming a kind of inverted specific implement of the contract. They first insist on performing their part of the contract, against the will of the other party, and then claim that he must perform his part and pay the contract price for unwanted services. In my opinion, my Lords, the appellants' only remedy was damages, and they were bound to take steps to minimise their loss, according to a well-established rule of law. Far from doing this, having incurred no expense at the date of the repudiation, they made no attempt to procure another advertiser, but deliberately went on to incur expense and perform unwanted services with the intention of creating a money debt which did not exist at the date of the repudiation.

. . . The course of action followed by the appellants seems to me unreasonable and oppressive, but it is not on that ground that I would reject their claim. I would reject it for the reasons which I have already given.

Notes

1. The majority considered that there was no duty to mitigate because they felt that on affirmation there was no breach. However, if on the contractual date for performance, there is no performance there will inevitably be a breach, which on these facts the plaintiffs affirmed. Arguably, therefore, the plaintiffs should have mitigated as from this date.

The action here was an action for an agreed sum, so that damages rules such as that relating to mitigation do not apply. This decision illustrates the unsatisfactory nature of the consequences that follow from this distinction. It is submitted that the duty to mitigate should apply to the action for an agreed sum.

2. *White & Carter* v *McGregor* has been limited in subsequent decisions by reference to two apparent limitations placed upon it by Lord Reid. The first is that the plaintiffs could perform without the cooperation of the defendant and the second, that an injured party cannot continue with the performance unless he has a legitimate interest in so doing.

In *Clea Shipping Corp* v *Bulk Oil International Ltd, The Alaskan Trader* (page 358), Lloyd J explained these limitations:

Lord Reid agreed with Lord Hodson and Lord Tucker that on the facts the plaintiffs' claim in debt must succeed. But his speech contains two important observations on the law. First, he pointed out that it is only in rare cases that the innocent party will be able to complete performance of his side of the contract, without the assent or co-operation of the party in breach. Obviously, if the innocent party cannot complete performance, he is restricted to his claim for damages. A buyer who refuses to accept delivery of the goods, and thereby prevents property passing, cannot, in the ordinary case, be made liable for the price. The peculiarity of *White & Carter* v *McGregor* [1961] 3 All ER 1178 at 182, [1962] AC 413 at 429, as Lord Reid pointed out, was that the plaintiffs could completely fulfil their part of the contract without any co-operation from the defendant.

The second observation which Lord Reid made as to the law was that a party might well be unable to enforce his contractual remedy if 'he had no legitimate interest, financial or otherwise, in performing the contract rather than claiming damages'. Lord Reid did not go far in explaining what he meant by legitimate interest except to say that the de minimis principle would apply. Obviously it would not be sufficient to establish that the innocent party was acting unreasonably. . . .

It is clear that, on the facts, no attempt had been made by the defendant to establish absence of legitimate interest. Accordingly, counsel for the owners was right when he submitted that the two observations which I have mentioned were both, strictly speaking, obiter.

In the following case, Megarry J considered that cooperation in this context meant passive as well as active cooperation.

Hounslow London Borough Council v *Twickenham Garden Developments Ltd*
[1971] Ch 233

Contractors were working on a site belonging to the local authority. The local authority 'repudiated' their contract but the contractors refused to accept this and elected to proceed with the work on site. The question was whether they had the right to insist on continuing to perform the contract. Held: they did not have that right.

MEGARRY J: . . . The case before me is patently one in which the contractor cannot perform the contract without any co-operation by the borough. The whole machinery of the contract is geared to acts by the architect and quantity surveyor, and it is a contract that is to be performed on the borough's land. True, the contractor already has de facto possession or control of the land; there is no question of the borough being required to do the act of admitting the contractor into possession, and so in that respect the contractor can perform the contract without any 'co-operation' by the borough. But I do not think that the point can be brushed aside so simply. Quite apart from questions of active co-operation, cases where one party is lawfully in possession of property of the other seem to me to raise issues not before the House of Lords in *White and Carter (Councils) Ltd* v *McGregor* [1962] AC 413. Suppose that A, who

owns a large and valuable painting, contracts with B, a picture restorer, to restore it over a period of three months. Before the work is begun, A receives a handsome offer from C to purchase the picture, subject to immediate delivery of the picture in its unrestored state, C having grave suspicions of B's competence. If the work of restoration is to be done in A's house, he can effectually exclude B by refusing to admit him to the house: without A's 'co-operation' to this extent B cannot perform his contract. But what if the picture stands in A's locked barn, the key of which he has lent to B so that he may come and go freely, or if the picture has been removed to B's premises? In these cases can B insist on performing his contract, even though this makes it impossible for A to accept C's offer? In the case of the barn, A's co-operation may perhaps be said to be requisite to the extent of not barring B's path to the barn or putting another lock on the door: but if the picture is on B's premises, no active co-operation by A is needed. Nevertheless, the picture is A's property, and I find it difficult to believe that Lord Reid intended to restrict the concept of 'co-operation' to active co-operation. In *White and Carter (Councils) Ltd* v *McGregor* no co-operation by the proprietor, either active or passive, was required: the contract could be performed by the agents wholly without reference to the proprietor or his property. The case was far removed from that of a property owner being forced to stand impotently aside while a perhaps ill-advised contract is executed on property of his which he has delivered into the possesion of the other party, and is powerless to retrieve.

Accordingly, I do not think that *White and Carter (Councils) Ltd* v *McGregor* has any application to the case before me. I say this, first, because a considerable degree of active co-operation under the contract by the borough is requisite, and second, because the work is being done to property of the borough. I doubt very much whether the *White* case can have been intended to apply where the contract is to be performed by doing acts to property owned by the party seeking to determine it. I should add that it seems to me that the ratio of the *White* case involves acceptance of Lord Reid's limitations, even though Lord Tucker and Lord Hodson said nothing of them: for without Lord Reid there was no majority for the decision of the House. Under the doctrine of precedent, I do not think that it can be said that a majority of a bare majority is itself the majority.

Notes

1. This interpretation has considerably diminished the scope of *White & Carter (Councils) Ltd* v *McGregor*, since the performance of many contracts will require at least passive cooperation from the other party. There appears to be a difference between a contractor working on the site of the owner and working on the site of a third party. Should this make a difference?

2. Lord Reid's comment on the need to establish a legitimate interest in continuing to perform rather than claim damages was not accepted by the other members of the House of Lords, but Megarry J appears to treat it as part of the *ratio* of the case. Did the plaintiffs in *White & Carter* v *McGregor* have a legitimate interest in performing the contract?

3. In *Attica Sea Carriers Corporation* v *Ferrostaal Poseidon Bulk Reederei GmbH, The Puerto Buitrago* [1976] 1 Lloyd's Rep 250, the Court of Appeal was faced with the question of whether the shipowners could ignore a repudiation by the charterers in redelivering a vessel in breach of a repair obligation and sue for the charter hire until the repairs were completed (the

evidence being that the repairs would cost $2 million which would be greatly in excess of the value of the vessel). Lord Denning MR stated:

> . . . [*White & Carter Ltd* v *McGregor*] has been criticized in a leading textbook (Cheshire & Fifoot, pp. 600 and 601). It is said to give a 'grotesque' result. Even though it was a Scots case, it would appear that the House of Lords, as at present constituted, would expect us to follow it in any case that is precisely on all fours with it. But I would not follow it otherwise. It has no application whatever in a case where the plaintiff ought, in all reason, to accept the repudiation and sue for damages — provided that damages would provide an adequate remedy for any loss suffered by him. The reason is because, by suing for the money, the plaintiff is seeking to enforce specific performance of the contract — and he should not he allowed to do so when damages would be an adequate remedy. Take a servant, who has a contract for six months certain, but is dismissed after one month. He cannot sue for his wages for each of the six months by alleging that he was ready and willing to serve. His only remedy is damages. Take a finance company which lets a machine or motor-car on hire purchase, but the hirer refuses to accept it. The finance company cannot sue each month for the instalments. Its only remedy is in damages: see *National Cash Register Co.* v *Stanley* [1921] 3 KB 292; *Karsales (Harrow)* v *Wallis* [1956] 1 WLR 936 (2nd point). So here, when the charterers tendered redelivery at the end of the period of the charter — in breach of the contract to repair — the shipowners ought in all reason to have accepted it. They cannot sue for specific performance — either of the promise to pay the charter hire, or of the promise to do the repairs — because damages are an adequate remedy for the breach. What is the alternative which the shipowners present to the charterers? Either the charterers must pay the charter hire for years to come, whilst the vessel lies idle and useless for want of repair. *Or* the charterers must do repairs which would cost twice as much as the ship would be worth when repaired — after which the shipowners might sell it as scrap, making the repairs a useless waste of money. In short, on either alternative, the shipowners seek to compel specific performance of one or other of the provisions of the charter — with most unjust and unreasonable consequences — when damages would be an adequate remedy. I do not think the law allows them to do this. I think they should accept redelivery and sue for damages. . . .

Orr LJ (with whose conclusion Browne LJ agreed) referred to the judgment of Lord Reid in *White & Carter Ltd* v *McGregor*, and continued:

> The present case differs from that case in that here it cannot be said that the owners could fulfil the contract without any cooperation from the charterers and also because in this case the charterers have set out to prove that the owners have no legitimate interest in claiming the charter hire rather than claiming damages, and the passages above quoted strongly suggest to me that if either or both of these factors had been present in *White & Carter* v *McGregor* Lord Reid might well have agreed with Lord Morton and Lord Keith as to the outcome of the appeal, with the result that there would have been a majority in favour of dismissing it.

Clea Shipping Corp v *Bulk Oil International Ltd, The Alaskan Trader* [1984] 1 All ER 129

After 12 months of a two-year charter the vessel suffered a serious engine breakdown necessitating several months of repair. The charterers indicated that they would not require the vessel but the owners went ahead with

repairs costing £800,000 which were completed in April 1981. They informed the charterers that the vessel was available and maintained a full crew ready to sail between April and December 1981. The charterers sought repayment of the hire they had paid between April and December, alleging that the owners should have accepted the charterers' conduct as repudiating the contract and claimed damages. The owners argued that they were free to elect to affirm and keep the vessel at the disposal of the charterers. Held: although in general, there was an unfettered right to elect, in exceptional cases the court would exercise its general equitable jurisdiction to refuse to allow the injured party to affirm if there was no legitimate interest in performing the contract rather than claiming damages. The arbitrator had found that the plaintiffs had acted wholly unreasonably and Lloyd J upheld this finding. Therefore, although the charterers were liable in damages, they could recover the hire.

LLOYD J: . . . Whether one takes Lord Reid's language, which was adopted by Orr and Browne LJJ in *The Puerto Buitrago*, or Lord Denning MR's language in that case ('in all reason'), or Kerr J's language in *The Odenfeld* ('wholly unreasonable . . . quite unrealistic, unreasonable and untenable'), there comes a point at which the court will cease, on general equitable principles, to allow the innocent party to enforce his contract according to its strict legal terms. How one defines that point is obviously a matter of some difficulty, for it involves drawing a line between conduct which is merely unreasonable (see per Lord Reid in *White & Carter* v *McGregor* [1961] 3 All ER 1178 at 1182, [1962] AC 413 at 429–430) and conduct which is wholly unreasonable (see per Kerr J in *The Odenfeld* [1978] 2 Lloyd's Rep 357 at 374). But however difficult it may be to define the point, that there is such a point seems to me to have been accepted both by the Court of Appeal in *The Puerto Buitrago* and by Kerr J in *The Odenfeld*.

I appreciate that the House of Lords has recently re-emphasised the importance of certainty in commercial contracts, when holding that there is no equitable jurisdiction to relieve against the consequences of the withdrawal clause in a time charter: see *Scandinavian Trading Tanker Co AB* v *Flota Petrolera Ecuatoriana, The Scaptrade* [1983] 2 All ER 763, [1983] 3 WLR 203. I appreciate, too, that the importance of certainty was one of the main reasons urged by Lord Hodson in *White & Carter* v *McGregor* in upholding the innocent party's unfettered right to elect. But, for reasons already mentioned, it seems to me that this court is bound to hold that there is *some* fetter, if only in extreme cases; and, for want of a better way of describing that fetter, it is safest for this court to use the language of Lord Reid, which, as I have already said, was adopted by a majority of the Court of Appeal in *The Puerto Buitrago*.

B: TERMINATION

The innocent party 'accepts' the repudiatory breach as terminating the contract. Can the innocent party 'accept' the repudiation merely by failing to perform his own future obligations under the contract?

Vitol SA v *Norelf Ltd, The Santa Clara*
[1996] 3 All ER 193 (HL)

Under the terms of the contract for the sale of a cargo, the ship carrying the cargo was to arrive, berth and leave Houston between 1-7 March 1991.

After loading the cargo the contract required specific actions to be taken by the parties. While the cargo was being loaded, the plaintiff buyers sent a telex (on 8 March) purporting to reject the cargo for breach of condition on the basis that the loading would not be completed within the contractual period. The vessel completed loading and sailed on 9 March, but thereafter neither party took any steps to perform the contract. The market price of the cargo fell and the sellers resold it for a much reduced price. The arbitrator held that the buyers' telex constituted an anticipatory repudiatory breach which had been accepted by the sellers as terminating the contract since, to the knowledge of the buyers, they had not taken any steps thereafter to perform the contract. The buyers appealed on this point, arguing that mere inactivity could not constitute acceptance of the repudiation.

Whereas Phillips J, at first instance, upheld the arbitrator's decision and held that the sellers' failure to perform their own contractual obligations constituted 'acceptance' of the buyers' repudiation, the Court of Appeal allowed the buyers' appeal and held that a mere failure to perform contractual obligations could not as a matter of law constitute such acceptance. The sellers appealed. Held: although it was possible as a matter of law for an innocent party to accept a repudiatory breach as terminating the contract simply by failing to perform his own contractual obligations, whether it did so was a question of fact depending on the particular contractual relationship and the particular circumstances of the case. The House of Lords accepted that the factual question of whether there had been an acceptance sufficient to communicate the fact of election to terminate was a matter within the exclusive jurisdiction of the arbitrator (who had found that, by not tendering the bill of lading, the sellers had accepted the buyers' repudiatory breach in the telex as terminating the contract).

LORD STEYN (with whose judgment the other members of the House of Lords agreed): . . . My Lords, the question of law before the House does not call for yet another general re-examination of the principles governing an anticipatory breach of a contract and the acceptance of the breach by an aggrieved party. For present purposes I would accept as established law the following propositions: (1) Where a party has repudiated a contract the aggrieved party has an election to accept the repudiation or to affirm the contract: *Fercometal SARL* v *Mediterranean Shipping Co. SA, The Simona* [1988] 2 All ER 742, [1989] AC 788. (2) An act of acceptance of a repudiation requires no particular form: a communication does not have to be couched in the language of acceptance. It is sufficient that the communication or conduct clearly and unequivocally conveys to the repudiating party that that aggrieved party is treating the contract as at an end. (3) It is rightly conceded by counsel for the buyers that the aggrieved party need not personally, or by an agent, notify the repudiating party of his election to treat the contract as at an end. It is sufficient that the fact of the election comes to the repudiating party's attention, for example notification by an unauthorised broker or other intermediary may be sufficient: *Wood Factory Pty Ltd* v *Kiritos Pty Ltd* [1985] 2 NSWLR 105 at 146 per McHugh J, *Majik Markets Pty Ltd* v *S & M Motor Repairs Pty Ltd (No. 1)* (1987) 10 NSWLR 49 at 54

per Young J and Carter and Harland *Contract Law in Australia*, (3rd edn, 1996) pp. 689–691, para 1970.

The arbitrator did not put forward any heterodox general theory of the law of repudiation. On the contrary, he expressly stated that unless the repudiation was accepted by the sellers and the acceptance was communicated to the buyers the election was of no effect. It is plain that the arbitrator directed himself correctly in accordance with the governing general principle. The criticism of the arbitrator's reasoning centres on his conclusion that 'the failure of [the sellers] to take any further step to perform the contract which was apparent to [the buyers] constituted sufficient communication of acceptance'. By that statement the arbitrator was simply recording a finding that the buyers knew that the sellers were treating the contract as at an end. That interpretation is reinforced by the paragraph in his award read as a whole. The only question is whether the relevant holding of the arbitrator was wrong in law.

It is now possible to turn directly to the first issue posed, namely whether non-performance of an obligation is ever as a matter of law capable of constituting an act of acceptance. On this aspect I found the judgment of Phillips J entirely convincing. One cannot generalise on the point. It all depends on the particular contractual relationship and the particular circumstances of the case. But, like Phillips J, I am satisfied that a failure to perform may sometimes signify to a repudiating party an election by the aggrieved party to treat the contract as at an end. Postulate the case where an employer at the end of a day tells a contractor that he, the employer, is repudiating the contract and that the contractor need not return the next day. The contractor does not return the next day or at all. It seems to me that the contractor's failure to return may, in the absence of any other explanation, convey a decision to treat the contract as at an end. Another example may be an overseas sale providing for shipment on a named ship in a given month. The seller is obliged to obtain an export licence. The buyer repudiates the contract before loading starts. To the knowledge of the buyer the seller does not apply for an export licence with the result that the transaction cannot proceed. In such circumstances it may well be that an ordinary businessman, circumstanced as the parties were, would conclude that the seller was treating the contract as at an end. Taking the present case as illustrative, it is important to bear in mind that the tender of a bill of lading is the pre-condition to payment of the price. Why should an arbitrator not be able to infer that when, in the days and weeks following loading and the sailing of the vessel, the seller failed to tender a bill of lading to the buyer, he clearly conveyed to a trader that he was treating the contract as at an end? In my view therefore the passage from the judgment of Kerr LJ in the *Golodetz* case [*State Trading Corp. of India Ltd* v *M. Golodetz Ltd (now Transcontinental Affiliates Ltd)*] [1989] 2 Lloyd's Rep 277 at 286, if it was intended to enunciate a general and absolute rule, goes too far. It will be recalled, however, that Kerr LJ spoke of a *continuing* failure to perform. One can readily accept that a continuing failure to perform, ie a breach commencing before the repudiation and continuing thereafter, would necessarily be equivocal. In my view too much has been made of the observation of Kerr LJ. Turning to the observation of Nourse LJ ([1995] 3 All ER 971 at 976–977, [1996] QB 108 at 116–117) that a failure to perform a contractual obligation is necessarily and always equivocal, I respectfully disagree. Sometimes in the practical world of businessmen an omission to act may be as pregnant with meaning as a positive declaration. While the analogy of offer and acceptance is imperfect, it is not without significance that while the general principle is that there can be no acceptance of an offer by silence, our law does in exceptional cases recognise acceptance of an offer by silence. Thus in *Rust* v *Abbey Life Assurance Co. Ltd* [1979] 2 Lloyd's Rep 334 the Court of Appeal held that a failure by a

proposed insured to reject a proffered insurance policy for seven months justified on its own an inference of acceptance. See also Treitel *The Law of Contract* (9th edn, 1995) pp. 30–32. Similarly, in the different field of repudiation, a failure to perform may sometimes be given a colour by special circumstances and may only be explicable to a reasonable person in the position of the repudiating party as an election to accept the repudiation.

My Lords, I would answer the question posed by this case in the same way as Phillips J did. In truth the arbitrator inferred an election, and communication of it, from the tenor of the rejection telex and the failure *inter alia* to tender the bill of lading. That was an issue of fact within the exclusive jurisdiction of the arbitrator.

For these reasons I would allow the appeal of the sellers.

Note

In a case note ([1996] CLJ 430) Hedley effectively summarises the position as being that, although acceptance of a repudiation must be communicated, that will be achieved where the 'repudiator has been left in no doubt' that the repudiation has been accepted.

If the injured party accepts the anticipatory repudiatory breach as terminating the contract, then the injured party can claim damages from that time and does not have to wait for the time fixed for performance.

Hochster v *De La Tour*
(1853) 2 E & B 678; 118 ER 922 (QB)

On 12 April 1852, the defendant agreed to employ the plaintiff as a courier for three months as from 1 June 1852. On 11 May, the defendant wrote to the plaintiff stating that he had changed his mind and that the plaintiff's services were no longer required. The plaintiff commenced an action on 22 May for breach of contract, and the defendant argued that there could be no breach of contract before 1 June. Held: the plaintiff was entitled to commence an action for damages on 22 May and did not have to wait until 1 June.

LORD CAMPBELL CJ: . . . [I]t cannot be laid down as a universal rule that, where by agreement an act is to be done on a future day, no action can be brought for a breach of the agreement till the day for doing the act has arrived. If a man promises to marry a woman on a future day, and before that day marries another woman, he is instantly liable to an action for breach of promise of marriage. If a man contracts to execute a lease on and from a future day for a certain term, and, before that day, executes a lease to another for the same term, he may be immediately sued for breaking the contract. So, if a man contracts to sell and deliver specific goods on a future day, and before the day he sells and delivers them to another, he is immediately liable to an action at the suit of the person with whom he first contracted to sell and deliver them. One reason alleged in support of such an action is, that the defendant has, before the day, rendered it impossible for him to perform the contract at the day: but this does not necessarily follow; for, prior to the day fixed for doing the act, the first wife may have died, a surrender of the lease executed might be obtained, and the defendant might have repurchased the goods so as to be in a situation to sell and

deliver them to the plaintiff. . . . If the plaintiff has no remedy for breach of the contract unless he treats the contract as in force, and acts upon it down to the 1st June 1852, it follows that, till then, he must enter into no employment whch will interfere with his promise 'to start with the defendant on such travels on the day and year,' and that he must then be properly equipped in all respects as a courier for a three months' tour on the continent of Europe. But it is surely much more rational, and more for the benefit of both parties, that, after the renunciation of the agreement by the defendant, the plaintiff should be at liberty to consider himself absolved from any future performance of it, retaining his right to sue for any damage he has suffered from the breach of it. Thus, instead of remaining idle and laying out money in preparations which must be useless, he is at liberty to seek service under another employer, which would go in mitigation of the damages to which he would otherwise be entitled for a breach of the contract. It seems strange that the defendant, after renouncing the contract, and absolutely declaring that he will never act under it, should be permitted to object that faith is given to his assertion, and that an opportunity is not left to him of changing his mind. If the plaintiff is barred of any remedy by entering into an engagement inconsistent with starting as a courier with the defendant on the 1st June, he is prejudiced by putting faith in the defendant's assertion: and it would be more consonant with principle, if the defendant were precluded from saying that he had not broken the contract when he declared that he entirely renounced it. Suppose that the defendant, at the time of his renunciation, had embarked on a voyage for Australia, so as to render it physically impossible for him to employ the plaintiff as a courier on the continent of Europe in the months of June, July and August 1852: according to decided cases, the action might have been brought before the 1st June; but the renunciation may have been founded on other facts, to be given in evidence, which would equally have rendered the defendant's performance of the contract impossible. The man who wrongfully renounces a contract into which he has deliberately entered cannot justly complain if he is immediately sued for a compensation in damages by the man whom he has injured: and it seems reasonable to allow an option to the injured party, either to sue immediately, or to wait till the time when the act was to be done, still holding it as prospectively binding for the exercise of this option, which may be advantageous to the innocent party, and cannot be prejudicial to the wrongdoer. . . . If it should be held that, upon a contract to do an act on a future day, a renunciation of the contract by one party dispenses with a condition to be performed in the meantime by the other, there seems no reason for requiring that other to wait till the day arrives before seeking his remedy by action: and the only ground on which the condition can be dispensed with seems to be, that the renunciation may be treated as a breach of the contract.

Note

The injured party must mitigate (see page 397) from the date of accepting the breach as terminating the contract. On the facts, the plaintiff had found another engagement to start later in June.

10 REMEDIES FOR BREACH OF CONTRACT

SECTION 1: DAMAGES FOR BREACH OF CONTRACT

The aim of contractual damages is to compensate the injured party for the loss suffered as a result of the other party's breach of contract.

Contractual damages are not punitive and, where the innocent party has suffered no loss, it is not possible to recover damages which transfer the benefit gained by the guilty party as a result of the breach of contract, even if that breach was deliberate. The innocent party can recover only for his actual loss.

Surrey County Council* v *Bredero Homes Ltd
[1993] 3 All ER 705 (CA)

The council had sold land to the defendant developer on the basis of a contract which required the developer to develop the land in accordance with the already granted planning permission for 72 houses. After the sale, however, the defendant obtained a new planning permission allowing an additional five houses to be built on the site. The defendant then deliberately breached the contract term requiring it to abide by the original planning permission and constructed the extra houses. The council sought damages for the breach based on the sum from their profits which they argued the defendant would have had to pay to the council in order to obtain a relaxation of the covenant in the contract. Held: the council were entitled to recover only nominal damages since they had not suffered any loss as a result of the breach, and in financial terms were already in the position they would have been had the covenant been performed.

Notes

1. See Burrows (1993) LMCLQ 453.

2. It has been argued that the law should be prepared to award restitutionary damages to reverse enrichment gained by a breach of contract (see pages 422–3). See Birks (1993) 109 LQR 518. It is argued that this would counter deliberate breaches of contract in these circumstances since there would then be no advantage to the party in breach. Steyn LJ rejected this, partly on the basis that the motive of the party committing the breach is not a factor in assessing damages for breach of contract and also because of reasons of policy:

> . . . The introduction of restitutionary remedies to deprive cynical contract breakers of the fruits of their breaches of contract will lead to greater uncertainty in the assessment of damages in commercial and consumer disputes. It is of paramount importance that the way in which disputes are likely to be resolved by the courts must be readily predictable. Given the premise that the aggrieved party has suffered no loss, is such a dramatic extension of restitutionary remedies justified in order to confer a windfall in each case on the aggrieved party? I think not. In any event such a widespread availability of restitutionary remedies will have a tendency to discourage economic activity in relevant situations. In a range of cases such liability would fall on underwriters who have insured relevant liability risks. Inevitably underwriters would have to be compensated for the new species of potential claims. Insurance premiums would have to go up. That, too, is a consequence which militates against the proposed extension. The recognition of the proposed extension will in my view not serve the public interest. It is sound policy to guard against extending the protection of the law of obligations too widely. For these substantive and policy reasons I regard it as undesirable that the range of restitutionary remedies should be extended in the way in which we have been invited to do so.

See Goodhart, 'Restitutionary Damages for Breach of Contract' [1995] RLR 3.

3. The Law Commission Consultation Paper No. 132, 'Aggravated, Exemplary and Restitutionary Damages', 1993, suggested that gain-based damages should be available if the gain was attributable to an interference with a proprietary or analogous right, or to deliberate wrongdoing which could have been restrained by injunction. If this were accepted much would depend on the meaning of 'proprietary interest'. However, Steyn LJ expressly stated that he considered the link with the availability of a remedy of injunction was unsatisfactory since this was a 'wholly different and discretionary' remedy.

A: EXPECTATION LOSS

Contractual damages are usually awarded to compensate for the injured party's loss of expectation, i.e., what the injured party would have received had the contract been properly performed. In *Robinson* v *Harman* (1848) 1 Exch 850, Parke B said (at p. 855): 'The rule of the common law is, that where a party sustains a loss by reason of a breach of contract, he is, so far as money can do it, to be placed in the same situation, with respect to damages, as if the contract had been performed.'

(a) Measurement: difference in value

One measure is the difference in value between what the injured party expected to receive and what he actually did receive, e.g., in relation to defective goods, the measure will be the difference in value between the goods as promised and the goods actually received.

Difference in value should be the appropriate measure where a party has contracted and paid for a superior service but the service supplied is substandard. The measure of damages should be the difference between the market value of what had been contracted for and the market value of what was actually obtained. (But see the *White Arrow Express Ltd* v *Lamey's Distribution Ltd* [1995] NLJR 1504, where, probably as a result of the way the claim was pleaded, the plaintiffs were confined to nominal damages for such a breach.)

Sale of Goods Act 1979

50. Damages for non-acceptance

(3) Where there is an available market for the goods in question the measure of damages is prima facie to be ascertained by the difference between the contract price and the market or current price at the time or times when the goods ought to have been accepted or (if no time was fixed for acceptance) at the time of the refusal to accept.

51. Damages for non-delivery

(3) Where there is an available market for the goods in question the measure of damages is prima facie to be ascertained by the difference between the contract price and the market or current price of the goods at the time or times when they ought to have been delivered or (if no time was fixed) at the time of the refusal to deliver.

Question

Can the damages awarded to the seller include the loss of profit on this sale which does not actually take place (a 'lost volume' sale)?

If there is an unlimited supply of the goods in question, one sale will have been lost and the loss of profit on that sale can be recovered.

Thompson (W. L.) Ltd v *Robinson (Gunmakers) Ltd* [1955] Ch 177

The defendant company refused to accept delivery of a 'Vanguard' motor car which they had contracted to buy from the plaintiffs, who were motor dealers. The 'Vanguard' car was readily available. Although the dealers took the car back, the plaintiffs contended that they were still entitled to the lost profit on the repudiated sale, namely £61. The defendants, relying on s. 50(3) contended that the plaintiffs' loss was only nominal. Held: there was no available market for the goods within s. 50(3), and therefore the loss of the bargain meant a loss of profit.

UPJOHN J: . . . [I]t would seem to me on the facts which I have to consider to be quite plain that the plaintiffs' loss in this case is the loss of their bargain. They have

sold one 'Vanguard' less than they otherwise would. The plaintiffs, as the defendants must have known, are in business as dealers in motor-cars and make their profit in buying and selling motor-cars, and what they have lost is their profit on the sale of this 'Vanguard.' There is no authority exactly in point in this country, although it seems to me that the principle to be applied is a clear one. It is to be found in *In re Vic Mill Ld* [1913] 1 Ch 465. In that case the supplier was to supply certain machines which he had to make, and they were to be made to the particular specification of the purchaser although they were of a type generally in common use. It was not the present case of a sale by a motor-dealer of a standardized product. The purchaser repudiated his order, and with a view to mitigating damages the supplier, on getting another order for somewhat similar machinery, very sensibly made such alterations as were necessary to the machinery that he had made for the original purchaser and sold the machinery so altered to the second purchaser. His costs of doing that were comparatively trivial. It was said by the supplier that the measure of his damages was the loss of his bargain; by the purchaser that the measure of damages was merely the cost of the conversion of the machinery for the second purchaser and his slight loss on the re-sale . . .

Buckley LJ put the matter succinctly in this way:

> As regards No. 1, where the goods were manufactured, the respondents are, I think, entitled to both profits, because they were not bound to give the appellants the benefit of another order that the respondents had received. The respondents were left with these goods on their hands. They altered them and sold them to another buyer, but they could have made, and would otherwise, I suppose, have made, other goods for that buyer, and not employed these goods for that purpose. If they had done so, they would have made both profits.

It seems to me that in principle that covers this case. True, the motor-car in question was not sold to another purchaser, but the plaintiffs did what was reasonable, they got out of their bargain with George Thompson Ld., but they sold one less 'Vanguard,' and lost their profit on that transaction . . .

The main case, however, put by the defendants is this: they submit that subsection (3) of section 50 applies, because they say that there is an available market for the goods in question, and in that available market we know that the price of the 'Vanguard' is fixed. It is fixed by the manufacturers. Therefore, they say, the measure of damages must necessarily be little more than nominal. Had the plaintiffs kept the car and sold it to another at a later stage, no doubt they would have been entitled to the costs of storage in the meantime, possibly interest on their money laid out, and so on, but as they had in fact mitigated their damages by getting out of the contract, damages are nil.

. . . [A]n 'available market' merely means that the situation in the particular trade in the particular area was such that the particular goods could freely be sold, and that there was a demand sufficient to absorb readily all the goods that were thrust on it, so that if a purchaser defaulted, the goods in question could readily be disposed of. Indeed, such was the situation in the motor trade until very recently. It was, of course, notorious that dealers all over the country had long waiting lists for new motor-cars. People put their names down and had to wait five or six years, and whenever a car was spared by the manufacturer from export it was snatched at, and if any purchaser fell out there were many waiting to take his place, and it was conceded that if those circumstances were still applicable to the 'Vanguard' motor-car the claim for damages must necessarily have been purely nominal. But on the assumed facts circumstances

had changed in relation to 'Vanguard' motor-cars, and in March of this year there was not a demand in the East Riding which could readily absorb all the 'Vanguard' motor-cars available for sale. If a purchaser defaults, that sale is lost, and there is no means of readily disposing of the 'Vanguard' contracted to be sold so that there is not even on the extended definition an available market.

Notes

1. If demand exceeds supply then loss of profit is not recoverable (*Charter* v *Sullivan* [1957] 2 QB 117).

2. In *Lazenby Garages Ltd* v *Wright* [1976] 2 All ER 770, the Court of Appeal held that there was no 'available market' for secondhand cars within s. 50(3) since a secondhand car was 'unique'. Therefore, the measure was that in s. 50(2), and the fact that the plaintiffs would sell one car less out of their total of secondhand car sales could not have been contemplated by the defendant. Lord Denning MR stated (at pp. 771–2):

> The cases show that if there are a number of new cars, all exactly of the same kind, available for sale, and the dealers can prove that they sold one car less than they otherwise would have done, they would be entitled to damages amounting to their loss of profit on the one car: see the judgment of Upjohn J in *W. L. Thompson* v *Robinson (Gunmakers) Ltd* . . .
>
> But it is entirely different in the case of a secondhand car. Each secondhand car is different from the next, even though it is the same make. The sales manager of the garage admitted in evidence that some secondhand cars, of the same make, even of the same year, may sell better than others of the same year. Some may sell quickly, others sluggishly. You simply cannot tell why. But they are all different.
>
> In the circumstances the cases about new cars do not apply. We have simply to apply to s. 50 of the Sale of Goods Act 1893. There is no 'available market' for secondhand cars. So its not sub-s. (3) but sub-s. (2). The measure of damages is the estimated loss directly and naturally resulting in the ordinary course of events from the buyer's breach of contract. That throws us back to the test of what could reasonably be expected to be in the contemplation of the parties as a natural consequence of the breach. The buyer in this case could not have contemplated that the dealer would sell one car less. At most he would contemplate that, if they resold this very car at a lower price, they would suffer by reason of that lower price and should recover the difference. But if they resold this very car at a higher price, they would suffer no loss. Seeing that these plaintiffs resold this car for £100 more than the sale to Mr Wright, they clearly suffered no damage at all.

3. Although the normal measure of damages where a supply contract is repudiated will be the loss of profit (net profit) on that contract, in some circumstances (where it is not possible to replace the contract with other work) gross profit can be recovered (less expenses of performance).

Western Webb Offset Printers Ltd v *Independent Media Ltd* [1996] CLC 77 (CA)

The defendant, publishers of a local newspaper, had a printing contract with the plaintiff printers. The defendant repudiated this contract before

the end of the contract period. The plaintiff accepted the repudiation as terminating the contract and sought damages of its gross profit on the contract (£176,903, namely the price it would have been paid for the remaining printing under the contract after deducting the direct expenses of carrying out the work, e.g. paper and ink). The plaintiff argued that as a result of the recession it was unable to replace the defendant's contract with other work so that this sum was a loss of turnover otherwise available to cover its fixed overheads. However, the trial judge accepted the defendant's argument that damages should be limited to the net profit of £38,245. Held: allowing the appeal and awarding £176,903 as damages, damages were intended to compensate the plaintiff for what he had been deprived of as a result of the breach and, although in many cases loss of profit would achieve that, there was no general principle limiting damages to loss of profit. As a result of the recession and the inability to find an alternative contract, the plaintiff's loss included loss of the gross profit figure to defray overheads.

WARD LJ: . . . [Counsel for the defendant] seeks to uphold the judge and to support him by a submission that the true principle in law is that the measure of damages is the loss of net profit. I reject that submission. The correct principle, and perhaps almost the only principle, which needs no authority for its citation, is that if one party to an agreement makes a default in performing his side of the contract then the loss to the other party is the value of the benefit of which he has been deprived through the breach. He is entitled, so far as money can do it, to be put in the same position as if the contract had been duly performed and had not been broken. He is entitled, in other words, to be compensated for the loss of his bargain. An application of that basic principle may very well lead — and, I venture to think, in a large majority of cases will lead — to an assessment of damages based on the loss of net profit, and nothing in this judgment should call that approach into question. Thus the judge was no doubt right to observe, and counsel for the plaintiff was no doubt right to concede, that with regard to a typical building case:

> in such a contract general principles would mean the normal measure of damages would be the contract price less the costs incurred in executing the contract and those costs would be calculated on the contractor's indirect as well as direct costs and the indirect costs would include overheads.

That passage in his judgment seems to have been lifted from a passage in *McGregor on Damages* at para. 1094. In my judgment the error is, however, to approach this as a typical case for materials and labour. Viscount Haldane LC warned in *British Westinghouse Electric and Manufacturing Co. Ltd* v *Underground Electric Railways Co. of London Ltd* [1912] AC 673 at p. 688:

> In some of the cases there are expressions as to the principles governing the measure of general damages which at first sight seem difficult to harmonize. The apparent discrepancies are, however, mainly due to the varying nature of the particular questions submitted for decision. The quantum of damages is a question of fact, and the only guidance the law can give is to lay down general principles which afford at times but scanty assistance in dealing with particular cases.

What, then, are the particulars facts of this particular case? The plaintiffs are a substantial firm of printers. Their turnover was in excess of £3m. The contract price

for these 48 lost issues was something in excess of £400,000. It represented, as I have already pointed out, some 12–13 per cent of their turnover. Because of the recession it is, inevitably perhaps, a fact that the company's order books were not full. There was spare capacity, as the judge found. . . . the plaintiff had taken steps to replace the work lost by this breach and had succeeded, but not to an extent which was capable of mitigating their loss because it did not fill up their spare capacity. The fact remains that the loss of this contract led to a loss of revenue of £139,000 (£177,000 minus £38,000), which would have been available to defray the overheads. On the judge's findings the overheads could not reasonably be reduced. There were no savings to be made from the dismissal of staff other than those which had occurred and which the judge correctly held not to amount to any mitigation. In this case, the plaintiffs were not guilty of any failure to mitigate. Because that £139,000 was not received, the net profit on the remainder of the plaintiffs' activities was reduced by £139,000. It caused the plaintiffs a loss accordingly. The income and expenditure account for the period in question would have shown that the plaintiffs' overall net profits were reduced by that £139,000.

The judge was reluctant to award gross profit. He was concerned for these reasons:

> If Mr Marshall's argument is correct its effect, as he agreed, is that in times of depression any business concerned with contracts providing materials and labour and services could argue that its measure of loss for a breach of contract was not just the ordinary net loss which would have been the profit they would have expected to make on the contract but additionally the amount of indirect costs which would have been allocated to that contract when it was priced and the price agreed between the parties. To my mind this argument was to say the least novel. It was tantamount to saying that if a party who has entered into a contract to be provided with materials and labour breaks his contract, the damages recoverable varied with the financial state of the supplying company and the economic climate affecting the particular industry. I said I was surprised I had not met this argument before during the past year or two if it was valid, and asked Mr Marshall if he knew of any reported case in support of it. He knew of none and nor do I.
>
> He said his argument was based on general principle. The defendants not only should have known but knew that by breaking the contract the defendants would suffer loss equal to the gross profit they would have made on the contract, that is to say substantially more than they would have received from the contract had it been completed.
>
> I reject this argument. It confuses the general principle in sale of goods cases that the loss is what the seller has lost on a sale or the opportunity of a sale with the general principle applicable where by breach of contract he has been deprived of providing future materials and work and also with the duty to mitigate a loss.
>
> It amounts to saying that if there is no opportunity to mitigate loss due to general adverse economic conditions, then the seller of the materials and work can claim more for not being allowed to provide the future materials and work than he would generally be able to claim.

It is with great hesitation that I would interfere with a judge as experienced in this field as is Judge Fallon. But, with the proper respect to the judge, I fear he has been confused by seeking to draw analogies from particular classes of case such as sale of goods cases or cases for material and work done and he has fallen into error. In my judgment confusion is caused by labelling claims. Even too slavish an adoption of classifications such as direct and indirect costs or net and gross profit is liable to be

distracting from the general principle of ascertaining the loss of the bargain. Confusion is only avoided by going back to the basic principle of ascertaining how the breach of contract caused loss to the particular party.

For the reasons that I have endeavoured to explain, these plaintiffs are not claiming more than they have lost overall during this period of 48 weeks. Overall their profit and expenditure account is depreciated, not just by the notional net profit but by the loss of the availability of £139,000 to help defray the existing and inevitable overheads. In my judgment the judge was in error, and I would allow the appeal and substitute a judgment for the plaintiff in the sum of £176,903.88 with the appropriate interest. . . .

NOURSE LJ: . . . If reference to gross or net profit is avoided, the point at issue on this appeal can be seen to be both short and simple. The plaintiff claimed damages over a period of 48 weeks less the amount of the costs which it would have incurred in producing the newspaper, very largely the costs of the paper on which it would have been printed. The judge, while deciding that the plaintiff had not been guilty of any failure to mitigate its loss, declined to adopt that measure of damages and reduced them further by deducting the amount of the indirect costs, that is to say the appropriate share of the plaintiff's general overheads attributable to this particular contract.

In many cases such a deduction would no doubt be correct. But it assumes that the plaintiff was able to defray the indirect costs out of additional business taken on to fill the gaps in its schedule exposed by the loss of the defendant's business. On the facts found by the judge that was not this case. So the plaintiff has suffered additional loss through not having received funds from the defendant out of which to defray the indirect costs. I see no impediment to its being compensated for that additional loss. Indeed, it would be contrary to every principle on which damages are awarded for it not to be so compensated.

For these reasons, as well as for those given, I too would allow the appeal.

(b) Measurement: cost of cure

When, if ever, can the cost of cure be recovered?

Ruxley Electronics & Construction Ltd v *Forsyth*
[1995] 3 All ER 268 (HL)

The defendant contracted with the two plaintiff companies for the construction of an enclosed swimming pool in his garden. The contract terms required that the maximum depth of the pool should be 7′6″. In fact it was later discovered to be only 6′9″ as a maximum, and only 6′ at the diving point. When the plaintiffs claimed the unpaid balance of the purchase price, the defendant counterclaimed for breach of contract. The trial judge found as a fact that the pool as constructed was perfectly safe to dive into and that there was no difference in value between the swimming pool contracted for and that supplied. He refused to award the claimed cost of cure damages of £21,560 so that the specified depth could be achieved, on the basis that it would be unreasonable to award such damages which were 'wholly disproportionate to the disadvantage' of having a pool of this depth, and he was not satisfied that the defendant intended to carry out the

reconstruction work. Instead the judge awarded £2,500 for loss of amenity. The majority of the Court of Appeal (Staughton and Mann LJJ; Dillon LJ dissenting), allowing the appeal, awarded cost of cure damages on the basis that it was the only way to fulfil the defendant's contractual objective. Reasonableness was not a factor in its own right but was only relevant to mitigation and, given that there was no cheaper way of compensating for the loss, it was not unreasonable to award such cost of cure damages. Although the defendant had given an undertaking to rebuild on the appeal, it was held that this was irrelevant. Held: on appeal restoring the award of the trial judge, that cost of cure damages could be recovered only if it was reasonable to do so, and it would be reasonable only if the cost was not out of all proportion to the benefit to be obtained. The intention to rebuild was relevant to the reasonableness of awarding cost of cure because otherwise there would not be a loss needing to be compensated. The House of Lords confirmed the award of £2,500 for loss of amenity.

LORD JAUNCEY: . . . Damages are designed to compensate for an established loss and not to provide a gratuitous benefit to the aggrieved party, from which it follows that the reasonableness of an award of damages is to be linked directly to the loss sustained. If it is unreasonable in a particular case to award the cost of reinstatement it must be because the loss sustained does not extend to the need to reinstate. A failure to achieve the precise contractual objective does not necessarily result in the loss which is occasioned by a total failure. This was recognised by the High Court of Australia in the passage in *Bellgrove* v *Eldridge* [(1954) 90 CLR 613 at pp. 617–18] where it was stated that the cost of reinstatement work subject to the qualification of reasonableness was the extent of the loss, thereby treating reasonableness as a factor to be considered in determining what was that loss rather than, as the respondents argued, merely a factor in determining which of two alternative remedies were appropriate for a loss once established. Further support for this view is to be found in the following passage in the judgment of Megarry V-C in *Tito* v *Waddell (No. 2)* [1977] 3 All ER 129 at 316, [1977] Ch 106 at 332:

> Per contra, if the plaintiff has suffered little or no monetary loss in the reduction of value of his land, and he has no intention of applying any damages towards carrying out the work contracted for, or its equivalent, I cannot see why he should recover the cost of doing work which will never be done. It would be a mere pretence to say that this cost was a loss and so should be recoverable as damages.

Megarry V-C was, as I understand it, there saying that it would be unreasonable to treat as a loss the cost of carrying out work which would never in fact be done.

I take the example suggested during argument by my noble and learned friend Lord Bridge of Harwich. A man contracts for the building of a house and specifies that one of the lower courses of brick should be blue. The builder uses yellow brick instead. In all other respects the house conforms to the contractual specification. To replace the yellow bricks with blue would involve extensive demolition and reconstruction at a very large cost. It would clearly be unreasonable to award to the owner the cost of reconstructing because his loss was not the necessary cost of reconstruction of his house, which was entirely adequate for its design purpose, but merely the lack of aesthetic pleasure which he might have derived from the sight of blue bricks. Thus in the present appeal the respondent has acquired a perfectly serviceable swimming pool,

albeit one lacking the specified depth. His loss is thus not the lack of a usable pool with consequent need to construct a new one. Indeed were he to receive the cost of building a new one and retain the existing one he would have recovered not compensation for loss but a very substantial gratuitous benefit, something which damages are not intended to provide.

What constitutes the aggrieved party's loss is in every case a question of fact and degree. Where the contract breaker has entirely failed to achieve the contractual objective it may not be difficult to conclude that the loss is the necessary cost of achieving that objective. Thus if a building is constructed so defectively that it is of no use for its designed purpose the owner may have little difficulty in establishing that his loss is the necessary cost of reconstructing. Furthermore, in taking reasonableness into account in determining the extent of loss it is reasonableness in relation to the particular contract and not at large. Accordingly, if I contracted for the erection of a folly in my garden which shortly thereafter suffered a total collapse it would be irrelevant to the determination of my loss to argue that the erection of such a folly which contributed nothing to the value of my house was a crazy thing to do. As Oliver J said in *Radford* v *De Froberville* [1978] 1 All ER 33 at 42, [1977] 1 WLR 1262 at 1270:

> If he contracts for the supply of that which he thinks serves his interests, be they commercial, aesthetic or merely eccentric, then if that which is contracted for is not supplied by the other contracting party I do not see why, in principle, he should not be compensated by being provided with the cost of supplying it through someone else or in a different way, subject to the proviso, of course, that he is seeking compensation for a genuine loss and not merely using a technical breach to secure an uncovenanted profit.

However, where the contractual objective has been achieved to a substantial extent the position may be very different.

It was submitted that where the objective of a building contract involved satisfaction of a personal preference the only measure of damages available for a breach involving failure to achieve such satisfaction was the cost of reinstatement. In my view this is not the case. Personal preference may well be a factor in reasonableness and hence in determining what loss has been suffered but it cannot per se be determinative of what that loss is.

My Lords, the trial judge found that it would be unreasonable to incur the cost of demolishing the existing pool and building a new and deeper one. In so doing he implicitly recognised that the respondent's loss did not extend to the cost of reinstatement. He was, in my view, entirely justified in reaching that conclusion. It therefore follows that the appeal must be allowed.

. . . The appellant argued that the cost of reinstatement should only be allowed as damages where there was shown to be an intention on the part of the aggrieved party to carry out the work. Having already decided that the appeal should be allowed I no longer find it necessary to reach a conclusion on this matter. However, I should emphasise that in the normal case the court has no concern with the use to which a plaintiff puts an award of damages for a loss which has been established. Thus, irreparable damage to an article as a result of a breach of contract will entitle the owner to recover the value of the article irrespective of whether he intends to replace it with a similar one or to spend the money on something else. Intention, or lack of it, to reinstate can have relevance only to reasonableness and hence to the extent of the loss which has been sustained. Once that loss has been established intention as to the subsequent use of the damages ceases to be relevant. . . .

LORD MUSTILL: . . . In my opinion there would indeed be something wrong if, on the hypothesis that cost of reinstatement and the depreciation in value were the only available measures of recovery, the rejection of the former necessarily entailed the adoption of the latter; and the court might be driven to opt for the cost of reinstatement, absurd as the consequence might often be, simply to escape from the conclusion that the promisor can please himself whether or not to comply with the wishes of the promisee which, as embodied in the contract, formed part of the consideration for the price. Having taken on the job the contractor is morally as well as legally obliged to give the employer what he stipulated to obtain, and this obligation ought not to be devalued. In my opinion, however, the hypothesis is not correct. There are not two alternative measures of damage, at opposite poles, but only one: namely the loss truly suffered by the promisee. In some cases the loss cannot be fairly measured except by reference to the full cost of repairing the deficiency in performance. In others, and in particular those where the contract is designed to fulfil a purely commercial purpose, the loss will very often consist only of the monetary detriment brought about by the breach of contract. But these remedies are not exhaustive, for the law must cater for those occasions where the value of the promise to the promisee exceeds the financial enhancement of his position which full performance will secure. This excess, often referred to in the literature as the 'consumer surplus' (see e.g. the valuable discussion by Harris, Ogus and Phillips, 'Contract Remedies and the Consumer Surplus' (1979) 95 LQR 581) is usually incapable of precise valuation in terms of money, exactly because it represents a personal, subjective and non-monetary gain. Nevertheless, where it exists the law should recognise it and compensate the promisee if the misperformance takes it away. The lurid bathroom tiles, or the grotesque folly instanced in argument by my noble and learned friend Lord Keith of Kinkel, may be so discordant with general taste that in purely economic terms the builder may be said to do the employer a favour by failing to instal them. But this is too narrow and materialistic a view of the transaction. Neither the contractor nor the court has the right to substitute for the employer's individual expectation of performance a criterion derived from what ordinary people would regard as sensible. As my Lords have shown, the test of reasonableness plays a central part in determining the basis of recovery, and will indeed be decisive in a case such as the present when the cost of reinstatement would be wholly disproportionate to the non-monetary loss suffered by the employer. But it would be equally unreasonable to deny all recovery for such a loss. The amount may be small, and since it cannot be quantified directly there may be room for difference of opinion about what it should be. But in several fields the judges are well accustomed to putting figures to intangibles, and I see no reason why the imprecision of the exercise should be a barrier, if that is what fairness demands.

My Lords, once this is recognised, the puzzling and paradoxical feature of this case, that it seems to involve a contest of absurdities, simply falls away. There is no need to remedy the injustice of awarding too little by unjustly awarding far too much. The judgment of the trial judge acknowledges that the employer has suffered a true loss and expresses it in terms of money. Since there is no longer any issue about the amount of the award, as distinct from the principle, I would simply restore his judgment by allowing the appeal.

LORD LLOYD: [Lord Lloyd cited the judgment of Cardozo J in *Jacob & Youngs Inc.* v *Kent* (1921) 230 NY 239 and continued:]

Cardozo J's judgment is important because it establishes two principles which I believe to be correct and which are directly relevant to the present case: first, the cost

of reinstatement is not the appropriate measure of damages if the expenditure would be out of all proportion to the good to be obtained, and secondly, the appropriate measure of damages in such a case is the difference in value, even though it would result in a nominal award.

The first of these principles is contrary to Staughton LJ's view that the plaintiff is entitled to reinstatement, however expensive, if there is no cheaper way of providing what the contract requires. The second principle is contrary to the whole thrust of [counsel for the defendant's] argument that the judge had no alternative but to award the cost of reinstatement, once it became apparent that the difference in value produced a nil result.

[He then cited *Bellgrove* v *Eldridge* (1954) 90 CLR 613, *East Ham BC* v *Bernard Sunley & Sons Ltd* [1965] 3 All ER 619 and *G W Atkins Ltd* v *Scott* (1980) 7 Const LJ 215.] . . . It seems to me that in the light of these authorities [counsel for the plaintiff] was right when he submitted, and Dillon LJ was right when he held, that mitigation is not the only area in which the concept of reasonableness has an impact on the law of damages.

If the court takes the view that it would be unreasonable for the plaintiff to insist on reinstatement, as where, for example, the expense of the work involved would be out of all proportion to the benefit to be obtained, then the plaintiff will be confined to the difference in value. If the judge had assessed the difference in value in the present case at, say, £5,000, I have little doubt that the Court of Appeal would have taken that figure rather than £21,560. The difficulty arises because the judge has, in the light of the expert evidence, assessed the difference in value as nil. But that cannot make reasonable what he has found to be unreasonable.

So I cannot accept that reasonableness is confined to the doctrine of mitigation. It has a wider impact. . . .

How then does [counsel for the defendant] seek to support the majority judgment? It can only be, I think, by attacking the judge's finding of fact that the cost of rebuilding the pool would have been out of all proportion to the benefit to be obtained. [Counsel] argues that this was not an ordinary commercial contract but a contract for a personal preference. . . .

I am far from saying that personal preferences are irrelevant when choosing the appropriate measure of damages ('predilections' was the word used by Ackner LJ in *G W Atkins Ltd* v *Scott* (1980) 7 Const LJ 215 at 221, adopting the language of Oliver J in *Radford* v *De Froberville* [1978] 1 All ER 33, [1977] 1 WLR 1262). But such cases should not be elevated into a separate category with special rules. If, to take an example mentioned in the course of argument, a landowner wishes to build a folly in his grounds, it is no answer to a claim for defective workmanship that many people might regard the presence of a well-built folly as reducing the value of the estate. The eccentric landowner is entitled to his whim, provided the cost of reinstatement is not unreasonable. But the difficulty of that line of argument in the present case is that the judge, as is clear from his judgment, took Mr Forsyth's personal preferences and predilections into account. Nevertheless, he found as a fact that the cost of reinstatement was unreasonable in the circumstances. The Court of Appeal ought not to have disturbed that finding.

Intention

I fully accept that the courts are not normally concerned with what a plaintiff does with his damages. But it does not follow that intention is not relevant to reasonableness, at least in those cases where the plaintiff does not intend to reinstate. Suppose in the present case Mr Forsyth had died, and the action had been continued by his

executors. Is it to be supposed that they would be able to recover the cost of reinstatement, even though they intended to put the property on the market without delay?

There is, as Staughton LJ observed, a good deal of authority to the effect that intention may be relevant to a claim for damages based on cost of reinstatement. The clearest decisions on the point are those of Megarry V-C in *Tito* v *Waddell (No. 2)* [1977] 3 All ER 129, [1977] Ch 106 and Oliver J in *Radford* v *De Froberville* [1978] 1 All ER 33, [1977] 1 WLR 1262. One of the many questions in the former case was whether the plaintiffs could recover the cost of replanting the plots of land in question, or whether the recovery of damages was limited to the difference in the market value of the land by reason of the work not having been done. Megarry V-C said ([1977] 3 All ER 129 at 316, [1977] Ch 106 at 332):

> Again, some contracts for alterations to buildings, or for their demolition, might not, if carried out, enhance the market value of the land, and sometimes would reduce it. The tastes and desires of the owner may be wholly out of step with the ideas of those who constitute the market; yet I cannot see why eccentricity of taste should debar him from obtaining substantial damages unless he sues for specific performance. Per contra, if the plaintiff has suffered little or no monetary loss in the reduction of value of his land, and he has no intention of applying any damages towards carrying out the work contracted for, or its equivalent, I cannot see why he should recover the cost of doing work which will never be done. It would be a mere pretence to say that this cost was a loss and so should be recoverable as damages.

In the present case the judge found as a fact that Mr Forsyth's stated intention of rebuilding the pool would not persist for long after the litigation had been concluded. In these circumstances it would be 'mere pretence' to say that the cost of rebuilding the pool is the loss which he has in fact suffered. This is the critical distinction between the present case and the example given by Staughton LJ of a man who has had his watch stolen. In the latter case, the plaintiff is entitled to recover the value of the watch because that is the true measure of his loss. He can do what he wants with the damages. But if, as the judge found, Mr Forsyth had no intention of rebuilding the pool, he has lost nothing except the difference in value, if any. . . .

Does Mr Forsyth's undertaking to spend any damages which he may receive on rebuilding the pool make any difference? Clearly not. He cannot be allowed to create a loss which does not exist in order to punish the defendants for their breach of contract. The basic rule of damages, to which exemplary damages are the only exception, is that they are compensatory not punitive.

Notes

1. See Poole, 'Damages for Breach of Contract — Compensation and "Personal Preferences"' (1996) 59 MLR 272.

2. Cost of cure damages are an example of compensation that takes account of the innocent party's subjective contractual preferences or subjective valuation of the contractual performance, i.e. that the innocent party's loss may be more than the objective difference in value measure and that the only way to compensate that party is to provide him with the means to fulfil that subjective requirement. (See Harris, Ogus and Phillips, 'The Consumer Surplus' (1979) 95 LQR 581.)

3. The arguments in favour of awarding cost of cure damages on facts such as these are, first, that not to do so sends the wrong signals to the construction industry by indicating that they will not have to pay substantial damages if

they do not fulfil the subjective preferences of the other party specified in the contract; secondly, it can be argued that the innocent party does not actually receive what he specifically requested under the contract. This assumes that there are to be no limits set by the courts on the ability to compensate for loss of subjective preferences when some limit is clearly called for in order to avoid windfall damages and unjust enrichment to the innocent party as a result of a damages award. The crucial factor in *Ruxley* appears to have been the relative triviality of the breach. Although Mr Forsyth's wishes were relevant, they could not dictate an award of cost of cure damages when reconstruction was not a reasonable course of action in the circumstances. However, the House of Lords did make it clear that there can be no objection in principle to fulfilling unusual tastes where these are contracted for.

4. The example of the folly in the judgment of Lord Jauncey is a useful one in explaining why and where the line on recovery is likely to be drawn. What would the position be if the breach was that the folly had been constructed six inches to the right of the preferred spot? Would counsel for Mr Forsyth have argued that Mr Forsyth was entitled to substantial damages if the pool had been constructed to a depth of 7 feet 5 inches?

5. The conclusion of Staughton and Mann LJJ in the Court of Appeal that there was no requirement to establish an intention to carry out the repair had also received support from Steyn and Dillon LJJ *Darlington BC* v *Wiltshier Northern Ltd* [1995] 3 All ER 895, page 214, but it has now been revived by the House of Lords as being relevant to reasonableness and establishing the loss sustained. (See the judgment of Lord Lloyd above.)

6. It has been argued that the damages in a case like *Ruxley* should be restitutionary damages to prevent unjust enrichment of the contractor by making him liable for the amount he has saved by not performing the obligation in question. However, this was not argued in *Ruxley* and it was rejected in *Surrey* v *Bredero* [1993] 3 All ER 705. For an outline of other suggested alternatives on damages see Poole (1996) 59 MLR 272, 284–5.

7. For further discussion of the award for loss of amenity see pages 389–90 below.

8. See also Loke, 'Cost of Cure or Difference in Market Value? Toward a Sound Choice in the Basis for Quantifying Expectation Damages' (1996) 10 JCL 189 and Phang [1996] JBL 362.

Watts v *Morrow*
[1991] 4 All ER 937 (CA)

The plaintiffs purchased a country house for £177,500 in reliance on the defendant's survey, in which he stated that overall the dwelling house was sound, stable and in good condition, although there were minor defects. When the plaintiffs took possession, they discovered that there were substantial defects not mentioned in the report which required urgent repair, including renewal of the roof, windows and floor boards. The true value of the house at the date of purchase was therefore only £162,500 (a

difference in value of £15,000). The plaintiffs carried out the repairs at a cost of nearly £34,000 and brought an action to recover those costs. At first instance the cost of repairs was awarded. Held: although it was reasonable for the plaintiffs to retain the property and carry out the repairs, the proper measure of damages was the difference in value, since this was the amount required to put the plaintiffs into the position that they would have been in had the survey been carried out properly and the true value of the house paid. If they recovered the cost of repairs they would be recovering damages for breach of warranty as to the condition of the house when no such warranty had been given.

RALPH GIBSON LJ: It was rightly acknowledged for the plaintiffs that proof that the plaintiff, properly advised, would not have bought the property does not by itself cause the diminution in value rule to be inapplicable. It was contended, however, that it becomes inapplicable if it is also proved that it is reasonable for the plaintiff to retain the property and to do the repairs. I cannot accept that submission for the following reasons.

(i) The fact that it is reasonable for the plaintiff to retain the property and to do the repairs seems to me to be irrelevant to determination of the question whether recovery of the cost of repairs is justified in order to put the plaintiff in the position in which he would have been if the contract, ie the promise to make a careful report, had been performed. The position is no different from that in *Philips* v *Ward* [1956] 1 All ER 874: either the plaintiff would have refused to buy or he would have negotiated a reduced price. Recovery of the cost of repairs after having gone into possession, that is to say in effect the acquisition of the house at the price paid less the cost of repairs at the later date of doing those repairs, is not a position into which the plaintiff could have been put as a result of proper performance of the contract. Nor is that cost recoverable as damages for breach of any promise by the defendant because, as stated above, there was no promise that the plaintiff would not incur any such cost.

(ii) In the context of the contract proved in this case, I have difficulty in seeing when or by reference to what principle it would not be reasonable for the purchaser of a house to retain it and to do the repairs. He is free to do as he pleases. He can owe no duty to the surveyor to take any cheaper course. The measure of damages should depend, and in my view does depend, upon proof of the sum needed to put the plaintiff in the position in which he would have been if the contract was properly performed, and a reasonable decision by him to remain in the house and to repair it, upon discovery of the defects, cannot alter that primary sum, which remains the amount by which he was caused to pay more than the value of the house in its condition.

Note

The surveyor owed a duty to exercise reasonable care and skill in carrying out the survey. He had not warranted that no repairs would be needed. To award the cost of repair would involve treating the surveyor's obligation as strict when it was only qualified.

B: RELIANCE LOSS

The injured party may wish to claim for reliance loss ('wasted expenditure'), i.e., the expenses incurred in preparing to perform or performing the contract

which have now been wasted as a result of the breach. When can reliance interest damages be claimed?

(a) Where expectation or profit is too speculative

An injured party will be forced to claim for his reliance interest damages where the expectation or profit under the contract is too speculative to establish.

McRae* v *Commonwealth Disposals Commission
(1951) 84 CLR 377 (High Court of Australia)

The Commission invited tenders 'for the purchase of an oil tanker lying on Jourmaund Reef. The vessel is said to contain oil'. The plaintiff's tender of £285 was accepted. The plaintiff spent money in fitting out a salvage expedition but there was no tanker at the location. Held: the Commission were in breach of contract since they had promised that there was an oil tanker at the location given (see page 426). The amount that the plaintiff was entitled to recover was £285 (the purchase price) and damages of £3,000 (being the cost of the salvage expedition which was wasted in reliance on the promise that the oil tanker was at the stated location). This salvage expedition was within the reasonable contemplation of the parties. However, since the Commission had not promised to deliver any oil or a tanker of any specified size, the claim for the loss of profit on the tanker and the oil was too speculative.

DIXON J and FULLAGER J (McTiernan J concurring): '[I]t is quite impossible to place any value on what the Commission purported to sell. The plaintiffs indeed, on one basis of claim which is asserted in their statement of claim, assessed their damages on the basis of an 'average-sized tanker, 8,000-10,000 ton oil tanker, valued at £1,000,000, allowing for the said tanker lying on Jourmaund Reef, valued at £250,000', and, for good measure, they added their 'estimated value of cargo of oil' at the figure of £50,000. But this, as a basis of damages, seems manifestly absurd. The Commission simply did not contract to deliver a tanker of any particular size or of any particular value or in any particular condition, nor did it contract to deliver any oil.

It was strongly argued for the plaintiffs that mere difficulty in estimating damages did not relieve a tribunal from the responsibility of assessing them as best it could. This is undoubtedly true. In the well-known case of *Chaplin* v *Hicks* [1911] 2 KB 786 Vaughan Williams LJ said: — 'The fact that damages cannot be assessed with certainty does not relieve the wrongdoer of the necessity of paying damages for his breach of contract'. That passage, and others from the same case, are quoted by Street CJ in *Howe* v *Teefy* (1927) 27 SR (NSW) 301, but the learned Chief Justice himself states the position more fully. He says: — 'The question in every case is: has there been any assessable loss resulting from the breach of contract complained of? There may be cases where it would be impossible to say that any assessable loss had resulted from a breach of contract, but, short of that, if a plaintiff has been deprived of something which has a monetary value, a jury is not relieved from the duty of assessing the loss merely because the calculation is a difficult one or because the circumstances do not

admit of the damages being assessed with certainty' . . . It does not seem possible to say that 'any assessable loss has resulted from' non-delivery as such. In *Chaplin* v *Hicks* [1911] 2 KB 786, if the contract had been performed, the plaintiff would have had a real chance of winning the prize, and it seems proper enough to say that that chance was worth something. It is only in another and quite different sense that it could be said here that, if the contract had been performed, the plaintiffs would have had a chance of making a profit. The broken promise itself in *Chaplin* v *Hicks* [1911] 2 KB 786 was, in effect, 'to give the plaintiff a chance': here the element of chance lay in the nature of the thing contracted for itself. Here we seem to have something which cannot be assessed. If there were nothing more in this case than a promise to deliver a stranded tanker and a failure to deliver a stranded tanker, the plaintiffs would, of course, be entitled to recover the price paid by them, but beyond that, in our opinion, only nominal damages.

Note

There is a distinction between a loss which is merely speculative and a 'real' loss of a chance, as in *Chaplin* v *Hicks*, where the court should seek to quantify the loss. See also *Allied Maples Group Ltd* v *Simmons & Simmons (a firm)* [1995] 4 All ER 907, where the plaintiff's loss resulting from the defendant's negligence depended on the hypothetical action of a third party. The Court of Appeal held that the plaintiff could succeed if he proved that there was a substantial chance of the action being taken and not merely a speculative chance. This substantial chance could then be evaluated by the court and would lie 'somewhere between something that just qualifies as real or substantial on the one hand and near certainty on the other'.

Anglia Television Ltd v *Reed*
[1972] 1 QB 60 (CA)

The defendant, an American actor, contracted with the plaintiffs to play the leading male role from 9 September to 11 October in a television play. On 3 September, the defendant repudiated. The plaintiffs could not get a substitute and abandoned the production. The plaintiffs sued the defendant for damages of £2,750, their total wasted expenditure on the production. The defendant argued that they could only recover the expenditure incurred after they made the contract (£854). The Court of Appeal awarded £2,750. Held: since the plaintiffs had elected to claim their wasted expenditure instead of loss of profits, they could also recover pre-contract expenditure as long as it was reasonably in the contemplation of the parties as likely to be wasted if the contract was broken. (For a discussion of remoteness, see page 391.)

LORD DENNING MR: . . . Anglia Television do not claim their profit. They cannot say what their profit would have been on this contract if Mr Reed had come here and performed it. So, instead of claim for loss of profits, they claim for the wasted expenditure. They had incurred the director's fees, the designer's fees, the stage manager's and assistant manager's fees, and so on. It comes in all to £2,750. Anglia Television say that all that money was wasted because Mr Reed did not perform his contract.

Mr Reed's advisers take a point of law. They submit that Anglia Television cannot recover for expenditure incurred *before* the contract was concluded with Mr Reed. They can only recover the expenditure *after* the contract was concluded. They say that the expenditure *after* the contract was only £854.65, and that is all that Anglia Television can recover.

The master rejected that contention: he held that Anglia Television could recover the whole £2,750; and now Mr Reed appeals to this court.

. . . It seems to me that a plaintiff in such a case as this has an election: he can either claim for loss of profits; or for his wasted expenditure. But he must elect between them. He cannot claim both. If he has not suffered any loss of profits — or if he cannot prove what his profits would have been — he can claim in the alternative the expenditure which has been thrown away, that is, wasted, by reason of the breach. That is shown by *Cullinane* v *British 'Rema' Manufacturing Co. Ltd* [1954] 1 QB 292, 303, 308.

If the plaintiff claims the wasted expenditure, he is not limited to the expenditure incurred *after* the contract was concluded. He can claim also the expenditure incurred *before* the contract, provided that it was such as would reasonably be in the contemplation of the parties as likely to be wasted if the contract was broken. Applying that principle here, it is plain that, when Mr Reed entered into this contract, he must have known perfectly well that much expenditure had already been incurred on director's fees and the like. He must have contemplated — or, at any rate, it is reasonably to be imputed to him — that if he broke his contract, all that expenditure would be wasted, whether or not it was incurred before or after the contract. He must pay damages for all the expenditure so wasted and thrown away. This view is supported by the recent decision of Brightman J in *Lloyd* v *Stanbury* [1971] 1 WLR 535. There was a contract for the sale of land. In anticipation of the contract — and before it was concluded — the purchaser went to much expense in moving a caravan to the site and in getting his furniture there. The seller afterwards entered into a contract to sell the land to the purchaser, but afterwards broke his contract. The land had not increased in value, so the purchaser could not claim for any loss of profit. But Brightman J held, at p. 547, that he could recover the cost of moving the caravan and furniture, because it was 'within the contemplation of the parties when the contract was signed.' That decision is in accord with the correct principle, namely, that wasted expenditure can be recovered when it is wasted by reason of the defendant's breach of contract. It is true that, if the defendant had never entered into the contract, he would not be liable, and the expenditure would have been incurred by the plaintiff without redress: but, the defendant having made his contract and broken it, it does not lie in his mouth to say he is not liable, when it was because of his breach that the expenditure has been wasted.

Notes

1. Expectation loss (i.e., the loss of profits on the television film) was too speculative to be claimed.

2. Although Lord Denning states that an election must be made between recovering expectation and reliance loss, the position is that the injured party cannot recover gross profit as expectation loss as well as the costs of performing the contract, since the gross profit figure includes those costs and it is not possible to recover twice for the same loss. There is no reason, however, why a claim could not be combined for net profit and wasted expenditure since there would then be no double recovery.

In *CCC Films (London) Ltd* v *Impact Quadrant Films Ltd* [1984] 3 All ER 298, Hutchison J said (at p. 306):

> . . . the plaintiff has an unfettered choice: it is not only where he establishes by evidence that he cannot prove loss of profit or that such loss of profit as he can prove is small that he is permitted to frame his claim as one for wasted expenditure. I consider that when Lord Denning MR says, 'If he has not suffered any loss of profits — or if he cannot prove what his profits would have been — he can claim in the alternative the expenditure which has been thrown away', and when Evershed MR says 'if it were shown that the profit-earning capacity was, in fact, very small, the plaintiff would probably elect so to base his claim', each is describing factors which would be likely to motivate the plaintiff to elect to claim on the lost expenditure basis rather than laying down what must be proved before such a claim can be entertained. In other words, I consider that those cases are authority for the proposition that a plaintiff may always frame his claim in the alternative way if he chooses. I reach this conclusion all the more readily when I reflect that to hold that there had to be evidence of the impossibility of making profits might in many cases saddle the plaintiff with just the sort of difficulties of proof that this alternative measure is designed to avoid.

5. However, note that the judgments of the High Court of Australia in *Commonwealth of Australia* v *Amann Aviation Pty Ltd* (1991) 66 ALJR 123 (noted Treitel (1992) 108 LQR 226), suggest that there is no right of election between expectation and reliance interest damages, and Toohey and McHugh JJ considered that reliance damages could only be recovered in cases where there was either no profit, or where it was not possible to establish a profit with any certainty.

(b) 'Bad bargains'

It is not possible to recover reliance loss to compensate the plaintiff for having made a 'bad bargain', since this would put an injured party in a better position than if the contract were performed.

C & P Haulage v *Middleton*
[1983] 3 All ER 94 (CA)

The plaintiff was granted a contractual licence by the defendant to occupy premises for the purposes of his work. The plaintiff spent money making the premises suitable by building an enclosing wall and putting in electricity, even though it was expressly provided that fixtures put in by him were not to be removed when the licence expired. The plaintiff was unlawfully ejected by the defendant but the local authority allowed him to use his own garage for business purposes which meant that he saved £60–£100 a week rent. The plaintiff claimed the cost of the improvements to the premises. Held: the court had to endeavour to put the plaintiff in the position that he would have been in had the contract been performed, but the plaintiff had suffered no loss so that his damages were nominal.

ACKNER LJ: . . . It, is not the function of the courts where there is a breach of contract knowingly, as this would be the case, to put the plaintiff in a better financial position than if the contract had been properly performed. In this case the appellant, if he was right in his claim, would indeed be in a better position because, as I have already indicated, had the contract been lawfully determined, as it could have been in the middle of December, there would have been no question of his recovering these expenses.

Question

Who bears the burden of proving whether the plaintiff has made a bad bargain, i.e., whether the expenditure would have been recouped?

CCC Films (London) Ltd v *Impact Quadrant Films Ltd*
[1984] 3 All ER 298

The plaintiffs had been given a licence by the defendants to exploit, distribute and exhibit films, but due to the defendants' breach of contract the plaintiffs did not receive the tapes of the films and so could not exploit the licence. Held: where the plaintiff was claiming for reliance expenditure (here the US$12,000 spent on the licence) and had been prevented by the defendant's breach of contract from recouping his expenditure, the onus was on the defendant to show that the expenditure would not have been recouped even if the plaintiff had been able to exploit the licence. On the facts the defendants had not discharged this burden. Hutchison J relied on the statements of Learned Hand CJ in *L. Albert & Son v Armstrong Rubber Co.* (1949) 178 F 2d 182, 189.

HUTCHISON J: . . . In cases where the venture would have proved profitable to the promisee there is no reason why he should not recover his expenses. On the other hand, on those occasions in which the performance would not have covered the promisee's outlay, such a result imposes the risk of the promisee's contract upon the promisor. We cannot agree that the promisor's default in performance should under this guise make him an insurer of the promisee's venture; yet it does not follow that the breach should not throw upon him the duty of showing that the value of the performance would in fact have been less than the promisee's outlay. It is often very hard to learn what the value of the performance would have been; and it is a common expedient, and a just one, in such situations to put the peril of the answer upon the party who by his wrong has made the issue relevant to the rights of the other. On principle, therefore, the proper solution would seem to be that the promisee may recover this outlay in preparation for the performance, subject to the privilege of the promisor to reduce it by as much as he can show that the promisee would have lost, if the contract had been performed.

. . . It seems to me that, at least in those cases where the plaintiff's decision to base his claim on abortive expenditure was dictated by the practical impossibility of proving loss of profit rather than by unfettered choice, any other rule would largely, if not entirely, defeat the object of allowing this alternative method of formulating the claim. This is because, notwithstanding the distinction to which I have drawn attention between proving a loss of net profit and proving in general terms the probability of sufficient returns to cover expenditure, in the majority of contested cases impossibility

of proof of the first would probably involve like impossibility in the case of the second. It appears to me to be eminently fair that in such cases, where the plaintiff has by the defendant's breach been prevented from exploiting the chattel or the right contracted for and, therefore, putting to the test the question of whether he would have recouped his expenditure, the general rule as to the onus of proof of damage should be modified in this manner.

It follows that, the onus being on the defendants to prove that the expenditure incurred by the plaintiffs is irrecoverable because they would not have recouped their expenditure (and that onus admittedly not having been discharged), the plaintiffs are entitled to recover such expenditure as was wasted as a result of such breach or breaches of contract as they have proved.

Notes

1. Although this case is traditionally cited as authority for the fact that the burden of establishing that it is not a good bargain rests with the guilty party, the Court of Appeal in *Dataliner Ltd* v *Vehicle Builders & Repairers Association* (1995) *The Independent*, 30 August, has explained the statement of Hutchison J in *CCC Films* as being that the burden of proof actually depends on the effect of the breach. In general the burden will lie on the innocent party to establish on the balance of probabilities that he made a good bargain (i.e. that but for the defendant's breach he would have recouped this expenditure). For example, in *Dataliner*, where the plaintiff had wasted expenses in attending a trade show which the defendants, as conference organisers, had failed properly to promote, the judge found that the plaintiff's expectation that it would at least recover its expenditure was reasonable and justified. However, if, as in *CCC Films*, the defendant's breach makes it impossible for the plaintiff to prove that the expenditure would have been recouped, then the burden shifts to the defendant to establish that the plaintiff would not have recovered his expenditure in any event.

2. This is clearly a preferable position on the burden of proof because, in general, the guilty party will have difficulty discharging this burden where the relevant information is more readily available to the innocent party. However, where it is the guilty party's breach that prevents the plaintiff being able to establish that he would have recovered his expenses, the burden should lie with the defendant.

3. The decision in *Commonwealth of Australia* v *Amann Aviation Pty Ltd* (1991) 66 ALJR 123, is a good illustration of the difficulties in establishing whether the expenditure would have been recouped. On the facts it was arguable that, even if the contract had not been wrongfully terminated, the company would have recouped its expenditure only if the contract had been renewed for a further term.

C: DAMAGES FOR DISAPPOINTMENT AND DISTRESS

In *Addis* v *Gramophone Company Ltd* [1909] AC 488, the House of Lords held that any damages award for wrongful dismissal must not compensate for injured feelings.

There are two exceptional cases where such damages for distress can be recovered in contract:

(a) Contracts whose object is to provide peace of mind or freedom from distress

Bliss* v *South East Thames Regional Health Authority
[1987] ICR 700 (CA)

The plaintiff was employed by the defendant health authority as a consultant orthopaedic surgeon. Following a dispute with a colleague, the Regional Health Authority required him to undergo a psychiatric examination, but the plaintiff refused to comply and was suspended. The plaintiff's solicitors alleged that the defendant had repudiated the plaintiff's employment contract. The plaintiff then brought an action against the defendant health authority for damages for breach of contract, and the judge's award included £2,000 damages for mental distress. Held: in contract it was not possible to recover damages for distress in cases of wrongful dismissal. The Court of Appeal overruled *Cox* v *Philips Industries Ltd* [1976] 3 All ER 161, which had suggested that such damages were more widely available.

DILLON LJ: It remains to consider . . . the validity of the judge's award of £2,000 with interest by way of general damages for frustration and mental distress. In making such an award, the judge considered that he was justified by the decision of Lawson J in *Cox* v *Philips Industries Ltd* [1976] ICR 138. With every respect to them, however, the views of Lawson J in that case and of the judge in the present case are on this point, in my judgment, wrong.

The general rule laid down by the House of Lords in *Addis* v *Gramophone Co. Ltd* [1909] AC 488 is that where damages fall to be assessed for breach of contract rather than in tort it is not permissible to award general damages for frustration, mental distress, injured feelings or annoyance occasioned by the breach. Modern thinking tends to be that the amount of damages recoverable for a wrong should be the same whether the cause of action is laid in contract or in tort. But in the *Addis* case Lord Loreburn regarded the rule that damages for injured feelings cannot be recovered in contract for wrongful dismissal as too inveterate to be altered, and Lord James of Hereford supported his concurrence in the speech of Lord Loreburn by reference to his own experience at the Bar.

There are exceptions now recognised where the contract which has been broken was itself a contract to provide peace of mind or freedom from distress: see *Jarvis* v *Swans Tours Ltd* [1973] QB 233 and *Heywood* v *Wellers* [1976] QB 446. Those decisions, do not however cover this present case.

In *Cox* v *Philips Industries Ltd* [1976] ICR 138 Lawson J took the view that damages for distress, vexation and frustration, including consequent ill-health, could be recovered for breach of a contract of employment if it could be said to have been in the contemplation of the parties that the breach would cause such distress etc. For my part, I do not think that that general approach is open to this court unless and until the House of Lords has reconsidered its decision in the *Addis* case.

Note
Holiday contracts fall within the category of contracts 'to provide peace of mind' where such damages are recoverable.

Jarvis v *Swans Tours Ltd*
[1973] QB 233 (CA)

As his annual fortnight's holiday, the plaintiff booked a Christmas skiing holiday with the defendants for £63.45. The defendants' brochure described the holiday as a 'House party' and stated that the hotel had its own 'Alphutte Bar' which would be open several evenings a week. It was also stated that a welcome party, afternoon tea and cakes, a fondue party and yodeller evening were included in the price. In fact there were only 13 people at the hotel in the first week, and in the second week the plaintiff was the only resident so that there was no house party at all. The skiing did not correspond to the claims in the brochure, the cakes consisted of potato crisps and dry nut cakes, and the yodeller was a man who came in in his working clothes and quickly sang a few songs. The bar was open on one evening. The plaintiff claimed damages for these breaches of contract. Held: the plaintiff was entitled to be compensated for his disappointment and distress at the loss of his holiday and the loss of the facilities which had been promised in the brochure.

LORD DENNING MR: . . . In a proper case damages for mental distress can be recovered in contract, just as damages for shock can be recovered in tort. One such case is a contract for a holiday, or any other contract to provide entertainment and enjoyment. If the contracting party breaks his contract, damages can be given for the disappointment, the distress, the upset and frustration caused by the breach. I know that it is difficult to assess in terms of money, but it is no more difficult than the assessment which the courts have to make every day in personal injury cases for loss of amenities. Take the present case. Mr Jarvis has only a fortnight's holiday in the year. He books it far ahead, and looks forward to it all that time. He ought to be compensated for the loss of it.

A good illustration was given by Edmund Davies LJ in the course of the argument. He put the case of a man who has taken a ticket for Glyndbourne. It is the only night on which he can get there. He hires a car to take him. The car does not turn up. His damages are not limited to the mere cost of the ticket. He is entitled to general damages for the disappointment he has suffered and the loss of the entertainment which he should have had. Here, Mr Jarvis's fortnight's winter holiday has been a grave disappointment. It is true that he was conveyed to Switzerland and back and had meals and bed in the hotel. But that is not what he went for. He went to enjoy himself with all the facilities which the defendants said he would have. He is entitled to damages for the lack of those facilities and for his loss of enjoyment . . .

I think the judge was in error in taking the sum paid for the holiday £63.45 and halving it. The right measure of damages is to compensate him for the loss of entertainment and enjoyment which he was promised, and which he did not get.

Looking at the matter quite broadly, I think the damages in this case should be the sum of £125.

Notes

1. An example of a contract the purpose of which is freedom from distress is provided by *Heywood* v *Wellers* [1976] QB 446. The plaintiff employed the defendant solicitors to secure a method of preventing a former male friend

from pestering her. The solicitors sought a non-molestation injunction but were negligent in making the application so that the injunction was ineffective, and the plaintiff was molested on three or four further occasions, causing her mental distress and upset. The Court of Appeal awarded damages which included a sum to compensate her for the anxiety and distress she had suffered in consequence of the continued molestation, since this was a direct and foreseeable consequence of the solicitors' failure to obtain the relief which it was the very purpose of the contract to secure.

2. In these examples it appears that damages for distress were available in order to compensate the plaintiff for loss of expectation under those contracts. The very purpose of the contracts had been lost.

3. In these exceptional cases the courts take account of 'subjective' losses.

Hayes v *James and Charles Dodd*
[1990] 2 All ER 815 (CA)

The plaintiffs wished to purchase larger premises for their motor repair business. The premises they wished to purchase had only a narrow access through a tunnel at the front, but the plaintiffs' solicitor negligently informed them that there was a right of way over land at the rear so that there would be access to the garage. The plaintiffs purchased the property but the owner of the land at the rear blocked the access. This had a devastating effect on the plaintiffs' business and after 12 months the business was closed down. At first instance the damages award included £1,500 damages for each plaintiff for anguish and vexation. The Court of Appeal overturned this award. Held: such damages were not available if, as here, they arose out of a breach of a purely commercial contract.

STAUGHTON LJ: Like the judge, I consider that the English courts should be wary of adopting what he called 'the United States practice of huge awards'. Damages awarded for negligence or want of skill, whether against professional men or anyone else, must provide fair compensation, but no more than that. And I would not view with enthusiasm the prospect that every shipowner in the Commercial Court, having successfully claimed for unpaid freight or demurrage, would be able to add a claim for mental distress suffered while he was waiting for his money.

In a sense, the wrong done to the plaintiffs in this action, for which they seek compensation under this head, lay in the defendants' failure to admit liability at an early stage. On 6 July 1983 the defendants acknowledged that there was no right of way, but denied negligence. Had they on that very day admitted liability and tendered a sum on account of damages, or offered interim reparation in some other form, the anxiety of the plaintiffs, and their financial problems, could have been very largely relieved. But liability was not admitted until January 1987. I believe that in one or more American states damages are awarded for wrongfully defending an action. But there is no such remedy in this country so far as I am aware.

In *Perry* v *Sidney Phillips & Son (a firm)* [1982] 3 All ER 705, [1982] 1 WLR 1297 damages were awarded for the distress, worry, inconvenience and trouble which the plaintiff had suffered while living in the house he bought, owing to the defects which his surveyor had overlooked. Lord Denning MR considered that these consequences

were reasonably foreseeable (see [1982] 3 All ER 705 at 709, [1982] 1 WLR 1297 at 1302). Kerr LJ stated a narrower test ([1982] 3 All ER 705 at 712, [1982] 1 WLR 1297 at 1307):

> So far as the question of damages for vexation and inconvenience is concerned, it should be noted that the deputy judge awarded these not for the tension or frustration of a person who is involved in a legal dispute in which the other party refuses to meet its liabilities. If he had done so, it would have been wrong, because such aggravation is experienced by almost all litigants. He awarded these damages because of the physical consequences of the breach, which were all foreseeable at the time. The fact that in such cases damages under this head may be recoverable, if they have been suffered but not otherwise, is supported by the decision of this court in *Hutchinson* v *Harris* (1978) 10 Build LR 19.
>
> I would emphasise the reference to physical consequences of the breach. . . .
> I am not convinced that it is enough to ask whether mental distress was reasonably foreseeable as a consequence, or even whether it should reasonably have been contemplated as not unlikely to result from a breach of contract. It seems to me that damages for mental distress in contract are, as a matter of policy, limited to certain classes of case. I would broadly follow the classification provided by Dillon LJ in *Bliss* v *South East Thames Regional Health Authority* [1987] ICR 700 at 718:
>
> > . . . where the contract which has been broken was itself a contract to provide peace of mind or freedom from distress . . .
>
> It may be that the class is somewhat wider than that. But it should not, in my judgment, include any case where the object of the contract was not comfort or pleasure, or the relief of discomfort, but simply carrying on a commercial activity with a view to profit. So I would disallow the item of damages for anguish and vexation.

Notes

1. Staughton and Purchas LJJ stressed the fact that such damages could be recovered only for distress caused by the breach rather than the litigation process. On the facts the distress was primarily caused by the fact that the plaintiffs had financial difficulties and the solicitors did not admit liability until 1987.

2. See Macdonald (1994) 7 JCL 134, particularly, 142–7, the 'objects' exception, and Enonchong (1996) 16 Oxf JLS 617.

(b) Distress directly consequent on physical inconvenience caused by the defendant's breach of contract

Perry v *Sidney Phillips & Son*
[1982] 3 All ER 705 (CA)

The plaintiff purchased a house in reliance on a survey report prepared by the defendants. This stated that the house was in good order. After moving in the plaintiff discovered that the roof leaked and was in poor condition, and that the septic tank was inefficient and caused a nuisance by its smell. The Court of Appeal awarded damages for discomfort caused by the repairs since this was foreseeable.

In *Watts* v *Morrow* [1991] 4 All ER 937 (page 377), the Court of Appeal also awarded damages for distress caused by the physical inconvenience of living in the house during the repairs. Ralph Gibson LJ said (at pp. 956–8):

> In his judgment, Judge Bowsher, after reference to *Hayes* v *James & Charles Dodd (a firm)* and to *Perry's* case, held that a negligent surveyor of a residential property, which he has undertaken to survey for a prospective purchaser who intends to live there, may be liable to his client in damages to compensate him for 'inconvenience and distress arising out of living in the property, not out of litigation about it' (see 24 Con LR 125 at 145). Judge Bowsher continued that that seemed to him to be the case whether the position be rationalised by reference to 'special relationship' or 'a contract to provide peace of mind or freedom from distress'. A prospective buyer of a house goes to a surveyor, said Judge Bowsher, not just to be advised on the financial advisability of one of the most important transactions of his life, but also to receive reassurance that, when he buys the house, he will have 'peace of mind and freedom from distress.'
>
> It is clear, I think, that the judge was regarding the contract between these plaintiffs and the defendant as a contract in which the subject matter was to provide 'peace of mind or freedom from distress' within the meaning of Dillon LJ's phrase in *Bliss's* case [1987] ICR 700 at 718 cited by Purchas LJ in *Hayes* v *Dodd* [1990] 2 All ER 815 at 826. That, with respect, seems to me to be an impossible view of the ordinary surveyor's contract. No doubt house buyers hope to enjoy peace of mind and freedom from distress as a consequence of the proper performance by a surveyor of his contractual obligation to provide a careful report, but there was no express promise for the provision of peace of mind or freedom from distress and no such implied promise was alleged. In my view, in the case of the ordinary surveyor's contract, damages are only recoverable for distress caused by physical consequences of the breach of contract.

Notes

1. In *Alexander* v *Rolls Royce Motor Cars* [1996] RTR 95, the Court of Appeal rejected the argument that a contract to repair a car was akin to a contract to provide freedom from worry and anxiety, so that damages for distress or loss of enjoyment in the use of the car were not available if the car was not repaired in breach of contract.
2. In *Ruxley Electronics* v *Forsyth* [1995] 3 All ER 268 page 371, the House of Lords confirmed the trial judge's award of £2,500 for loss of pleasurable amenity. For tactical reasons there was no substantial argument before the House of Lords regarding this figure or the basis for the award. The only judgment to deal with the matter in any depth is that of Lord Lloyd:

> *Loss of amenity*
>
> I turn last to the head of damages under which the judge awarded £2,500. . . . In the Court of Appeal Mr Forsyth sought to increase the award under this head. According to Staughton LJ this led to an interesting argument. But the Court of Appeal did not find it necessary to deal with the point.
>
> Before your Lordships, [counsel for the defendant] abandoned the point altogether, for what [counsel for the plaintiff] described as forensic reasons. It undermined the main theme of his argument that since difference in value gave Mr Forsyth nothing

by way of damages, he must be entitled to the cost of reinstatement. So [counsel for the defendant] was contending that the judge's award of £2,500 was without precedent in the field of damages, and was fundamentally inconsistent with the decision of this House in *Addis* v *Gramophone Co. Ltd* [1909] AC 488, [1908–10] All Rep 1. For obvious reasons, [counsel for the plaintiff] did not press the contrary argument. So your Lordships are placed in something of a difficulty. The House does not have the benefit of the views of the Court of Appeal on the point, and the submissions before your Lordships have been artificially restricted.

Addis v *Gramophone Co. Ltd* established the general rule that in claims for breach of contract, the plaintiff cannot recover damages for his injured feelings. But the rule, like most rules, is subject to exceptions. One of the well-established exceptions is when the object of the contract is to afford pleasure, as, for example, where the plaintiff has booked a holiday with a tour operator. If the tour operator is in breach of contract by failing to provide what the contract called for, the plaintiff may recover damages for his disappointment (see *Jarvis* v *Swans Tours Ltd* [1973] 1 All ER 71, [1973] QB 233 and *Jackson* v *Horizon Holidays Ltd* [1975] 3 All ER 92, [1975] 1 WLR 1468).

This was, as I understand it, the principle which Judge Diamond applied in the present case. He took the view that the contract was one 'for the provision of a pleasurable amenity'. In the event, Mr Forsyth's pleasure was not so great as it would have been if the swimming pool had been 7ft 6 in deep. This was a view which the judge was entitled to take. If it involves a further inroad on the rule in *Addis* v *Gramophone Co. Ltd* then so be it. But I prefer to regard it as a logical application or adaptation of the existing exception to a new situation. I should, however, add this note of warning. Mr Forsyth was, I think, lucky to have obtained so large an award for his disappointed expectations. But as there was no criticism from any quarter as to the quantum of the award as distinct from the underlying principle, it would not be right for your Lordships to interfere with the judge's figure.

That leaves one last question for consideration. I have expressed agreement with the judge's approach to damages based on loss of amenity on the facts of the present case. But in most cases such an approach would not be available. What is then to be the position where, in the case of a new house, the building does not conform in some minor respect to the contract, as, for example, where there is a difference in level between two rooms, necessitating a step? Suppose there is no measurable difference in value, and the cost of reinstatement would be prohibitive. Is there any reason why the court should not award by way of damages for breach of contract some modest sum, not based on difference in value, but solely to compensate the buyer for his disappointed expectations? Is the law of damages so inflexible, as I asked earlier, that it cannot find some middle ground in such a case? I do not give a final answer to that question in the present case. But it may be that it would have afforded an alternative ground for justifying the judge's award of damages. And if the judge had wanted a precedent, he could have found it in Sir David Cairns' judgment in *G W Atkins Ltd* v *Scott* 7 Const LJ 215, where, it will be remembered, the Court of Appeal upheld the judge's award of £250 for defective tiling. Sir David Cairns said (at 221):

> There are many circumstances where a judge has nothing but his commonsense to guide him in fixing the quantum of damages, for instance, for pain and suffering, for loss of pleasurable activities or for inconvenience of one kind or another.
>
> . . .

See the argument in Poole (1996) 59 MLR 272, at 280–85, that it is difficult to justify *Addis* v *Gramophone* as the basis for this award.

D: REMOTENESS OF DAMAGE

Hadley v *Baxendale*
(1854) 9 Exch 341, 156 ER 145 (Exchequer)

The plaintiffs, owners of a flour mill, contracted with the defendant carriers for the carriage of the crank shaft to Greenwich for use as a pattern for a new crank shaft. The carriage was delayed due to the negligence of the defendants so that the new shaft was received late. The plaintiffs claimed their loss of profits in operating the mill during the delay. The defendants argued that this loss was too remote for them to be liable for it. Held: the loss of profits was not recoverable.

ALDERSON B: Now we think the proper rule in such a case as the present is this: — Where two parties have made a contract which one of them has broken, the damages which the other party ought to receive in respect of such breach of contract should be such as may fairly and reasonably be considered either arising naturally, i.e., according to the usual course of things, from such breach of contract itself, or such as may reasonably be supposed to have been in the contemplation of both parties, at the time they made the contract, as the probable result of the breach of it. Now, if the special circumstances under which the contract was actually made were communicated by the plaintiffs to the defendants, and thus known to both parties, the damages resulting from the breach of such a contract, which they would reasonably contemplate, would be the amount of injury which would ordinarily follow from a breach of contract under these special circumstances so known and communicated. But, on the other hand, if these special circumstances were wholly unknown to the party breaking the contract, he, at the most, could only be supposed to have had in his contemplation the amount of injury which would arise generally, and in the great multitude of cases not affected by any special circumstances, from such a breach of contract. For, had the special circumstances been known, the parties might have specially provided for the breach of contract by special terms as to the damages in that case; and of this advantage it would be very unjust to deprive them . . . Now, in the present case, if we are to apply the principles above laid down, we find that the only circumstances here communicated by the plaintiffs to the defendants at the time the contract was made, were, that the article to be carried was the broken shaft of a mill, and that the plaintiffs were the millers of that mill. But how do these circumstances shew reasonably that the profits of the mill must be stopped by an unreasonable delay in the delivery of the broken shaft by the carrier to the third person? Suppose the plaintiffs had another shaft in their possession put up or putting up at the time, and that they only wished to send back the broken shaft to the engineer who made it; it is clear that this would be quite consistent with the above circumstances, and yet the unreasonable delay in the delivery would have no effect upon the intermediate profits of the mill. Or, again, suppose that, at the time of the delivery to the carrier, the machinery of the mill had been in other respects defective, then, also, the same results would follow. Here it is true that the shaft was actually sent back to serve as a model for a new one, and that the want of a new one was the only cause of the stoppage of the mill, and that the loss of profits really arose from not sending down the new shaft in proper time, and that this arose from the delay in delivering the broken one to serve as a model. But it is obvious that, in the great multitude of cases of millers sending off broken shafts to third persons by a carrier under ordinary circumstances, such

consequences would not, in all probability, have occurred; and these special circumstances were here never communicated by the plaintiffs to the defendants. It follows, therefore, that the loss of profits here cannot reasonably be considered such a consequence of the breach of contract as could have been fairly and reasonably contemplated by both the parties when they made this contract. For such loss would neither have flowed naturally from the breach of this contract in the great multitude of such cases occurring under ordinary circumstances, nor were the special circumstances, which, perhaps, would have made it a reasonable and natural consequence of such breach of contract, communicated to or known by the defendants. . . .

Note

1. There are two distinct limbs to this remoteness rule:

(a) Losses 'arising naturally' are inevitably within the parties' reasonable contemplation. The stoppage of the mill did not arise naturally from the carrier's delay because there might have been a spare shaft so that the mill could have kept working.

(b) 'Abnormal losses' will only be within the parties' reasonable contemplation if the special circumstances giving rise to the loss were known to both parties at the time of the contract. The carriers had been told only that they were transporting a broken crank shaft to be used as a pattern for a new one. If they had been told that the mill would have to stop or that there was no spare shaft, then the loss of profits could have been recovered.

2. However, Evans LJ in *Kpohraror* v *Woolwich Building Society* [1996] 4 All ER 119, 127–28, stated that 'I would prefer to hold the starting point for any application of *Hadley* v *Baxendale* is the extent of shared knowledge of both parties when the contract was made . . . When that is established it may often be the case that the first and second parts of the rule overlap, or at least that it is unnecessary to draw a clear line of demarcation between them'.

3. Is the size of the mill important to the imputed knowledge of the carrier? For example, if the mill is small would the carrier be taken to know that there was no spare shaft?

4. In *Balfour Beatty Construction (Scotland) Ltd* v *Scottish Power plc* (1994) 71 BLR 20, the House of Lords had to consider whether knowledge of a construction process, namely the need for continuous pour of concrete, could be imputed to the electricity supplier, so that when the electricity supply failed the consequential demolition and rebuilding costs could be recovered as 'a loss arising naturally'. The House of Lords held that there was no general rule that contracting parties were presumed to have knowledge of each other's business practices, but the simpler the activity the easier it would be to infer knowledge of the practice. However, where, as here, it was a complicated construction technique, the supplier was not deemed to know about it.

Victoria Laundry (Windsor) Ltd v *Newman Industries Ltd* [1949] 2 KB 528 (CA)

The plaintiffs were launderers and dyers who wished to extend their business. They contracted with the defendants, an engineering firm, for the

purchase of a boiler which was to be delivered on 5 June. The boiler was damaged before delivery so that it was not delivered until 8 November. The defendants were aware of the nature of the plaintiffs' business and had been informed by letter that the plaintiffs intended to put the boiler to immediate use in their business. In an action for breach of contract the plaintiffs claimed:

(a) the profit that they would have earned using the boiler between 5 June and 8 November from the expansion of their business; and

(b) the profit on a number of highly lucrative dyeing contracts which they 'could and would have accepted' with the Ministry of Supply.

Held: although the loss of normal business profits was a *reasonably foreseeable* consequence of the delayed delivery, the defendants had no knowledge of the highly lucrative dyeing contracts so that this loss was too remote.

ASQUITH LJ (delivering the judgment of the Court): . . . What propositions applicable to the present case emerge from the authorities as a whole . . . We think they include the following:-

(1) It is well settled that the governing purpose of damages is to put the party whose rights have been violated in the same position, so far as money can do so, as if his rights had been observed: (*Sally Wertheim* v *Chicoutimi Pulp Company* [1911] AC 301). This purpose, if relentlessly pursued, would provide him with a complete indemnity for all loss de facto resulting from a particular breach, however improbable, however unpredictable. This, in contract at least, is recognized as too harsh a rule. Hence,

(2) In cases of breach of contract the aggrieved party is only entitled to recover such part of the loss actually resulting as was at the time of the contract reasonably foreseeable as liable to result from the breach.

(3) What was at that time reasonably so foreseeable depends on the knowledge then possessed by the parties or, at all events, by the party who later commits the breach.

(4) For this purpose, knowledge 'possessed' is of two kinds; one imputed, the other actual. Everyone, as a reasonable person, is taken to know the 'ordinary course of things' and consequently what loss is liable to result from a breach of contract in that ordinary course. This is the subject matter of the 'first rule' in *Hadley* v *Baxendale* (1854) 9 Exch 341. But to this knowledge, which a contract-breaker is assumed to possess whether he actually possesses it or not, there may have to be added in a particular case knowledge which he actually possesses, of special circumstances outside the 'ordinary course of things,' of such a kind that a breach in those special circumstances would be liable to cause more loss. Such a case attracts the operation of the 'second rule' so as to make additional loss also recoverable.

(5) In order to make the contract-breaker liable under either rule it is not necessary that he should actually have asked himself what loss is liable to result from a breach. As has often been pointed out, parties at the time of contracting contemplate not the breach of the contract, but its performance. It suffices that, if he had considered the question, he would as a reasonable man have concluded that the loss in question was liable to result.

(6) Nor, finally, to make a particular loss recoverable, need it be proved that upon a given state of knowledge the defendant could, as a reasonable man, foresee that a breach must necessarily result in that loss. It is enough if he could foresee it was likely so to result. It is indeed enough if the loss (or some factor without which it would not have occurred) is a 'serious possibility' or a 'real danger.' For short, we have used the word 'liable' to result. Possibly the colloquialism 'on the cards' indicates the shade of meaning with some approach to accuracy. . . .

Notes

1. The Court of Appeal applied a test of reasonable foreseeability which suggested that the test for remoteness in contract was the same as that for recovery in tort.

2. Asquith LJ pointed out that the headnote to *Hadley* v *Baxendale* is misleading since it suggests that the carrier knew that the mill had stopped. If that were so then the loss should have been recoverable under the second limb of the rule.

3. It is argued that the second limb encourages the sharing of risks, and if a party is aware of the scope of likely liability, that party can take out insurance to cover it.

4. In *Seven Seas Properties Ltd* v *Al-Essa (No. 2)* [1993] 3 All ER 577, it was held that where the defendants' default had caused the plaintiffs to lose their profit on a sub-sale of property, the defendants would be liable for this loss only if, at the time of the main contract, they were aware of the intention to enter into the sub-sale. On the facts this information had been deliberately withheld, and therefore this loss was not within the parties' reasonable contemplations. (In the case of sale of goods where there is an available market for the goods in question, it is assumed that the injured party can purchase a substitute on the date of non-delivery and consequently is able to fulfil the sub-sale. This case, however, involved a sale of land.)

5. It is not clear what is required to enable recovery to occur under this second limb. Must the other party have actual knowledge of the facts, or must he actually accept the risk in question? In *Kemp* v *Intasun Holidays Ltd* [1987] FTLR 234, the casual mention by the plaintiff's wife of her husband's asthma to the travel agent at the time of booking, was not sufficient to make his attack reasonably contemplatable.

Koufos v *C. Czarnikow Ltd, The Heron II*
[1969] 1 AC 350 (HL)

Charterers chartered a vessel from the owners for the carriage of sugar from Constanza to Basrah. The shipowners knew that the charterers were sugar merchants and that there was a sugar market at Basrah but did not actually know that the charterers intended to sell the sugar promptly on arrival at Basrah. In breach of the charterparty, the vessel deviated from the voyage, so that instead of arriving at Basrah on 22 November the vessel did not arrive until 2 December. The market price of sugar at Basrah had fallen in this period from £32 10s per ton to £31 2s 9d per ton. Held: the charterers

were entitled to recover the difference in price caused by the delay. Knowledge was imputed to them that it was *not unlikely* (to use the words of Lord Reid) that the sugar would be sold on arrival and that market prices fluctuate. Lord Reid rejected the reasonable foreseeability test used in *Victoria Laundry* v *Newman Industries* (page 392), since the test in contract was different to that in tort.

LORD REID: So the question for decision is whether a plaintiff can recover as damages for breach of contract a loss of a kind which the defendant, when he made the contract, ought to have realised was not unlikely to result from a breach of contract causing delay in delivery. I use the words 'not unlikely' as denoting a degree of probability considerably less than an even chance but nevertheless not very unusual and easily foreseeable.

[Lord Reid then referred to *Hadley* v *Baxendale*. He continued:]

Alderson B clearly did not and could not mean that it was not reasonably foreseeable that delay might stop the resumption of work in the mill. He merely said that in the great multitude — which I take to mean the great majority — of cases this would not happen. He was not distinguishing between results which were foreseeable or unforeseeable, but between results which were likely because they would happen in the great majority of cases, and results which were unlikely because they would only happen in a small minority of cases. He continued:

> It follows, therefore, that the loss of profits here cannot reasonably be considered such a consequence of the breach of contract as could have been fairly and reasonably contemplated by both the parties when they made this contract.

He clearly meant that a result which will happen in the great majority of cases should fairly and reasonably be regarded as having been in the contemplation of the parties, but that a result which, though foreseeable as a substantial possibility, would only happen in a small minority of cases should not be regarded as having been in their contemplation. . . .

I am satisfied that the court did not intend that every type of damage which was reasonably foreseeable by the parties when the contract was made should either be considered as arising naturally, i.e., in the usual course of things, or be supposed to have been in the contemplation of the parties. Indeed the decision makes it clear that a type of damage which was plainly foreseeable as a real possibility but which would only occur in a small minority of cases cannot be regarded as arising in the usual course of things or be supposed to have been in the contemplation of the parties: the parties are not supposed to contemplate as grounds for the recovery of damage any type of loss or damage which on the knowledge available to the defendant would appear to him as only likely to occur in a small minority of cases.

In cases like *Hadley* v *Baxendale* (1854) 9 Exch 341 or the present case it is not enough that in fact the plaintiff's loss was directly caused by the defendant's breach of contract. It clearly was so caused in both. The crucial question is whether, on the information available to the defendant when the contract was made, he should, or the reasonable man in his position would, have realised that such loss was sufficiently likely to result from the breach of contract to make it proper to hold that the loss flowed naturally from the breach or that loss of that kind should have been within his contemplation.

The modern rule of tort is quite different and it imposes a much wider liability. The defendant will be liable for any type of damage which is reasonably foreseeable as

liable to happen even in the most unusual case, unless the risk is so small that a reasonable man would in the whole circumstances feel justified in neglecting it. And there is good reason for the difference. In contract, if one party wishes to protect himself against a risk which to the other party would appear unusual, he can direct the other party's attention to it before the contract is made, and I need not stop to consider in what circumstances the other party will then be held to have accepted responsibility in that event. But in tort there is no opportunity for the injured party to protect himself in that way, and the tortfeasor cannot reasonably complain if he has to pay for some very unusual but nevertheless foreseeable damage which results from his wrongdoing. I have no doubt that today a tortfeasor would be held liable for a type of damage as unlikely as was the stoppage of Hadley's Mill for lack of a crankshaft: to anyone with the knowledge the carrier had that may have seemed unlikely but the chance of it happening would have been seen to be far from negligible. But it does not at all follow that *Hadley* v *Baxendale* (1854) 9 Exch 341 would today be differently decided.

[Lord Reid, then referred to *Victoria Laundry* v *Newman Industries* [1949] 2 KB 528 and Asquith LJ's formulation . . .] To bring in reasonable foreseeability appears to me to be confusing measure of damages in contract with measure of damages in tort. A great many extremely unlikely results are reasonably foreseeable: it is true that Lord Asquith may have meant foreseeable as a likely result, and if that is all he meant I would not object further than to say that I think that the phrase is liable to be misunderstood. For the same reason I would take exception to the phrase 'liable to result'. Liable is a very vague word but I think that one would usually say that when a person foresees a very improbable result he foresees that it is liable to happen.

. . . It has never been held to be sufficient in contract that the loss was foreseeable as 'a serious possibility' or 'a real danger' or as being 'on the cards.' It is on the cards that one can win £100,000 or more for a stake of a few pence — several people have done that. And anyone who backs a hundred to one chance regards a win as a serious possibility — many people have won on such a chance. And the *Wagon Mound (No. 2)* [1961] AC 388 could not have been decided as it was unless the extremely unlikely fire should have been foreseen by the ship's officer as a real danger. It appears to me that in the ordinary use of language there is wide gulf between saying that some event is not unlikely or quite likely to happen and saying merely that it is a serious possibility, a real danger, or on the cards. Suppose one takes a well-shuffled pack of cards, it is quite likely or not unlikely that the top card will prove to be a diamond: the odds are only 3 to 1 against. But most people would not say that it is quite likely to be the nine of diamonds for the odds are then 51 to 1 against. On the other hand I think that most people would say that there is a serious possibility or a real danger of its being turned up first and of course it is on the cards. If the tests of 'real danger' or 'serious possibility' are in future to be authoritative then the *Victoria Laundry* case [1949] 2 KB 528 would indeed be a landmark because it would mean that *Hadley* v *Baxendale* (1854) 9 Exch 341 would be differently decided today. I certainly could not understand any court deciding that, on the information available to the carrier in that case, the stoppage of the mill was neither a serious possibility nor a real danger. If those tests are to prevail in future then let us cease to pay lip service to the rule in *Hadley* v *Baxendale* (1854) 9 Exch 341. But in my judgement to adopt these tests would extend liability for breach of contract beyond what is reasonable or desirable. From the limited knowledge which I have of commercial affairs I would not expect such an extension to be welcomed by the business community and from the legal point of view I can find little or nothing to recommend it.

Questions

1. Do you agree with Lord Reid that if the test is reasonable foreseeability, then the carrier in *Hadley* v *Baxendale* would have been liable?
2. Is there a distinction between 'natural losses' and 'foreseeable losses'?

Note

Lord Reid justified a stricter test of remoteness in contract because the parties will know each other and are therefore in a better position to assess the risk of loss due to the breach.

If we accept Lord Reid's distinction, what should the position be if an action on the facts could lie in both contract and tort? Can the injured party choose to formulate the action in tort so that recovery of losses will be wider?

H. Parsons (Livestock) Ltd v *Uttley Ingham & Co. Ltd*
[1978] 1 QB 791 (CA)

The plaintiffs, pig farmers, ordered a bulk food storage hopper for storing pig nuts from the defendants. When the defendants installed the hopper they failed to ensure that the ventilator on the top was open. The pig nuts went mouldy, and when the pigs ate them they became ill with an intestinal disease called 'e coli'. Two hundred and fifty-four pigs died. Held: (Scarman and Orr LJJ) that the death of the pigs was not too remote a loss since the parties might reasonably have contemplated some illness to the pigs resulting from this breach and they did not have to foresee the actual illness that occurred. Lord Denning also held that the death of the pigs was within the remoteness rule. He thought that the same distinction should be drawn in contract as applied in tort between physical damage and economic loss (loss of profit), and that the tort test of remoteness should apply to physical damage.

Notes

1. The decision of the majority means that if the type of loss is within the parties' reasonable contemplations, the extent of it need not be. See also *Brown* v *KMR Services Ltd* [1995] 4 All ER 598, where this principle was applied.
2. In *Victoria Laundry* v *Newman Industries* (page 392), the type of loss appears to be loss of profits but the profits on the dyeing contracts were not recoverable.

E: MITIGATION

The injured party is prevented from recovering for losses which he failed to mitigate. Viscount Haldane LC in *British Westinghouse Electric & Manufacturing Co. Ltd* v *Underground Electric Railways Company of London Ltd* [1912] AC 673, said (at p. 689):

> . . . I think that there are certain broad principles which are quite well settled. The first is that, as far as possible, he who has proved a breach of a bargain to supply what

he contracted to get is to be placed, as far as money can do it, in as good a situation as if the contract had been performed.

The fundamental basis is thus compensation for pecuniary loss naturally flowing from the breach; but this first principle is qualified by a second, which imposes on a plaintiff the duty of taking all reasonable steps to mitigate the loss consequent on the breach, and debars him from claiming any part of the damage which is due to his neglect to take such steps. In the words of James LJ in *Dunkirk Colliery Co.* v *Lever* (1878) 9 ChD 20, 'The person who has broken the contract is not to be exposed to additional cost by reason of the plaintiffs not doing what they ought to have done as reasonable men, and the plaintiffs not being under any obligation to do anything otherwise than in the ordinary course of business.'

As James LJ indicates, this second principle does not impose on the plaintiff an obligation to take any step which a reasonable and prudent man would not ordinarily take in the course of his business. But when in the course of his business he has taken action arising out of the transaction, which action has diminished his loss, the effect in actual diminution of the loss he has suffered may be taken into account even though there was no duty on him to act.

Note

Although the expression 'duty to mitigate' is used, it is not strictly accurate, since there is no liability if the injured party fails to mitigate. The effect of failure to mitigate is to reduce the damages that might otherwise have been payable.

(a) Reasonable steps

Payzu Ltd* v *Saunders
[1919] 2 KB 581 (CA)

The defendant contracted to sell crêpe de Chine to the plaintiffs, delivery as required within a nine-month period and payment within one month of delivery. When the plaintiffs failed to pay punctually for the first instalment the defendant refused to deliver any more under the contract. (This amounted to a repudiatory breach by the defendant.) However, the defendant did offer to deliver the goods at the contract price if the plaintiffs would agree to pay cash when ordering. The plaintiffs refused this offer and sought damages for breach of contract. The market price of crêpe de Chine had risen and damages of the difference between the market price and contract price were sought. Held: the plaintiffs should have mitigated their loss by accepting the defendant's offer. Damages were confined to the loss that the plaintiffs would have suffered if they had paid cash and acquired the goods at the contract price, i.e., the loss of a month's credit which had originally applied under the contract. The Court of Appeal also held that the question of whether the steps were reasonable was a question of fact in each case.

BANKES LJ: . . . It is plain that the question what is reasonable for a person to do in mitigation of his damages cannot be a question of law but must be one of fact in the circumstances of each particular case. There may be cases where as matter of fact

it would be unreasonable to expect a plaintiff to consider any offer made in view of the treatment he has received from the defendant. If he had been rendering personal services and had been dismissed after being accused in presence of others of being a thief, and if after that his employer had offered to take him back into his service, most persons would think he was justified in refusing the offer, and that it would be unreasonable to ask him in this way to mitigate the damages in an action of wrongful dismissal. But that is not to state a principle of law, but a conclusion of fact to be arrived at on a consideration of all the circumstances of the case. . . . [Counsel for the appellants] complained that the respondent had treated his clients so badly that it would be unreasonable to expect them to listen to any proposition she might make. I do not agree. In my view each party was ready to accuse the other of conduct unworthy of a high commercial reputation, and there was nothing to justify the appellants in refusing to consider the respondent's offer.

Note
See Bridge, 'Mitigation of damages in contract and the meaning of avoidable loss' (1989) 105 LQR 398.

Question
Who received the benefit of the rise in market price?

Note
Payzu v *Saunders* was applied by Harman J in the next case.

Pilkington* v *Wood
[1953] Ch 770

The plaintiff instructed the defendant solicitor to act for him in the purchase of a house. The defendant negligently advised that the title of the vendor was good when in fact the vendor held as trustee of the property. The defendant argued that the plaintiff should have mitigated his loss by bringing legal proceedings against the vendor for having conveyed a defective title. Held: there was no duty to embark on 'a complicated and difficult piece of litigation' in order to protect the defendant from the consequences of his own carelessness.

Note
It also appears that an injured party is not required to take action which will damage its reputation or public relations (*London & South of England Building Society* v *Stone* [1983] 1 WLR 1242).

(b) What if the reasonable steps increase the loss?

Banco de Portugal* v *Waterlow & Sons Ltd
[1932] AC 452 (HL)

The plaintiff bank had engaged the defendant printers to print bank notes. In breach of contract the defendants also delivered a large number of these

notes to a criminal who put them into circulation in Portugal. When the bank discovered this they withdrew the complete issue of the particular note and undertook to exchange all such notes presented to them for other notes. The defendants argued that they were liable only for the cost of printing new notes and that the remaining loss was caused by the bank's action in exchanging those notes for others. Held: (Lord Warrington of Clyffe and Lord Russell of Killowen dissenting) since the bank's actions had been reasonable, the value of the currency given in exchange was also recoverable.

LORD MACMILLAN: . . . Where the sufferer from a breach of contract finds himself in consequence of that breach placed in a position of embarrassment the measures which he may be driven to adopt in order to extricate himself ought not to be weighed in nice scales at the instance of the party whose breach of contract has occasioned the difficulty. It is often easy after an emergency has passed to criticize the steps which have been taken to meet it, but such criticism does not come well from those who have themselves created the emergency. The law is satisfied if the party placed in a difficult situation by reason of the breach of a duty owed to him has acted reasonably in the adoption of remedial measures, and he will not be held disentitled to recover the cost of such measures merely because the party in breach can suggest that other measures less burdensome to him might have been taken. . . . In my opinion the action of the Bank in honouring all notes of the type in question, genuine and spurious alike, between December 7 and December 26, 1925, was reasonable and justifiable in the circumstances, and Messrs Waterlow ought to be held responsible for whatever loss was occasioned to the Bank by the adoption of that policy. . . .

F: CAUSATION AND CONTRIBUTORY NEGLIGENCE

(a) Causation

The injured party must establish a causal link between his loss and the defendant's breach of contract. In *Galoo Ltd* v *Bright Grahame Murray* [1995] 1 All ER 16, the Court of Appeal held that in a breach of contract claim a plaintiff was entitled to claim damages where the breach was the effective or dominant cause of his loss. It was not sufficient that the breach merely provided the plaintiff with the opportunity to sustain loss. This is judged 'by the application of the court's common sense' (*per* Glidewell LJ, p. 29). The 'but for' test governing causation in tort was not sufficient in contract.

On the facts the breach of contract by the companies' auditors related to the fact that the audited accounts of the plaintiff companies contained substantial inaccuracies, but it was held that this merely provided the companies concerned with the opportunity to incur further trading losses and did not actually cause those losses.

An intervening cause may break the chain of causation.

Lexmead (Basingstoke) Ltd* v *Lewis
[1982] AC 225 (HL) (on appeal from ***Lambert* v *Lewis*** [1982] AC 225)

The defendant had been supplied with a towing hitch by garage retailers. The locking mechanism had broken but the defendant continued to use it.

The trailer became detached, causing an accident which resulted in death and personal injury. The defendant sought an indemnity from the retailer. Held: once it became apparent to the defendant that the locking mechanism was broken, there was no longer any promise by the retailers of its continued safety in use, and the chain of causation between the supplier's breach and the defendant's liability to pay damages was broken.

Beoco Ltd* v *Alfa Laval Co. Ltd
[1994] 4 All ER 464 (CA)

The first defendant installed a heat exchanger at the plaintiff company's premises. Some time later a leak was discovered and the plaintiff employed the second defendant to repair it. Without inspecting the repair, which would have revealed that it was defective, the plaintiff put the heat exchanger back into use. Two months later the heat exchanger exploded damaging the plaintiff's plant and causing loss of production.

In a claim against the first defendant for breach of warranty, the plaintiff sought the loss of profits which would have been suffered because of the defect in the heat exchanger necessitating further repair or replacement. This was a purely hypothetical loss because of the intervening explosion (which was attributed to the plaintiff's failure to inspect the repair). Held: the principles were the same as those applicable in tort (see, e.g., *Jobling* v *Associated Dairies Ltd* [1981] 2 All ER 752) so that the plaintiff could not recover for the hypothetical loss of profits when the intervening event (due to the plaintiff's negligence) had caused greater damage.

(b) Contributory negligence

If the injured party's negligent actions are not sufficient to break the chain of causation but contribute to the loss, can the damages in contract be apportioned to take account of this contributory negligence? Is the Law Reform (Contributory Negligence) Act 1945 wide enough to cover contractual actions?

Law Reform (Contributory Negligence) Act 1945

1. Apportionment of liability in case of contributory negligence

(1) Where any person suffers damage as the result partly of his own fault and partly of the fault of any other person or persons, a claim in respect of that damage shall not be defeated by reason of the fault of the person suffering the damage, but the damages recoverable in respect thereof shall be reduced to such extent as the court thinks just and equitable having regard to the claimant's share in the responsibility of the damage: . . .

4. Interpretation

'fault' . . . means negligence, breach of statutory duty or other act or omission which gives rise to liability in tort or would, apart from this Act, give rise to the defence of contributory negligence.

Forsikringsaktieselskapet Vesta* v *Butcher
[1988] 2 All ER 43

The plaintiffs were seeking to vary a contract of reinsurance through the defendant brokers. The brokers omitted to act. This was a breach of their duty of care owed to the plaintiffs in tort, and a breach of an implied term in their contract with the plaintiffs that they would exercise reasonable care and skill. The defendant brokers alleged that the plaintiffs had many opportunities to put the omission right and were therefore contributorily negligent. The plaintiffs alleged that by formulating their claim in contract they could avoid apportionment of damages under the 1945 Act. Held: where the defendant's liability in contract is the same as the liability in the tort of negligence (independent of the existence of any contract), the Act applied to enable the court to apportion damages even though the claim was made in contract. In the Court of Appeal O'Connor LJ explained the issues.

O'CONNOR LJ: The important issue of law is whether on the facts of this case there is power to apportion under the Law Reform (Contributory Negligence) Act 1945 and thus reduce the damages recoverable by Vesta.

I start by pointing out that Vesta pleaded its claim against the brokers in contract and tort. This is but a recognition of what I regard as a clearly established principle that where under the general law a person owes a duty to another to exercise reasonable care and skill in some activity, a breach of that duty gives rise to a claim in tort notwithstanding the fact that the activity is the subject matter of a contract between them. In such a case the breach of duty will also be a breach of contract. The classic example of this situation is the relationship between doctor and patient.

Since the decision of the House of Lords in *Hedley Byrne & Co Ltd* v *Heller & Partners Ltd* [1963] 2 All ER 575, [1964] AC 465 the relationship between the brokers and Vesta is another example. Counsel for Vesta accepts that this is so but he submits that, if a plaintiff makes his claim in contract, contributory negligence cannot be relied on by the defendant whereas it is available if the claim is made in tort. If this contention is sound then the law has been sadly adrift for a very long time for it would mean that in employers' liability cases an injured employee could debar the employer from relying on any contributory negligence by framing his action in contract.

The judge [Hobhouse J] dealt with this submission as follows ([1986] 2 All ER 488 at 508):

> The question whether the 1945 Act applies to claims brought in contract can arise in a number of classes of case. Three categories can conveniently be identified. (1) Where the defendant's liability arises from some contractual provision which does not depend on negligence on the part of the defendant. (2) Where the defendant's liability arises from a contractual obligation which is expressed in terms of taking care (or its equivalent) but does not correspond to a common law duty to take care which would exist in the given case independently of contract. (3) Where the defendant's liability in contract is the same as his liability in the tort of negligence independently of the existence of any contract.

The present case fell fairly and squarely within the judge's category (3). He said ([1986] 2 All ER 488 at 509):

The category (3) question has arisen in very many different types of case and the answer is treated as so obvious that it passes without any comment. It is commonplace that actions are brought by persons who have suffered personal injuries as the result of the negligence of the person sued and that there is a contractual as well as tortious relationship. In such cases apportionment of blame is invariably adopted by the court notwithstanding that the plaintiff could sue in contract as well as in tort. The example normally cited in the present context is the decision of the Court of Appeal in *Sayers* v *Harlow UDC* [1958] 2 All ER 342, [1958] 1 WLR 623, which concerned a contractual visitor to premises (a lady who had paid to use a public lavatory). The Court of Appeal said it did not matter whether the cause of action was put in tort or in contract and proceeded to apportion blame awarding her three-quarters of her damages. This was a decision on a category (3) case. The power to make an apportionment was part of the ratio decidendi and is binding on me. There are innumerable similar decisions to the same effect which could be cited, very many by appellate courts.

. . .

In my judgment *Sayers* v *Harlow UDC* is a category (3) case and the decision of the Court of Appeal that there is power to apportion was not only right but is binding on us just as the judge held it was binding on him.

I am satisfied that the judge came to the right conclusion on this topic and in respect of it I would dismiss Vesta's appeal.

Notes

1. This case fell within Hobhouse J's category (3) so that the Act applied. Hobhouse J indicated that the Act did not apply to category (1) cases, i.e. breaches of strict contractual obligations. The decision of the Court of Appeal was affirmed on other grounds ([1989] 1 All ER 402).

2. The Law Commission Working Paper No. 114, *Contributory Negligence as a Defence in Contract* (1990) (see especially pp. 69–73) recommended that, unless the contract expressly declared to the contrary, the courts should be able to apportion damages in all three contractual cases where the plaintiff's conduct contributed to his loss.

In its Report, Law Commission No. 219, 1993, the Law Commission recommends apportionment of damages where there is a breach of a qualified contractual obligation (contractual negligence), but not if the breach is of a strict contractual obligation. The Report recommends a separate legislative provision for the contractual position and includes a draft Bill. Under the proposed legislation it would, however, be possible to exclude apportionment for contributory negligence, either expressly or by implication (e.g., using a liquidated damages clause to fix the damages in advance, see further pages 404–7).

Barclays Bank plc v *Fairclough Building Ltd*
[1995] 1 All ER 289 (CA)

The defendant contractor was in breach of a contract to clean roofs containing asbestos, in that it had failed to execute the work in an expeditious, efficient and workmanlike manner and had failed to comply with statutory requirements relating to asbestos. The defendant argued that

the plaintiff had failed to supervise the work and therefore damages should be reduced for this contributory negligence under the 1945 Act. Held: contributory negligence was not a defence to a claim for damages based on a breach of a strict contractual obligation, even where the defendant might have also had a parallel liability in tort.

SIMON BROWN LJ: . . . when, as in a category (1) case, the contractual liability is by no means immaterial, when rather it is a strict liability arising independently of any negligence on the defendants' part, then there seem to me compelling reasons why the contract, even assuming it is silent as to apportionment, should be construed as excluding the operation of the 1945 Act. The very imposition of a strict liability upon the defendant is to my mind inconsistent with an apportionment of the loss. And not least because of the absurdities that the contrary approach carries in its wake. Assume a defendant, clearly liable under a strict contractual duty. Is his position to be improved by demonstrating that besides breaching that duty he was in addition negligent? Take this very case. Is this contract really to be construed so that the respondents are advantaged by an assertion of their own liability in nuisance or trespass as well as in contract? Are we to have trials at which the defendant calls an expert to implicate him in tortious liability, whilst the plaintiffs' expert seeks paradoxically to exonerate him? The answer to all these questions is surely No. Whatever arguments exist for apportionment in other categories of case — and these are persuasively deployed in the 1993 Law Commission Report, *Contributory Negligence as a Defence in Contract* (Law Com No. 219) — to my mind there are none in the present type of case and I for my part would construe the contract accordingly.

Note

This decision indicates the importance of correctly identifying the nature of the obligation broken (see page 347) and is in line with the Law Commission's position in its 1993 Report.

G: AGREED DAMAGES CLAUSES

The contract may provide that specified damages shall be payable in respect of particular types of breach, thus avoiding difficulties of quantification and avoiding disruptions to a continuing legal relationship.

However, a distinction has been drawn between 'liquidated damages clauses', which are enforceable, and 'penalty clauses', which are not enforceable beyond the amount of the injured party's actual loss. Liquidated damages represent 'a genuine pre-estimate of the loss' which will be suffered as a result of the breach. A penalty clause is not an attempt to compensate for actual loss suffered but is designed as a threat to compel performance.

(a) Is an agreed damages clause a liquidated damages clause or a penalty?

Dunlop Pneumatic Tyre Co. Ltd* v *New Garage & Motor Co. Ltd
[1915] AC 79 (HL)

The appellants supplied motor tyres, covers and tubes to the respondent dealers under an agreement whereby the respondents received certain trade

discounts and agreed not to tamper with the marks on the goods, not to sell or offer the goods to any private customer or to any cooperative society at less than the appellants' list prices, not to supply to persons to whom the appellants would not supply and 'to pay the sum of £5 by way of liquidated damages for every tyre, cover or tube sold or offered in breach of the agreement'. The respondents sold a tyre cover to a cooperative society at below the current list price and the appellants sought damages. The respondents pleaded that the clause was a penalty. Held: it was a liquidated damages clause, so the appellants could recover this amount as damages.

LORD DUNEDIN: . . . I shall content myself with stating succinctly the various propositions which I think are deducible from the decisions which rank as authoritative: —

1. Though the parties to a contract who use the words 'penalty' or 'liquidated damages' may prima facie be supposed to mean what they say, yet the expression used is not conclusive. The Court must find out whether the payment stipulated is in truth a penalty or liquidated damages. This doctrine may be said to be found passim in nearly every case.

2. The essence of a penalty is a payment of money stipulated as in terrorem of the offending party; the essence of liquidated damages is a genuine covenanted pre-estimate of damage (*Clydebank Engineering and Shipbuilding Co.* v *Don Jose Ramos Yzquierdo y Castaneda* [1905] AC 6).

3. The question whether a sum stipulated is penalty or liquidated damages is a question of construction to be decided upon the terms and inherent circumstances of each particular contract, judged of as at the time of the making of the contract, not as at the time of the breach . . .

4. To assist this task of construction various tests have been suggested, which if applicable to the case under consideration may prove helpful, or even conclusive. Such are:

(a) It will be held to be penalty if the sum stipulated for is extravagant and unconscionable in amount in comparison with the greatest loss that could conceivably be proved to have followed from the breach.

(b) It will be held to be a penalty if the breach consists only in not paying a sum of money, and the sum stipulated is a sum greater than the sum which ought to have been paid (*Kemble* v *Farren* (1829) 6 Bing 141). This though one of the most ancient instances is truly a corollary to the last test. . . .

(c) There is a presumption (but no more) that it is penalty when 'a single lump sum is made payable by way of compensation, on the occurrence of one or more or all of several events, some of which may occasion serious and others but trifling damage'.

On the other hand:

(d) It is no obstacle to the sum stipulated being a genuine pre-estimate of damage, that the consequences of the breach are such as to make precise pre-estimation almost an impossibility. On the contrary, that is just the situation when it is probable that pre-estimated damage was the true bargain between the parties . . .

Turning now to the facts of the case, it is evident that the damage apprehended by the appellants owing to the breaking of the agreement was an indirect and not a direct damage. So long as they got their price from the respondents for each article sold, it could not matter to them directly what the respondents did with it. Indirectly it did. Accordingly, the agreeement is headed 'Price Maintenance Agreement,' and the way

in which the appellants would be damaged if prices were cut is clearly explained in evidence by Mr Baisley, and no successful attempt is made to controvert that evidence. But though damage as a whole from such a practice would be certain, yet damage from any one sale would be impossible to forecast. It is just, therefore, one of those cases where it seems quite reasonable for parties to contract that they should estimate that damage at a certain figure, and provided that figure is not extravagant there would seem no reason to suspect that it is not truly a bargain to assess damages, but rather a penalty to be held in terrorem.

Notes

1. The terminology used is not conclusive.

2. In *Philips Hong Kong Ltd* v *AG of Hong Kong* (1993) 61 BLR 41, the Privy Council stressed the need for certainty in commercial contracts such as complex construction contracts, and the need for commercial parties to be able to rely upon damages clauses which they have agreed. Lord Woolf (giving the judgment) held that the general approach should therefore be against a finding that a clause was penal. In so doing he recognised the difficulty of drafting a clause that would never operate in a penal way.

It had been argued that the clause would necessarily be penal if, in the case of certain hypothetical breaches, the agreed sum would be greater than the actual loss. However, Lord Woolf stated (at pp. 58–59) that:

> Except possibly in the case of situations where one of the parties to the contract is able to dominate the other as to the choice of the terms of a contract, it will normally be insufficient to establish that a provision is objectionably penal to identify situations where the application of the provision could result in a larger sum being recovered by the injured party than his actual loss. Even in such situations so long as the sum payable in the event of non-compliance with the contract is not extravagant, having regard to the range of losses that it could reasonably be anticipated it would have to cover at the time the contract was made, it can still be a genuine pre-estimate of the loss that would be suffered and so a perfectly valid liquidated damage provision. The use in argument of unlikely illustrations should therefore not assist a party to defeat a provision as to liquidated damages . . . In seeking to establish that the sum described in the Philips contract as liquidated damages was in fact a penalty, Philips has to surmount the strong inference to the contrary resulting from its agreement to make the payments as liquidated damages and the fact that it is not suggesting in these proceedings that the sum claimed is excessive in relation to the actual loss suffered by the Government. The fact that the issue has to be determined objectively, judged at the date the contract was made, does not mean what actually happens subsequently is irrelevant. On the contrary it can provide valuable evidence as to what could reasonably be expected to be the loss at the time the contract was made. Likewise the fact that two parties who should be well capable of protecting their respective commercial interests agreed the allegedly penal provision suggests that the formula for calculating liquidated damages is unlikely to be oppressive. . . .

In the light of this pragmatic approach, it would appear that Lord Dunedin's guide-lines should not be interpreted too literally in the context of commercial contracts where the parties are of equal bargaining power.

3. If the clause is a liquidated damages clause, then the injured party recovers that amount irrespective of the actual loss sustained.

Cellulose Acetate Silk Company Ltd v Widnes Foundry (1925) Ltd
[1933] AC 20 (HL)

In a contract for the delivery and erection of plant, if the work was not completed within a certain time the contractors were to pay to the purchasers by way of 'penalty' a sum of £20 for every week they were in default. The contractors were 30 weeks late in completing the work. The contractors sought the purchase price but the defendant purchasers counterclaimed for their actual loss caused by the delay (£5,850). Held: it was a liquidated damages amount (even though it was set at *less* than the estimated loss). The plaintiffs were therefore only liable to pay £20 × 30 = £600.

4 The House of Lords in *Suisse Atlantique* [1967] 1 AC 361, page 309, distinguished liquidated damages and limitation clauses. Whereas a liquidated damages clause fixes the amount payable irrespective of the loss, a limitation clause merely places an upper limit on the damages available so that any amount of actual loss up to the limitation figure can be claimed.

In the following case the Court of Appeal held that if a clause is a penalty it is not struck out but remains a term of the contract. However, it will not be enforced beyond the amount of the injured party's actual loss.

Jobson v Johnson
[1989] 1 All ER 621 (CA)

The defendant contracted to purchase 62,566 shares in Southend United Football Club for a total price of £351,688, payable by an initial payment of £40,000 and the rest in six half-yearly instalments. If the defendant defaulted on the payment of the second or any subsequent instalment, he was required to transfer the shares back to the vendors for £40,000. The defendant defaulted when he had paid £140,000, and the vendor sought specific performance of the agreement for the retransfer of the shares. The defendant claimed that the contractual provision was a penalty and unenforceable. Held: the transfer of shares for £40,000 was not a genuine pre-estimate of the vendor's loss and was payable on the retransfer irrespective of how much the defendant had paid. Since it was a penalty, the retransfer clause could not be enforced beyond the amount of the vendor's loss.

NICHOLLS LJ: . . . [A] penalty clause in a contract is, in practice, a dead letter. An obligation to make a money payment stipulated in terrorem will not be enforced beyond the sum which represents the actual loss of the party seeking payment, namely, principal, interest and, if appropriate, costs, in those cases where (to use modern terminology) the primary obligation is to pay money, or where the primary obligation is to perform some other obligation, beyond the sum recoverable as damages for breach of that obligation. (For convenience I shall hereafter refer to that

sum as 'the actual loss of the innocent party'.) Hence normally there is no advantage in suing on the penalty clause. In *Wall* v *Rederiaktiebolaget Luggude* [1915] 3 KB 66 at 73 Bailhache J concluded his examination of the history of this matter in the context of a penalty clause in a charterparty with these words:

> This being the state of the law as I understand it, one easily sees why in charterparty cases no one sues on the penalty clause now. You cannot under it recover more than the proved damages, and if the proved damages exceed the penal sum you are restricted to the lower amount.

This accords with authoritative dicta in *Bridge* v *Campbell Discount Co. Ltd* [1962] 1 All ER 385 [1962] AC 600 . . . Lord Radcliffe said ([1962] 1 All ER 385 at 397, [1962] AC 600 at 625:

> In my opinion, a clause of this kind, when founded on in consequence of a contractual breach, comes within the range of the court's jurisdiction to relieve against penalties, and the respondents should be confined to the right of claiming from the appellant any damage that they can show themselves to have actually suffered from his failing down on the contract.

Although in practice a penalty clause in a contract is effectively a dead letter, it is important in the present case to note that, contrary to the submissions of counsel for the defendant, the strict legal position is not that such a clause is simply struck out of the contract, as though with a blue pencil, so that the contract takes effect as if it had never been included therein. Strictly, the legal position is that the clause remains in the contract and can be sued on, but it will not be enforced by the court beyond the sum which represents, in the events which have happened, the actual loss of the party seeking payment. . . .

Notes

1. See page 416 for further discussion of this case.
2. Therefore, if the actual loss is lower than the penalty amount, the lower actual loss is recoverable because the penalty is invalid.
3. What is the position if a clause is a penalty and the actual loss is greater than this amount? Can the higher actual loss be recovered? There appears to be some support for concluding that it can from the decision in *Wall* v *Rederiaktiebolaget Luggude* [1915] 3 KB 66. Although the question was left open in *Cellulose Acetate Silk Co. Ltd* v *Widnes Foundry (1925) Ltd*, it would appear that the Court of Appeal in *Jobson* is suggesting that actual loss damages prevail. (See Hudson (1974) 90 LQR 31 and (1975) 91 LQR 25, and Barton (1976) 92 LQR 20.)
4. In *Nutting* v *Baldwin* [1995] 2 All ER 321, Rattee J had to consider a rule of an association formed to co-ordinate claims by Lloyd's names. This rule provided that any defaulting members who did not pay their subscriptions could (at the discretion of the committee) be excluded from sharing in any distribution of sums recovered by the association. The defaulting members claimed that since they were in breach of contract in failing to pay their subscriptions, and since depriving them of their share was not related to the likely loss to the association through their failure to pay their subscription, this rule amounted to an unenforceable penalty. Rattee J rejected this

contention on the ground that the underlying basis of the association was benefit and burden in the enforcement of claims, so that if a member did not accept his share of the burden he could not take the benefit.

5. The Unfair Terms in Consumer Contract Regulations 1994, sch. 3(1)(e) provides that in a consumer contract a term may be unfair and unenforceable if it requires 'any consumer who fails to fulfil his obligation to pay a disproportionately high sum in compensation'. This will also strike down penalty clauses. However, the courts (or the Director-General of Fair Trading) will need to make an assessment of what is meant by a 'disproportionately high sum' in the general context of unfairness and good faith. Such an assessment will clearly turn on the facts of each case. The examples thus far given in the Office of Fair Trading *Bulletins* (page 346) indicate that the Director-General has intervened where no figure is given but it is left within the discretion of the seller or supplier.

(b) **Penalties payable on events other than breach of contract**

The penalty rule applies only where the sum specified is payable on breach. The penalty will be enforceable where it operates on an event other than breach even if it is penal in nature, e.g., a threat to compel performance. This leads to unsatisfactory fine distinctions.

Alder v *Moore*
[1961] 2 QB 57 (CA)

The Association Football Players and Trainers Union took out a policy of insurance on behalf of its members. It provided that if a member of the union suffered permanent total disability which prevented him from playing as a professional footballer he would be paid £500. The defendant received an eye injury in the course of a match and was certified totally disabled. He was paid £500 under the policy and signed a declaration required by the terms of the policy agreeing to 'take no part as a playing member in any form of professional football in the future and that in the event of an infringement of this condition I will be subject to a penalty of the amount stated above' (£500). Within four months of receiving this payment the defendant began to play professional football on a part-time basis. The insurers claimed the return of the £500 and the defendant argued that it was a penalty and unenforceable. Held: (Devlin LJ dissenting) this declaration amounted to a promise to repay the £500 if the defendant played again rather than a promise not to play with a £500 penalty for breach of that promise. The penalty rule did not apply here to relieve the defendant and he had to repay the £500.

Export Credits Guarantee Department v *Universal Oil Products Co.*
[1983] 1 WLR 399 (HL)

The defendants were involved in the construction of oil refineries for the Newfoundland companies. The construction was financed by a bank

consortium in return for the issue of promissory notes by the Newfoundland companies. The plaintiffs guaranteed these notes to the bank consortium, and by clause 7(1) of their agreement with the defendants, the defendants were to repay to the plaintiffs any sums paid by the plaintiffs under this guarantee if the defendants defaulted in the performance of their obligations under the construction contracts. The Newfoundland companies dishonoured notes and the plaintiffs indemnified the bank consortium for £39,571,000 but claimed this from the defendants on the basis that clause 7(1) operated because the defendants had defaulted. The defendants argued that the clause was a penalty and unenforceable. Held: it was not a penalty since it was not a sum payable on breach of any contract between the plaintiffs and the defendants. It related to the defendants' breach of contractual obligations owed to a third party (the Newfoundland companies).

Note
In any event, it is difficult to see what the defendants had to gain by arguing that it was a penalty, since if it was then the plaintiffs could have claimed their actual loss.

The following case concerned the status of minimum payment clauses in hire-purchase contracts (i.e., minimum sums payable if the contract is terminated).

Bridge v *Campbell Discount Co. Ltd*
[1962] AC 600 (HL)

Bridge hired a car under a hire-purchase agreement with a finance company. Clause 6 provided for termination by the hirer on giving notice. Clause 9 provided that in that event the hirer 'shall forthwith . . . pay to the owners . . . by way of agreed compensation for depreciation of the vehicle such further sums as may be necessary to make the rentals paid and payable equal to two-thirds of the hire-purchase price'. Bridge terminated the agreement when he had paid the initial payment and the first monthly instalment on the ground that he could not keep up the payments. Held: clause 9 was a penalty since the depreciation would increase as the clause amount decreased.

LORD RADCLIFFE: . . . Since the obligation under clause 9(b) may mature at any time from the beginning to the end of the hiring, a week after the beginning or a week before the end, it seems to me impossible to take a single formula for measuring the damage as any true pre-estimate. It produces the result, absurd in its own terms, that the estimated amount of depreciation becomes progressively less the longer the vehicle is used under the hire. This is because the sum agreed upon diminishes as the total of the cash payments increases. It is a sliding scale of compensation, but a scale that slides in the wrong direction, if the measure of anticipated depreciation is to be supposed to be the basis for the compensation agreed upon. The fact that this

anomalous result is deliberately produced by the formula employed suggests, I think, that the real purpose of this clause is not to provide compensation for depreciation at all but to afford the owners a substantial guarantee against the loss of their hiring contract. . . .

Notes

1. Bridge was in breach of his contractual obligations and therefore had not terminated under the option in clause 6. Since Bridge was in breach of contract, clause 9 was unenforceable and the finance company could recover only their actual loss.

2. Paradoxically, the hirer who breaks the hire-purchase contract by failing to pay can rely on the penalty rule and avoid the minimum payment, but if the hirer is not in breach and exercises an option to terminate, the penalty is enforceable and the minimum payment must be made. Lord Denning in *Bridge* v *Campbell Discount* said (at pp. 628–9):

> The truth is that this minimum-payment is not so much compensation for depreciation but rather compensation for loss of the future instalments which the hire-purchase company expected to receive, but which they had no right to receive. It is a penal sum which they exact because the hiring is terminated before two-thirds has been paid. In cases when the hiring is terminated; as it was here, within a few weeks, it is beyond doubt oppressive and unjust.
>
> . . . [I]f Bridge, after a few weeks, finds himself unable to keep up the instalments and, being a conscientious man, gives notice of termination and returns the car, without falling into arrear, he is liable to pay the penal sum of £206 3s. 4d. without relief of any kind. But if he is an unconscientious man who falls into arrear without saying a word, so that the company retake the car for his default, he will be relieved from payment of the penalty.
>
> Let no one mistake the injustice of this. It means that equity commits itself to this absurd paradox: it will grant relief to a man who breaks his contract but will penalise the man who keeps it. . . .

3. If there is a breach, the minimum payment clause will not apply because of the penalty rule. However, a failure to pay instalments is not a repudiatory breach and the owner can recover only for his loss occurring prior to termination (i.e., instalment arrears plus interest). Recovering for future losses would be similar in effect to enforcing the invalid penalty clause (*Financings Ltd* v *Baldock* [1963] 2 QB 104).

4. Although a minimum payment clause may be invalid, it appears that if the failure to pay is drafted as a breach of a condition, then the injured party can terminate for a repudiatory breach and recover the future instalments as actual loss resulting from the breach.

Lombard North Central plc v *Butterworth*
[1987] 1 All ER 267 (CA)

The full facts of this case appear at page 270. Clause 2 of the agreement provided that punctual payment of each instalment was of the essence of

the agreement. Clause 5 contained a right to terminate in the event of default in payment, and clause 6 entitled the owner to all future instalments which would have fallen due, as well as arrears. Held: clause 6 was an unenforceable penalty but, since clause 2 made punctual payment a condition of the contract, there had been a repudiatory breach entitling the owners to terminate independently of clause 5. They could recover their actual loss, and therefore recovered what would have been recovered had clause 6 operated.

MUSTILL LJ. . . . (7) A term of the contract prescribing what damages are to be recoverable when a contract is terminated for a breach of condition is open to being struck down as a penalty, if it is not a genuine covenanted pre-estimate of the damage, in the same way as a clause which prescribes the measure for any other type of breach. No doubt the position is the same where the clause is ranked as a condition by virtue of an express provision in the contract. (8) A clause expressly assigning a particular obligation to the category of condition is not a clause which purports to fix the damages for breaches of the obligation, and is not subject to the law governing penalty clauses. (9) Thus, although in the present case cl 6 is to be struck down as a penalty, cl 2(a)(i) remains enforceable. The plaintiffs were entitled to terminate the contract independently of cl 5, and to recover damages for loss of the future instalments. . . .

I believe that the real controversy in the present case centres on the eighth proposition. I will repeat it. A clause expressly assigning a particular obligation to the category of condition is not a clause which purports to fix the damages for breach of the obligation, and is not subject to the law governing penalty clauses. I acknowledge, of course, that by promoting a term into the category where all breaches are ranked as breaches of condition, the parties indirectly bring about a situation where, for breaches which are relatively small, the injured party is enabled to recover damages as on the loss of the bargain, whereas without the stipulation his measure of recovery would be different. But I am unable to accept that this permits the court to strike down as a penalty the clause which brings about this promotion. To do so would be to reverse the current of more than 100 years' doctrine, which permits the parties to treat as a condition something which would not otherwise be so. I am not prepared to take this step.

Note

(This continues the extract at page 270.

It seems a remarkably easy method of avoiding the effects of the penalty rule simply by including a clause making punctual payment of the essence of the contract.

The minimum payments clause in a consumer contract may not be binding on the consumer under the Unfair Terms in Consumer Contracts Regulations 1994 (see reg. 4(4) and sch. 3(1)(e), pages 345–6).

(c) Deposits and forfeiture clauses

A deposit is an advance payment, and if the payer defaults the other party is entitled to forfeit the deposit, i.e., keep it (*Howe* v *Smith* (1884) 27 ChD 89), whether or not he has suffered any loss as a result of the default. The deposit may also be seen as an incentive to perform, i.e. 'an earnest to bind the bargain'.

The only possible relief available to the defaulting payer is:

(a) if the deposit figure is unreasonable, so that the forfeiture clause is an unenforceable penalty; and/or

(b) if the court is (otherwise) prepared to grant relief against forfeiture. There is some debate concerning the jurisdiction to grant relief against forfeiture. In *Stockloser* v *Johnson* [1954] 1 QB 476, both Denning and Somervell LJJ thought that the deposit might be recoverable in equity if the forfeiture was penal and it was unconscionable for the injured party to retain the money. However, there was a strong dissent from Romer LJ, who stated that unless there was evidence of fraud or sharp practice by the payee, equity would not order repayment of the deposit. This is the view which has subsequently been followed (e.g., Sachs J in *Galbraith* v *Mitchenhall Estates Ltd* [1965] 2 QB 473).

Workers Trust and Merchant Bank Ltd v *Dojap Investments Ltd* [1993] 2 All ER 370 (PC)

The bank, acting as second mortgagee, agreed to sell land for Jamaican $11,500,000. The purchaser paid a deposit of 25 per cent ($2,875,000) in accordance with clause 4 of the contract. The contract provided for forfeiture of the deposit in the event of default by the purchaser. The contract also required the remainder of the price to be paid within 14 days of the auction sale and stated that time was of the essence of the contract. The purchaser defaulted, and although the balance plus interest was tendered a week later than required under the contract, the bank returned it and purported to forfeit the deposit. The purchaser sought relief against forfeiture of the deposit. Held: the deposit had to be repaid once the bank had subtracted from it its actual loss suffered as a result of the breach.

LORD BROWNE-WILKINSON: . . . In general, a contractual provision which requires one party in the event of his breach of the contract to pay or forfeit a sum of money to the other party is unlawful as being a penalty, unless such provision can be justified as being a payment of liquidated damages, being a genuine pre-estimate of the loss which the innocent party will incur by reason of the breach. One exception to this general rule is the provision for the payment of a deposit by the purchaser on a contract for the sale of land. Ancient law has established that the forfeiture of such a deposit (customarily 10% of the contract price) does not fall within the general rule and can be validly forfeited even though the amount of the deposit bears no reference to the anticipated loss to the vendor flowing from the breach of contract.

This exception is anomalous and at least one textbook writer has been surprised that the courts of equity ever countenanced it: see Farrand *Contract and Conveyancing* (4th edn, 1983) p. 204. The special treatment afforded to such a deposit derives from the ancient custom of providing an earnest for the performance of a contract in the form of giving either some physical token of earnest (such as a ring) or earnest money. The history of the law of deposits can be traced to the Roman law of arra, and possibly further back still: see *Howe* v *Smith* (1884) 27 Ch D 89 at 101–102, [1881–5] All ER Rep 201 at 208-209 per Fry LJ. Ever since the decision in *Howe* v *Smith* the nature

of such a deposit has been settled in English law. Even in the absence of express contractual provision, it is an earnest for the performance of the contract: in the event of completion of the contract the deposit is applicable towards payment of the purchase price; in the event of the purchaser's failure to complete in accordance with the terms of the contract, the deposit is forfeit, equity having no power to relieve against such forfeiture.

However, the special treatment afforded to deposits is plainly capable of being abused if the parties to a contract, by attaching the label 'deposit' to any penalty, could escape the general rule which renders penalties unenforceable. There are two authorities which indicate that this cannot be done. In *Stockloser* v *Johnson* [1954] 1 All ER 630 at 638, [1954] 1 QB 476 at 491 Denning LJ in considering the power of the court to relieve against forfeiture said, obiter:

> Again, suppose that a vendor of property, in lieu of the usual ten per cent. deposit, stipulates for an initial payment of fifty per cent. of the price as a deposit and part payment, and later, when the purchaser fails to complete, the vendor re-sells the property at a profit and, in addition, claims to forfeit the fifty per cent. deposit. Surely the court will relieve against the forfeiture. The vendor cannot forestall this equity by describing an extravagant sum as a deposit, any more than he can recover a penalty by calling it liquidated damages.

In *Linggi Plantations Ltd* v *Jagatheesan* [1972] 1 MLJ 89 Lord Hailsham LC delivered the judgment of the Board which upheld the claim to forfeit a normal 10% deposit even though the vendor had in fact suffered no loss. He referred on a number of occasions to a requirement that the amount of a deposit should be 'reasonable' and said (at 94):

> It is also no doubt possible that in a particular contract the parties may use language normally appropriate to deposits properly so called and even to forfeiture which turn out on investigation to be purely colourable and that in such a case the real nature of the transaction might turn out to be the imposition of a penalty, by purporting to render forfeit something which is in truth part payment. This no doubt explains why in some cases the irrecoverable nature of a deposit is qualified by the insertion of the adjective 'reasonable' before the noun. But the truth is that a reasonable deposit has always been regarded as a guarantee of performance as well as a payment on account, and its forfeiture has never been regarded as a penalty in English law or common English usage.

In the view of their Lordships these passages accurately reflect the law. It is not possible for the parties to attach the incidents of a deposit to the payment of a sum of money unless such sum is reasonable as earnest money. The question therefore is whether or not the deposit of 25% in this case was reasonable as being in line with the traditional concept of earnest money or was in truth a penalty intended to act in terrorem.

The Chief Justice tested the question of 'reasonableness' by reference to the evidence before him that it was of common occurrence for banks in Jamaica selling property at auction to demand deposits of between 15% and 50%. He held that, since this was a common practice, it was reasonable. Like the Court of Appeal, their Lordships are unable to accept this reasoning. In order to be reasonable a true deposit must be objectively operating as 'earnest money' and not as a penalty. To allow the test of reasonableness to depend upon the practice of one class of vendor, which exercises considerable financial muscle, would be to allow them to evade the law against penalties by adopting practices of their own.

However, although their Lordships are satisfied that the practice of a limited class of vendors cannot determine the reasonableness of a deposit, it is more difficult to define what the test should be. Since a true deposit may take effect as a penalty, albeit one permitted by law, it is hard to draw a line between a reasonable, permissible amount of penalty and an unreasonable, impermissible penalty. In their Lordships' view the correct approach is to start from the position that, without logic but by long continued usage both in the United Kingdom and formerly in Jamaica, the customary deposit has been 10%. A vendor who seeks to obtain a larger amount by way of forfeitable deposit must show special circumstances which justify such a deposit.

. . . In the view of their Lordships, since the 25% deposit was not a true deposit by way of earnest, the provision for its forfeiture was a plain penalty. There is clear authority that in a case of a sum paid by one party to another under the contract as security for the performance of that contract, a provision for its forfeiture in the event of non-performance is a penalty from which the court will give relief by ordering repayment of the sum so paid, less any damage actually proved to have been suffered as a result of non-completion: *Public Works Comr* v *Hills* [1906] AC 368, [1904–7] All ER Rep 919. Accordingly, there is jurisdiction in the court to order repayment of the 25% deposit.

. . .

Finally, it appears that the bank may have suffered some damage as a result of Dojap's failure to complete. If so, the bank is entitled to deduct the amount of such damages from the 'deposit' of 25%. Such damage has not been quantified in the judgment below but appears to be small in amount. It would not be right to keep Dojap out of all its money to await the outcome of the necessary inquiry as to damages. The bank ought accordingly to make immediate repayment of a substantial amount of the deposit, leaving a fund out of which the bank's damages, if any, can be satisfied.

Notes

1. See Beale, 'Unreasonable Deposits' (1993) 109 LQR 524.
2. The Law Commission Working Paper No. 161, 'Penalty Clauses and Forfeiture of Monies Paid' (1975), paras. 65 and 66, recommended that forfeiture clauses should be subject to the same rule as penalty clauses. The test applied by the Privy Council is different, in that the essential question determining whether a deposit is a penalty is one of 'unreasonableness' rather than whether the sum is a genuine pre-estimate of the loss.
3. If a contract requires a deposit amount which is later considered to be unreasonable, the courts will not insert a reasonable figure in its place and allow forfeiture.
4. It may be significant that it is far from clear whether the Privy Council was in fact dealing with the case on the basis of the penalty rule or on the basis of granting relief against forfeiture. Lord Browne-Wilkinson stated that it was not necessary for him to decide between the alternative positions on relief against forfeiture in *Stockloser* v *Johnson* and that the deposit was a penalty which the court would order to be repaid. If the case was being dealt with on the basis of granting equitable relief against forfeiture, the court would have far more of a discretion in terms of how the deposit should be dealt with. It is therefore suggested that this case in fact turns on the application of the penalty rule.

In *Jobson* v *Johnson* [1989] 1 All ER 621 (page 407), the re-transfer agreement was not only a penalty but also a form of security for payment of the price. The defendant had alternatively counterclaimed for relief against forfeiture. This counterclaim was struck out at trial on procedural grounds, but the Court of Appeal did discuss the relationship between the penalty rule and relief against forfeiture of a deposit.

Essentially, relief against a penalty is as of right and cuts down recovery to the extent of the injured party's actual loss, whereas relief against forfeiture is discretionary, granted subject to conditions, and overrides the forfeiture clause. It is helpful, therefore, if the forfeiture clause is a penalty since automatic penalty relief will follow.

Nicholls LJ in *Jobson* v *Johnson* said (at pp. 631, 634–5):

> In considering this appeal it is right to have in mind that the legal principles applicable today regarding penalty clauses in contracts and those applicable regarding relief from forfeiture stem from a common origin. A penalty clause in a contract, as that expression is normally used today, is a provision which, on breach of the contract, requires the party in default to make a payment to the innocent party of a sum of money which, however it may be labelled, is not a genuine pre-estimate of the damage likely to be sustained by the innocent party, but is a payment stipulated in terrorem of the party in default. For centuries equity has given relief against such provisions by not permitting the innocent party to recover under the penal provision more than his actual loss. . . .
>
> Likewise with forfeiture. Take the simple case of a provision for forfeiture of a lease on non-payment of rent. That provision was regarded by equity as a security for the rent. So that, where conscience so required, equity relieved against the forfeiture on payment of the rent with interest. . . . In the case of a penalty clause in a contract equity relieves by cutting down the extent to which the contractual obligation is enforceable: the 'scaling-down' exercise, as I have described it. In the case of forfeiture clauses equitable relief takes the form of relieving wholly against the contractual forfeiture provision, subject to compliance with conditions imposed by the court. Be that as it may, I see no reason why the court's ability to grant discretionary relief against forfeiture should deprive a defendant of the relief automatically granted in respect of a penalty clause if, exceptionally, a contractual provision has characteristics which enable a defendant to pray in aid both heads of relief. . . .
>
> Clause 6(b) . . . is something of a hybrid. It possesses the essential characteristics of a penalty clause in a contract. It also possesses features which resemble those of a forfeiture provision. Clause 6(b) provided that if the purchaser failed to pay all the agreed instalments, he would retransfer to the vendors a slice (44.9%) of the issued share capital of the company equal to the slice the vendors had sold to him. In substance cl. 6(b) is equivalent to a right to re-take the property being sold in default of payment of the full price. Clause 6(b) was inserted as an attempt to give the vendors some 'security' over the property being sold if the purchaser failed to pay in full. . . .

Notes

1. See Harpum, 'Equitable relief — penalties and forfeitures' [1989] CLJ 370.
2. The Unfair Terms in Consumer Contract Regulations 1994, sch. 3(1)(d), indicates that a term may be unfair in a consumer contract where it

permits 'the seller or supplier to retain sums paid by the consumer where the latter decides not to conclude or perform the contract, without providing for the consumer to receive compensation of any equivalent amount from the seller or supplier where the latter is the party cancelling the contract'.

3. In *Nutting* v *Baldwin* [1995] 2 All ER 231 (page 408), the defaulters also sought relief against forfeiture and, although the judge accepted that the operation of the rule in question did amount to forfeiture despite the fact that it was at the discretion of the committee, he concluded that this not an appropriate case for relief because relief would mean that they could wait until a claim was successful before paying the arrears in their subscriptions and this would frustate the very purpose and nature of the association.

SECTION 2: ACTION FOR AN AGREED SUM

If one party has performed his primary contractual obligations and the other party's breach consists of a failure to pay the contractual price or other agreed sum, the performing party can claim this agreed (liquidated) sum rather than damages.

In relation to an action for the price in a contract for the sale of goods, the Sale of Goods Act 1979, s. 49, provides:

> (1) Where, under a contract of sale, the property in the goods has passed to the buyer and he wrongfully neglects or refuses to pay for the goods according to the terms of the contract, the seller may maintain an action against him for the price of the goods.

Since it is a liquidated claim, the remoteness rules and duty to mitigate do not apply (see *White & Carter (Councils) Ltd* v *McGregor* [1962] AC 413 (page 352), which was an action for an agreed sum where the plaintiffs were able to continue with performance and claim the agreed sum without having to mitigate). In addition, because it is a liquidated claim it has the procedural advantage that summary judgment can be applied for (i.e., early judgment).

SECTION 3: SPECIFIC PERFORMANCE AND INJUNCTIONS

Specific performance is an order of the court requiring the party in breach to perform his primary obligations under the contract. In relation to the sale of goods the remedy has been put into statutory form. Section 52 of the Sale of Goods Act 1979 gives the court a discretion to order specific performance 'in any action for breach of contract to deliver specific or ascertained goods' (i.e., goods identified and agreed upon at the time of contracting or subsequently).

An injunction is an order restraining a breach of a negative stipulation in a contract, e.g., breach of a restraint of trade stipulation (page 581).

It is important to remember that, unlike damages, these are discretionary remedies.

Numerous restrictions are placed on the ability of the injured party to obtain an order for specific performance. These restrictions also apply to the

grant of an injunction against the breach of a negative stipulation in the contract which would have the same effect as an order to perform the obligation.

(a) If damages are an adequate remedy specific performance is not available

In *Beswick* v *Beswick* [1968] AC 58 (page 204), the loss to the estate caused by the nephew's failure to pay the widow the annuity was nominal since it was the widow who suffered the loss. The House of Lords ordered specific performance of the contract on the ground that damages to the estate would not provide an adequate remedy.

In relation to sale of goods, damages will be an adequate remedy if it is possible for the injured party to purchase substitute goods (*Société des Industries Metallurgiques SA* v *The Bronx Engineering Co. Ltd* [1975] 1 Lloyd's Rep 465). If the goods are unique, then damages might not be adequate.

Sky Petroleum Ltd* v *VIP Petroleum Ltd
[1974] 1 All ER 954

The plaintiff company had agreed to buy all the petrol and diesel fuel needed for its filling stations from the defendant at fixed prices for a period of 10 years. Three and a half years later the defendant purported to terminate the contract, alleging the plaintiff was in breach. The plaintiff sought an interlocutory injunction to restrain the defendant from withholding fuel supplies (an unascertained commodity) from the plaintiff. There was evidence that at that time, November 1973, the plaintiff would have little prospect of finding an alternative source of supply. Goulding J recognised that, if he granted the injunction, its effect would be to compel performance of the contract. He held that specific performance would be available because damages would not be an adequate remedy. The defendant was for all practical purposes the sole means of keeping the plaintiff's business going. Since specific performance would have been available, he granted an interlocutory injunction.

(b) Supervision

Specific performance may not be granted where the contract extends over a period of time because of the difficulty of constant supervision (*Ryan* v *Mutual Tontine Westminster Chambers Association* [1893] 1 Ch 116). However, Megarry J in *C. H. Giles Co. Ltd* v *Morris* [1972] 1 All ER 960, expressed dissatisfaction with any absolute restriction based on difficulties in supervision.

(c) Contracts for personal services

Generally a court will not order specific performance of a contract requiring personal services, e.g., where there is a negative stipulation in the contract whereby one party must render exclusive services to the other, and will not

grant an injunction to restrain the breach since it would have the same effect as specific performance and compel one person to work for another.

Page One Records Ltd v *Britton*
[1968] 1 WLR 157

The plaintiffs were the managers and publishers of the pop group, 'The Troggs'. The contract between them provided that the group would not 'engage any other person firm or corporation to act as [their] managers or agents or act themselves in such capacity'. The plaintiffs sought an interlocutory injunction to restrain the group from engaging Harvey Block Associates Ltd as their manager in breach of contract, and from publishing music performed by them. The plaintiffs also sought an injunction against Harvey Block Associates Ltd restraining any inducement to the defendants to break their contract with the plaintiffs. Held: enforcement of these negative covenants would be tantamount to ordering specific performance of the contract of personal services by the plaintiffs. It would be wrong to put pressure on the defendants to continue to employ in the fiduciary capacity of a manager and agent, someone in whom they had lost confidence.

STAMP J: . . . [T]his present case, in my judgment, fails, on the facts at present before me, on a more general principle, the converse of which was conveniently stated in the judgment of Branson J in *Warner Brothers Pictures Inc* v *Nelson* [1937] 1 KB 209. Branson J stated the converse of the proposition and the proposition, correctly stated, is, I think, this, that where a contract of personal service contains negative covenants the enforcement of which will amount either to a decree of specific performance of the positive covenants of the contract or to the giving of a decree under which the defendant must either remain idle or perform those positive covenants, the court will not enforce those negative covenants.

In the *Warner Brothers* case Branson J felt able to find that the injunction sought would not force the defendant to perform his contract or remain idle.

I quote from the report:

> It was also urged that the difference between what the defendant can earn as a film artiste and what she might expect to earn by any other form of activity is so great that she will in effect be driven to perform her contract. That is not the criterion adopted in any of the decided cases. The defendant is stated to be a person of intelligence, capacity and means, and no evidence was adduced to show that, if enjoined from doing the specified acts otherwise than for the plaintiffs, she will not be able to employ herself both usefully and remuneratively in other spheres of activity, though not as remuneratively as in her special line. She will not be driven, although she may be tempted, to perform the contract, and the fact that she may be so tempted is no objection to the grant of an injunction.

So it was said in this case that if an injunction is granted the Troggs could, without employing any other manager or agent, continue as a group on their own or seek other employment of a different nature. So far as the former suggestion is concerned, in the first place I doubt whether consistently with the terms of the agreements which I have read, the Troggs could act as their own managers; and, in the second place, I think I

can, and should, take judicial notice of the fact that these groups, if they are to have any great success, must have managers. Indeed, it is the plaintiffs' own case that the Troggs are simple persons, of no business experience, and could not survive without the services of a manager. As a practical matter on the evidence before me, I entertain no doubt that they would be compelled, if the injunction was granted, on the terms that the plaintiffs seek, to continue to employ the first plaintiff as their manager and agent and it is, I think, on this point that this case diverges from *Lumley* v *Wagner* (1852) 1 De GM & G 604 and the cases which have followed it, including the *Warner Brothers* case [1937] 1 KB 209: for it would be a bad thing to put pressure upon these four young men to continue to employ as a manager and agent in a fiduciary capacity one who, unlike the plaintiff in those cases (who had merely to pay the defendant money) has duties of a personal and fiduciary nature to perform and in whom the Troggs, for reasons good, bad or indifferent, have lost confidence and who may, for all I know, fail in its duty to them.

On the facts before me on this interlocutory motion, I should, if I granted the injunction, be enforcing a contract for personal services in which personal services are to be performed by the first plaintiff. In *Lumley* v *Wagner* Lord St Leonards, in his judgment, disclaimed doing indirectly what he could not do directly; and in the present case, by granting an injunction I would, in my judgment, be doing precisely that. I must, therefore, refuse the injunction which the first plaintiff seeks.

Notes

1. Particular stress was placed on the fact that this relationship was one requiring mutual trust and confidence.
2. Stamp J referred to the decision in the following case.

Warner Brothers Pictures Incorporated v *Nelson*
[1937] 1 KB 209

The actress, Bette Davis, had agreed to render her exclusive services as an actress to Warner Brothers for 52 weeks (with Warner Brothers having an option to renew) and undertook not to render such services to any other person. In breach of contract, she agreed with a third party to perform in the UK as a film artist. The plaintiffs sought an injunction, which in its terms was confined to forbidding the defendant, without the consent of the plaintiffs, from rendering any services in any motion picture or stage production for anyone other than the plaintiffs. (It did not require enforcement of a positive performance obligation which would not have been granted.) Branson J granted the injunction on the basis that the effect of the contract was not such as to force the defendant to perform this contract or be idle and starve. Although Bette Davis might earn more as a film actress, and therefore might be tempted to perform the contract with Warner Brothers, she could earn money in other ways and would not be *driven* to perform.

Notes

1. This decision appears to have been influenced by a wish to prevent parties 'departing from their contracts at their pleasure', leaving the injured party to damages which was not an adequate remedy.

2. 'The Troggs' in *Page One Records Ltd* v *Britton* did not have the experience or ability to operate as a pop group without a manager and would have been driven to continue to employ the plaintiffs.

Warren v *Mendy*
[1989] 3 All ER 103 (CA)

In January 1988, the plaintiff entered into a contract with the professional boxer, Nigel Benn, to act as Benn's manager for three years. Benn agreed to be managed and directed exclusively by the plaintiff and not to enter into any agreement with any other manager without the plaintiff's consent. By June 1988, Benn was dissatisfied with the plaintiff's management and entered into an agreement with the defendant whereby the defendant was to act as Benn's agent. The plaintiff brought an action against the defendant, claiming damages for inducing Benn to break his contract with the plaintiff and an *ex parte* injunction against the defendant to restrain him from acting as Benn's agent. However, the injunction was later discharged on the ground that restraining the defendant from acting as Benn's agent would have the effect of compelling the boxer to perform the positive obligation imposed on him to be managed and directed exclusively by the plaintiff. The plaintiff appealed. Held: the injunction was rightly discharged because it would compel Benn to use only the exclusive services of the plaintiff. It was also held that a court is less likely to grant an injunction where the contract of service contains obligations of mutual trust and confidence between the manager and the performer and the performer has genuinely lost confidence in the manager, as here.

NOURSE LJ: . . . [C]onsideration of the authorities has led us to believe that the following general principles are applicable to the grant or refusal of an injunction to enforce performance of the servant's negative obligations in a contract for personal services inseparable from the exercise of some special skill or talent. (We use the expressions 'master' and 'servant' for ease of reference and not out of any regard for the reality of the relationship in many of these cases.) In such a case the court ought not to enforce the performance of the negative obligations if their enforcement will effectively compel the servant to perform his positive obligations under the contract. Compulsion is a question to be decided on the facts of each case, with a realistic regard for the probable reaction of an injunction on the psychological and material, and sometimes the physical, need of the servant to maintain the skill or talent. The longer the term for which an injunction is sought, the more readily will compulsion be inferred. Compulsion may be inferred where the injunction is sought not against the servant but against a third party, if either the third party is the only other available master or if it is likely that the master will seek relief against anyone who attempts to replace him. An injunction will less readily be granted where there are obligations of mutual trust and confidence, more especially where the servant's trust in the master may have been betrayed or his confidence in him has genuinely gone.

In stating the principles as we have, we are not to be taken as intending to pay anything less than a full and proper regard to the sanctity of contract. No judge would wish to detract from his duty to enforce the performance of contracts to the very limit

which establish principles allow him to go. Nowhere is that duty better indicated than in the words of Lord St Leonards LC in *Lumley* v *Wagner* (1852) 1 De GM & G 604 at 619, [1843–60] All ER Rep 368 at 373. To that end the judge will scrutinise most carefully, even sceptically, any claim by the servant that he is under the human necessity of maintaining the skill or talent and thus will be compelled to perform the contract, or that his trust in the master has been betrayed or that his confidence in him has genuinely gone. But, if, having done that, the judge is satisfied that the grant of an injunction will effectively compel performance of the contract, he ought to refuse it. To do otherwise would be to disregard the authoritative observations which were made in this court in *Whitwood Chemical Co.* v *Hardman* [1891] 2 Ch 416.

Notes

1. This decision and *Page One Records* v *Britton* both involved a management contract and enforcement by the employee, whereas in *Warner Brothers* v *Nelson* the issue had been enforcement by the employer. Does this make a difference?
2. The Court of Appeal stressed that Benn needed the services of a manager to arrange his fights, and he had to fight in order to maintain his talent. Therefore the injunction would compel him to perform his contract with the plaintiff if that was the only way of exercising his talents. In *Warner Brothers* v *Nelson* it had been assumed that Bette Davis was not solely dependent upon acting and could obtain alternative work. *Warren* v *Mendy* confirms that a person who possesses a talent would necessarily have to exploit it rather than being faced with the choice of complying with the injunction or seeking alternative work which is less well paid.

SECTION 4: RESTITUTION

Restitution allows the injured party to recover money paid or the value of benefits conferred on the party in breach where it would be unjust to allow the guilty party to retain that benefit.

If the benefit consisted of a payment of money, it can be recovered where there has been a total failure of consideration (i.e., the injured party received no part of the contractual performance) but not if the failure of consideration is only partial, since the courts would have to calculate whether the contractual performance was equivalent to the sum paid. Bovill CJ in *Whincup* v *Hughes* (1871) LR 6 CP 78 explained this difficulty of apportionment (at p. 81):

> This is an action brought to recover a part of the premium paid upon the execution of an apprenticeship deed, on the ground of failure of consideration. The general rule of law is, that where a contract has been in part performed no part of the money paid under such contract can be recovered back. There may be some cases of partial performance which form exceptions to this rule, as, for instance, if there were a contract to deliver ten sacks of wheat and six only were delivered, the price of the remaining four might be recovered back. But there the consideration is clearly severable. The general rule being what I have stated, is there anything in the present case to take it out of such rule? The master instructed the apprentice under the deed

for the period of a year, and then died. It is clear law that the contract being one of a personal nature, the death of the master, in the absence of any stipulation to the contrary, puts an end to it for the future. The further performance of it has been prevented by the act of God, and there is thus no breach of contract upon which any action will lie against the executor. That being so, can any action be maintained otherwise than upon the contract? The contract having been in part performed, it would seem that the general rule must apply unless the consideration be in its nature apportionable. I am at a loss to see on what principle such apportionment could be made. It could not properly be made with reference to the proportion which the period during which the apprentice was instructed bears to the whole term. In the early part of the term the teaching would be most onerous, and the services of the apprentice of little value; as time went on his services would probably be worth more, and he would require less teaching. . . .

If the benefit consists of services, and there is no contractual provision for remuneration, the injured party can claim their reasonable value on a *quantum meruit* (*Planche* v *Colburn* (1831) 8 Bing 14, 131 ER 305). See also *British Steel Corporation* v *Cleveland Bridge & Engineering Co. Ltd* [1984] 1 All ER 504, page 76, where the services were requested by the benefited party. Compare *Regalian Properties plc* v *London Dockland Development Corp* [1995] 1 All ER 1005, page 77.

11 COMMON MISTAKE AND FRUSTRATION

In the absence of contractual allocation of the risk in question (*William Sindall plc* v *Cambridgeshire County Council* [1994] 3 All ER 932, page 439), if the parties entered into a contract under the same mistaken assumption, that contract may be void for 'common mistake' if the mistake is so fundamental that it 'nullifies' consent. This is often referred to as 'initial impossibility' because the impossibility already exists when the contract is made.

The impossibility may be 'subsequent', i.e., after the formation of the contract, events occur, without the fault of either party, which render further performance of the contract either impossible, illegal or radically different from what was originally envisaged. In this situation the contract may be automatically discharged on the grounds of frustration and the parties will be excused further performance of their contractual obligations. Statute also provides for adjustment of obligations arising before frustration. Again, however, the frustration doctrine will apply only in the absence of an express provision in the contract allocating the risk.

Although determining the existence of either initial or subsequent impossibility may turn on fine distinctions of timing (page 452), the legal consequences are quite different.

SECTION 1: COMMON MISTAKE

(Cases on this type of mistake often confusingly refer to common mistake as 'mutual' mistake but it should not be confused with true mutual mistake, see page 77).

The crucial characteristic of common mistake is that both parties make a mistake and it is the same mistake. In order for the contract to be void for common mistake, thereby excusing the parties from all performance, that mistake must be 'fundamental'.

A: *RES EXTINCTA*

Both parties are mistaken as to the existence of the subject matter of the contract.

Couturier v *Hastie*
(1856) 5 HL Cas 673; 10 ER 1065 (HL)

In May 1848, the parties entered into a contract for the sale of corn which was believed to be in transit from Salonica to the UK. Shipment had occurred in February 1848 and, unknown to both parties, before the contract was made in May, the corn had deteriorated to such an extent that the master of the ship had sold it at Tunis. When he discovered this fact the English buyer repudiated the contract but the seller argued that the buyer was still liable for the price. Held: the contract contemplated that there was an existing commodity to be sold and bought. Since this was not the case at the time of the sale to the buyer, he was not liable to pay the price.

Notes

1. *Couturier* v *Hastie* is often quoted as authority for the fact that a mistake by both parties as to the existence of the subject matter of the contract renders the contract void. This interpretation was placed on *Couturier* v *Hastie* by the legislative draftsman in the Sale of Goods Act 1893. Section 6 of the 1979 Act provides:

> 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.

However, the only issue the House of Lords had to decide was whether the buyer was liable to pay the price. The House of Lords held that he was not so bound, but this could have been because there was a contract that the goods existed and there was a total failure of consideration destroying the basis of the contract. The word 'mistake' is not even mentioned in the case, and the Lord Chancellor expressly states that the whole question turned upon the construction of the contract.

2. An alternative interpretation is that there is a condition precedent that the goods are capable of being sold, and if they are not, then the contract is void on that basis (see Denning LJ in *Solle* v *Butcher* [1950] 1 KB 671, page 432).

This is the approach accepted by Steyn J in the next case.

Associated Japanese Bank (International) Ltd v *Crédit du Nord*
[1988] 3 All ER 902

On a sale and lease back transaction, the plaintiff bank purchased four specified machines from Bennett and then leased them back to him.

Bennett received over £1 million under the transaction. As a condition of the transaction, Bennett's obligations under the lease back transaction were guaranteed by the defendant bank. Both banks believed that the four machines existed and were in Bennett's possession. After Bennett failed to keep up the payments under the lease it was discovered that the machines had never existed. When Bennett was declared bankrupt the plaintiff sought to enforce the guarantee against the defendant. The defendant argued that the guarantee was void for common mistake as to the existence of the machines. Held: on its true construction, the guarantee was subject to a condition precedent that there was a lease in respect of four existing machines. As these machines did not exist the plaintiff bank's claim failed. (Steyn J treated the subject matter of the guarantee as being the machines rather than the lease. On that basis the guarantee was void for the non-existence of the subject matter.)

3. See J.C. Smith, 'Contracts — Mistake, Frustration and Implied Terms' (1994) 110 LQR 400.

Note
The contract will not be void where one party assumes the risk of the existence of the subject matter.

McRae v *Commonwealth Disposals Commission*
(1951) 84 CLR 377 (High Court of Australia)

The Commission invited tenders for an oil tanker lying on Jourmaund Reef and said to contain oil. The plaintiffs' tender was accepted and a sales advice note described what was sold as 'one oil tanker including contents . . . '. In fact there was no such tanker at that location. The plaintiffs sought damages for breach of contract. The defendants alleged that because the subject matter of the contract did not exist, the alleged contract was void. Held: the plaintiffs were entitled to damages for breach of contract because the Commission were in breach of their 'promise' that there was an oil tanker at the location.

DIXON AND FULLAGAR JJ: The position so far, then, may be summed up as follows. It was not decided in *Couturier* v *Hastie* (1856) 5 HL Cas 673 that the contract in that case was void. The question whether it was void or not did not arise. If it had arisen, as in an action by the purchaser for damages, it would have turned on the ulterior question whether the contract was subject to an implied condition precedent. Whatever might then have been held on the facts of *Couturier* v *Hastie*, it is impossible in this case to imply any such term. The terms of the contract and the surrounding circumstances clearly exclude any such implication. The buyers relied upon, and acted upon, the assertion of the seller that there was a tanker in existence. It is not a case in which the parties can be seen to have proceeded on the basis of a common assumption of fact so as to justify the conclusion that the correctness of the assumption was intended by both parties to be a condition precedent to the creation of contractual obligations. The officers of the Commission made an assumption, but the plaintiffs did not make an assumption in the same sense. They knew nothing except what the Commission had told them. If they had been asked, they would

certainly not have said: 'Of course, if there is no tanker, there is no contract'. They would have said: 'We shall have to go and take possession of the tanker. We simply accept the Commission's assurance that there is a tanker and the Commission's promise to give us that tanker.' The only proper construction of the contract is that it included a promise by the Commission that there was a tanker in the position specified. The Commission contracted that there was a tanker there. If, on the other hand, the case of *Couturier* v *Hastie* and this case ought to be treated as cases raising a question of 'mistake', then the Commission cannot in this case rely on any mistake as avoiding the contract, because any mistake was induced by the serious fault of their own servants, who asserted the existence of a tanker recklessly and without any reasonable ground. There *was* a contract, and the Commission contracted that a tanker existed in the position specified. Since there was no such tanker, there has been a breach of contract, and the plaintiffs are entitled to damages for that breach.

The contract was made in Melbourne, and it would seem that its proper law is Victorian law. Section 11 of the Victorian Goods Act 1928 corresponds to s. 6 of the English Sale of Goods Act 1893. This has been generally supposed to represent the legislature's view of the effect of *Couturier* v *Hastie*. Whether it correctly represents the effect of the decision in that case or not, it seems clear that the section has no application to the facts of the present case. Here the goods never existed, and the seller ought to have known that they did not exist.

Notes

1. Since s. 6 of the Sale of Goods Act 1979 seems to accept that the goods did once exist, it does not apply where the subject matter never existed.

The problem with this interpretation is that it both limits the application of s. 6 (to goods which have at one time existed) and it restricts the principle in *McRae* v *CDC* to situations where one party accepts the risk that the goods do not exist at all.

2. Atiyah has argued ((1957) 73 LQR 340) that s. 6 is only a rule of construction which can be ousted by a contrary intention. However, it is not likely that this was intended, since, although other sections of the Act state that their application is subject to contrary agreement, s. 6 does not.

3. There is also a practical point here. If the High Court of Australia had held this to be a case of common mistake, the contract would have been void, and although the plaintiffs could have recovered the purchase price of the tanker, they could not have recovered the cost of the salvage expedition (see pages 379–80).

B: MISTAKES AS TO QUALITY

(a) Common law

A mistake as to quality made by both parties does not render performance as originally agreed impossible.

Bell v *Lever Brothers Ltd*
[1932] AC 161 (HL)

Bell and Snelling entered into a contract with the plaintiff company under which they agreed to serve for five years as chairman and vice-chairman of

the plaintiff's subsidiary company. While acting in these capacities and in breach of duty, they entered into secret speculations in cocoa for their own benefit. Subsequently their services were no longer required. The plaintiff company negotiated with them both to give up their appointments in return for monetary compensation. Being unaware of the breaches of duty and that these breaches would have justified terminating the agreements without compensation, the plaintiff company agreed to compensation of £30,000 and £20,000 respectively. The money was paid to the defendants, but on discovering the breaches of duty the plaintiff company sought to recover it. (The jury found that when they had agreed to the compensation the defendants had forgotten about their breaches of duty. Therefore it was a question of common mistake as both parties had made the same mistake). Held: the majority (3:2) rejected the argument that the compensation agreement was void for the common mistake, since this was a mistake as to a quality of the service contracts. (The judgments refer to mutual mistake as meaning common mistake.) Lord Atkin referred to *res extincta* and then continued:

LORD ATKIN: . . . Mistake as to quality of the thing contracted for raises more difficult questions. In such a case a mistake 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. Of course it may appear that the parties contracted that the article should possess the quality which one or other or both mistakenly believed it to possess. But in such a case there is a contract and the inquiry is a different one, being whether the contract as to quality amounts to a condition or a warranty, a different branch of the law.

. . .

We are now in a position to apply to the facts of this case the law as to mistake so far as it has been stated. . . . Is an agreement to terminate a broken contract different in kind from an agreement to terminate an unbroken contract, assuming that the breach has given the one party the right to declare the contract at an end? I feel the weight of the plaintiffs' contention that a contract immediately determinable is a different thing from a contract for an unexpired term, and that the difference in kind can be illustrated by the immense price of release from the longer contract as compared with the shorter. And I agree that an agreement to take an assignment of a lease for five years is not the same thing as to take an assignment of a lease for three years, still less a term for a few months. But, on the whole, I have come to the conclusion that it would be wrong to decide that an agreement to terminate a definite specified contract is void if it turns out that the agreement had already been broken and could have been terminated otherwise. 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 another way, or that if he had known the true facts he would not have entered into the bargain. A buys B's horse; he thinks the horse is sound and he pays the price of a sound horse; he would certainly not have bought the horse if he had known as the fact is that the horse is unsound. If B has made no representation as to soundness and has not contracted that the horse is sound, A is bound and cannot recover back the price. A buys a picture from B; both A and B believe it to be the work of an old master, and a high price is paid. It turns out to be a modern copy. A has no remedy in the absence of

representation or warranty. A agrees to take on lease or to buy from B an unfurnished dwelling-house. The house is in fact uninhabitable. A would never have entered into the bargain if he had known the fact. A has no remedy, and the position is the same whether B knew the facts or not, so long as he made no representation or gave no warranty. A buys a roadside garage business from B abutting on a public thoroughfare: unknown to A, but known to B, it has already been decided to construct a byepass road which will divert substantially the whole of the traffic from passing A's garage. Again A has no remedy. All these cases involve hardship on A and benefit B, as most people would say, unjustly. They can be supported on the ground that it is of paramount importance that contracts should be observed, and that if parties honestly comply with the essentials of the formation of contracts — i.e., agree in the same terms on the same subject-matter — they are bound, and must rely on the stipulations of the contract for protection from the effect of facts unknown to them.

. . . [I]f the contract expressly or impliedly contains a term that a particular assumption is a condition of the contract, the contract is avoided if the assumption is not true. But we have not advanced far on the inquiry how to ascertain whether the contract does contain such a condition. Various words are to be found to define the state of things which make a condition. 'In the contemplation of both parties fundamental to the continued validity of the contract,' 'a foundation essential to its existence,' 'a fundamental reason for making it,' are phrases found in the important judgment of Scrutton LJ in the present case. The first two phrases appear to me to be unexceptionable. They cover the case of a contract to serve in a particular place, the existence of which is fundamental to the service, or to procure the services of a professional vocalist, whose continued health is essential to performance. But 'a fundamental reason for making a contract' may, with respect, be misleading. The reason of one party only is presumedly not intended, but in the cases I have suggested above, of the sale of a horse or of a picture, it might be said that the fundamental reason for making the contract was the belief of both parties that the horse was sound or the picture an old master, yet in neither case would the condition as I think exist. Nothing is more dangerous than to allow oneself liberty to construct for the parties contracts which they have not in terms made by importing implications which would appear to make the contract more businesslike or more just. The implications to be made are to be no more than are 'necessary' for giving business efficacy to the transaction, and it appears to me that, both as to existing facts and future facts, a condition would not be implied unless the new state of facts makes the contract something different in kind from the contract in the original state of facts. . . . We therefore get a common standard for mutual mistake, and implied conditions whether as to existing or as to future facts. Does the state of the new facts destroy the identity of the subject-matter as it was in the original state of facts? To apply the principle to the infinite combinations of facts that arise in actual experience will continue to be difficult, but if this case results in establishing order into what has been a somewhat confused and difficult branch of the law it will have served a useful purpose.

Notes

1. The principle underlying this decision is that a mistake as to quality should not enable a completed contract to be undone since the parties have agreed in the same terms on the same subject matter. The net effect of *Bell* v *Lever Bros* is that it promotes certainty but at the expense of fairness and flexibility.
2. In *Associated Japanese (International) Ltd* v *Crédit du Nord SA* [1988] 3 All ER 902, Steyn J considered that the *ratio* of *Bell* v *Lever Bros* was that

in order for the contract to be void, the mistake as to quality had 'to make the thing without the quality essentially different from the thing as it was believed to be' (per Lord Atkin). However, Lord Atkin's examples of mistakes which will not be sufficiently fundamental to render the contract void indicate that this principle is very restrictive indeed.

Lord Thankerton stated that the mistake must 'relate to something which both [parties] must necessarily have accepted in their minds as an essential element of the subject matter'. The evidence was that only the plaintiff company regarded the validity of the service contracts as essential.

Treitel, *The Law of Contract*, 9th edn, pp. 264–70, argues that a fundamental mistake occurs if the particular quality is so important to the parties that they actually use it to identify the subject matter. In *Bell* v *Lever Brothers Ltd*, the parties would merely have stated that they were contracting about service contracts.

3. The minority in *Bell* v *Lever Bros* (Viscount Hailsham and Lord Warrington of Clyffe) considered that this mistake was sufficiently fundamental to the bargain. This may be because of the value involved in the mistake.

Sherwood v *Walker*
66 Mich 568 (1887); 33 NW 919
(Supreme Court of Michigan)

The plaintiffs agreed to buy a cow from the defendants for $80. Both parties believed the cow to be barren, but the defendants then discovered that the cow was in calf at the time the contract had been entered into (as a breeding cow the value soared to between $750–1,000). The defendants refused to deliver the cow, arguing that a common mistake had been made which went to 'the very nature of the thing'. The majority of the Supreme Court agreed that this mistake went to the whole substance of the agreement, stressing the difference in the price of the cow. It was so fundamental a mistake that it went beyond a mere mistake as to quality and affected the very character of the animal for all time.

Nicholson & Venn v *Smith-Marriott*
(1947) 177 LT 189

A set of linen napkins and table cloths bearing a royal coat of arms was described as 'all with the crest and arms of Charles I and . . . the authentic property of that monarch'. The plaintiffs, antique dealers, paid £787 for the linen on the faith of this description in the catalogue. In fact it was Georgian and worth only £105. Held: this was a sale by description within s. 13 of the Sale of Goods Act (now 1979), and since the linen did not correspond with the description there had been a breach of contract.

HALLETT J (*obiter*): Clearly, in this case, as it seems to me, what the defendants were intending to sell and the plaintiffs intending to buy was not two fine table cloths and twelve fine table napkins as such, but something which I will describe as a Carolean

relic. Using the language of Lord Atkin, I am disposed to the view that a Georgian relic, if there be such a thing — which I have no reason to suppose there is — is an 'essentially different' thing from a Carolean relic. I think that the absence of the crest and arms of Charles I — the absence of anything attesting or appearing to attest a connection between this table linen and that monarch, who at one time, after all, appeared in the English Prayer Book, if I am not mistaken, as a martyr, which none of the four Georgian kings did — did make the goods obtained different things in substance from those which the plaintiffs sought to buy and believed that they had bought. I should be disposed therefore, though recognising the great difficulties of the point and without any undue confidence in the correctness of my judgment, to hold if necessary that here there was a mutual mistake of the kind or category calculated to vitiate the assent of the parties and therefore to enable the plaintiffs to treat themselves as not bound by the contract.

Notes

1. Applying Treitel's suggested solution (page 430), if the parties had been asked what they were contracting about and had replied that it was 'Charles I napkins', then the contract would be void; but if they had merely replied 'antique table linen', it would be valid.
2. In *Solle* v *Butcher* [1950] 1 KB 671, Denning LJ disagreed with the view that the contract in *Nicholson & Venn* v *Smith-Marriott* was void. This has thrown serious doubts on its application as an example of a sufficiently fundamental mistake.
3. It may be possible to argue that a particular quality is a term of the contract. Section 13(1) of the Sale of Goods Act 1979 provides:

> Where there is a contract for the sale of goods by description, there is an implied term that the goods will correspond with the description.

However, in *Harlingdon & Leinster Enterprises Ltd* v *Christopher Hull Fine Art Ltd* [1990] 1 All ER 737, the Court of Appeal held in order for the sale of goods to be a sale 'by description' within s. 13(1), the description had to be influential in the sale. The court had to be able to impute a common intention to the parties that the description should be a term of the contract, and this depended on whether it was within the contemplation of the parties that the buyer would rely on the description.

There may be a misrepresentation as to quality. In *Leaf* v *International Galleries* [1950] 2 KB 86 (page 486), both parties entered into the contract mistakenly thinking that the painting was by Constable. On the facts there was a misrepresentation by the seller, but the only available remedy of rescission had been lost because of lapse of time. Evershed MR explained why such a mistake as to quality did not render the contract void.

> The plaintiff's case rested fundamentally upon this statement which he made: 'I contracted to buy a Constable. I have not had, and never had, a Constable.' Though that is, as a matter of language, perfectly intelligible, it nevertheless needs a little expansion if it is to be quite accurate. What he contracted to buy and what he bought was a specific chattel, namely, an oil painting of Salisbury Cathedral; but

he bought it on the faith of a representation, innocently made, that it had been painted by John Constable. It turns out, as the evidence now stands and as the county court judge has found, that it was not so painted. Nevertheless it remains true to say that the plaintiff still has the article which he contracted to buy. The difference is no doubt considerable, but it is, as Denning LJ has observed, a difference in quality and in value rather than in the substance of the thing itself.

(b) Voidable in equity for common mistake

Solle v *Butcher*
[1950] 1 KB 671 (CA)

In 1947, the plaintiff surveyor and the defendant were partners in an estate agents business. The defendant took a long lease of a building which had been converted into five flats. After work had been completed, the plaintiff told the defendant that he could charge £250 rent for flat 1, and both thought that the standard rent of £140 charged in 1938 would not apply because the premises would be free from rent control. Once the lease was executed a notice of intention to increase the rent could not be given during the continuation of the tenancy. In 1947, flat 1 was let by the defendant to the plaintiff for a seven-year term at a yearly rent of £250. Later the plaintiff claimed that the premises were covered by the rent control legislation and the standard rent was only £140. He therefore sought to recover the amount of the rent which had been overpaid. The defendant argued that the lease should be rescinded because it had been entered into under a common mistake. Held: (Bucknill and Denning LJJ) the lease must be set aside on terms.

DENNING LJ: In this plight the landlord seeks to set aside the lease. He says, with truth, that it is unfair that the tenant should have the benefit of the lease for the outstanding five years of the term at 140*l.* a year, when the proper rent is 250*l.* a year. If he cannot give a notice of increase now, can he not avoid the lease? The only ground on which he can avoid it is on the ground of mistake. It is quite plain that the parties were under a mistake. They thought that the flat was not tied down to a controlled rent, whereas in fact it was. In order to see whether the lease can be avoided for this mistake it is necessary to remember that mistake is of two kinds: first, mistake which renders the contract void, that is, a nullity from the beginning, which is the kind of mistake which was dealt with by the courts of common law; and, secondly, mistake which renders the contract not void, but voidable, that is, liable to be set aside on such terms as the court thinks fit, which is the kind of mistake which was dealt with by the courts of equity. Much of the difficulty which has attended this subject has arisen because, before the fusion of law and equity, the courts of common law, in order to do justice in the case in hand, extended this doctrine of mistake beyond its proper limits and held contracts to be void which were really only voidable, a process which was capable of being attended with much injustice to third persons who had bought goods or otherwise committed themselves on the faith that there was a contract. In the well-known case of *Cundy* v *Lindsay* (1878) 3 App Cas 459 [page 84], Cundy suffered such an injustice. He bought the handkerchiefs from the rogue, Blenkarn, before the Judicature Acts came into operation. Since the fusion of law and equity,

there is no reason to continue this process, and it will be found that only those contracts are now held void in which the mistake was such as to prevent the formation of any contract at all.

Let me first consider mistakes which render a contract a nullity. All previous decisions on this subject must now be read in the light of *Bell* v *Lever Bros Ld* [1932] AC 161. The correct interpretation of that case, 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 on his own mistake to say 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. The cases where goods have perished at the time of sale, or belong to the buyer, are really contracts which are not void for mistake but are void by reason of an implied condition precedent, because the contract proceeded on the basic assumption that it was possible of performance.

Applying these principles, it is clear that here there was a contract. The parties agreed in the same terms on the same subject-matter. It is true that the landlord was under a mistake which was to him fundamental: he would not for one moment have considered letting the flat for seven years if it meant that he could only charge 140*l.* a year for it. He made the fundamental mistake of believing that the rent he could charge was not tied down to a controlled rent; but, whether it was his own mistake or a mistake common to both him and the tenant, it is not a ground for saying that the lease was from the beginning a nullity. Any other view would lead to remarkable results, for it would mean that, in the many cases where the parties mistakenly think a house is outside the Rent Restriction Acts when it is really within them, the tenancy would be a nullity, and the tenant would have to go; with the result that the tenants would not dare to seek to have their rents reduced to the permitted amounts lest they should be turned out.

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 consequences 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* (1872) LR 8 Ch 118 per James LJ.

The court had, of course, to define what it 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.

. . . The House of Lords in 1867 in the great case of *Cooper* v *Phibbs* (1867) LR 2 HL 149, affirmed the doctrine there acted on as correct. In that case an uncle had

told his nephew, not intending to misrepresent anything, but being in fact in error, that he (the uncle) was entitled to a fishery; and the nephew, after the uncle's death, acting in the belief of the truth of what the uncle had told him, entered into an agreement to rent the fishery from the uncle's daughters, whereas it actually belonged to the nephew himself. The mistake there as to the title to the fishery did not render the tenancy agreement a nullity. If it had done, the contract would have been void at law from the beginning and equity would have had to follow the law. There would have been no contract to set aside and no terms to impose. The House of Lords, however, held that the mistake was only such as to make it voidable, or, in Lord Westbury's words, 'liable to be set aside' on such terms as the court thought fit to impose; and it was so set aside.

[The principle] is in no way impaired by *Bell* v *Lever Bros. Ld* [1932] AC 161 which was treated in the House of Lords as a case at law depending on whether the contract was a nullity or not. If it had been considered on equitable grounds, the result might have been different . . .

Applying that principle to this case, the facts are that the plaintiff, the tenant, was a surveyor who was employed by the defendant, the landlord, not only to arrange finance for the purchase of the building and to negotiate with the rating authorities as to the new rateable values, but also to let the flats. He was the agent for letting, and he clearly formed the view that the building was not controlled. He told the valuation officer so. He advised the defendant what were the rents which could be charged. He read to the defendant an opinion of counsel relating to the matter, and told him that in his opinion he could charge 250*l.* and that there was no previous control. He said that the flats came outside the Act and that the defendant was 'clear.' The defendant relied on what the plaintiff told him, and authorized the plaintiff to let at the rentals which he had suggested. The plaintiff not only let the four other flats to other people for a long period of years at the new rentals, but also took one himself for seven years at 250*l.* a year. Now he turns round and says, quite unashamedly, that he wants to take advantage of the mistake to get the flat at 140*l.* a year for seven years instead of the 250*l.* a year, which is not only the rent he agreed to pay but also the fair and economic rent; and it is also the rent permitted by the Acts on compliance with the necessary formalities. If the rules of equity have become so rigid that they cannot remedy such an injustice, it is time we had a new equity, to make good the omissions of the old. But, in my view, the established rules are amply sufficient for this case.

. . . What terms then, should be imposed here? . . . If the mistake here had not happened, a proper notice of increase would have been given and the lease would have been executed at the full permitted rent. I think that this court should impose terms which will enable the tenant to choose either to stay on at the proper rent or to go out.

Notes

1. See Cartwright (1987) 103 LQR 594.
2. The actual position was that the premises were subject to the standard rent but that the rent could have been increased to £250 if the proper notices had been given *before* any tenancy agreement had been entered into. The defendant had acted on the mistaken advice of the plaintiff in not issuing the proper notices. In these circumstances the plaintiff could not be allowed to take advantage of the parties' common misapprehension.

Why did the House of Lords in *Bell* v *Lever Bros* not make use of this doctrine to prevent the defendants from relying on their legal advantage of obtaining compensation when none should have been payable?

3. In *Frederick E. Rose (London) Ltd* v *William H. Pim Junior & Co. Ltd* [1953] 2 All ER 739 (page 95), Denning LJ repeated his view that a contract could be set aside in equity for a mistake as to quality. However, because the buyers and sub-buyers had accepted the goods, they could not claim rescission. The bars to rescission apply to contracts voidable for mistake, see page 484).

Grist v *Bailey*
[1967] Ch 532

The plaintiff contracted to purchase freehold property from the defendant for £850, 'subject to the existing tenancy thereof'. Both parties believed that the property was occupied by a protected tenant. When the defendant discovered that the protected tenant had died before the date of the contract she refused to complete and sought to have the contract set aside. The plaintiff claimed specific performance. The property with vacant possession was worth £2,250. Held: there was a common mistake as to the nature of the tenancy, and although at common law this mistake was not such as to avoid the contract, at equity it was fundamental since there was not in fact an 'existing tenancy' within the meaning of the contract, and neither party, knowing the true state of affairs and the value with vacant possession, would have negotiated for so small a price. Goff J rescinded the contract on terms, namely that the defendant undertook to give the plaintiff the chance to buy the property at £2,250.

Notes
1. It is interesting that equity pays more attention to the price which is paid as indicating whether the mistake is sufficiently fundamental for it to be set aside in equity.
2. The contract will not be set aside in favour of a party who is at fault himself. On these facts the result of equity intervening to set aside the contract was to protect the defendant, thereby enabling her to charge the true market value. Although Goff J held that the defendant was not at fault, she was clearly in the best position to know the status of her tenants.

Magee v *Pennine Insurance Co. Ltd*
[1969] 2 QB 507 (CA)

The plaintiff claimed £600 under a car insurance policy. The defendant insurers were prepared to offer him £385 in settlement and the plaintiff accepted this. However, the defendant insurers then claimed that they were not liable under the policy or compromise because of inaccurate statements by the plaintiff in the proposal form. Held: (Lord Denning MR and Fenton Atkinson LJ) in entering into the compromise agreement both parties were acting under the common fundamental mistake that the plaintiff had a valid claim under the insurance policy. In these circumstances the defendant was entitled to have the agreement set aside.

LORD DENNING MR: . . . Accepting that the agreement to pay £385 was a agreement of compromise. Is it vitiated by mistake? The insurance company wer clearly under a mistake. They thought that the policy was good and binding. They di not know, at the time of that letter, that there had been misrepresentations in th proposal form. If Mr Magee knew of their mistake — if he knew that the policy wa bad — he certainly could not take advantage of the agreement to pay £385. He woul be 'snapping at an offer which he knew was made under a mistake': and no man allowed to get away with that. But I prefer to assume that Mr Magee was innocent. think we should take it that both parties were under a common mistake. Both partie thought that the policy was good and binding. The letter of May 12, 1968, was writte on the assumption that the policy was good whereas it was in truth voidable.

What is the effect in law of this common mistake? [Counsel for the plaintiff] sai that the agreement to pay £385 was good, despite this common mistake. He relie much on *Bell* v *Lever Brothers, Ltd* [1932] AC 161, and its similarity to the presen case. He submitted that, inasmuch as the mistake there did not vitiate that contract the mistake here should not vitiate this one. I do not propose today to go through th speeches in that case. They have given enough trouble to commentators already. would say simply this: A common mistake, even on a most fundamental matter, doe not make a contract void at law: but it makes it voidable in equity. I analysed the case in *Solle* v *Butcher* [1950] 1 KB 671, and I would repeat what I said there, at p. 693:

> 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.

Applying that principle here, it is clear that, when the insurance company and Mr Magee made this agreement to pay £385, they were both under a common mistake which was fundamental to the whole agreement. Both thought that Mr Magee was entitled to claim under the policy of insurance, whereas he was not so entitled. That common mistake does not make the agreement to pay £385 a nullity, but it makes it liable to be set aside in equity.

This brings me to a question which has caused me much difficulty. Is this a case in which we ought to set the agreement aside in equity? I have hesitated on this point, but I cannot shut my eyes to the fact that Mr Magee had no valid claim on the insurance policy: and, if he had no claim on the policy, it is not equitable that he should have a good claim on the agreement to pay £385, seeing that it was made under a fundamental mistake. It is not fair to hold the insurance company to an agreement which they would not have dreamt of making if they had not been under a mistake. I would, therefore, uphold the appeal and give judgment for the insurance company.

WINN LJ *dissenting*: I do not desire to take long in expressing my opinion that on the principles of *Bell* v *Lever Brothers, Ltd* [1932] AC 161 applied to the circumstances of this case the contrary conclusion to that which my Lord has expressed is the correct conclusion. It appears to me that the parties were under a misapprehension. If there was any misapprehension shared commonly by both Magee and the insurers as to what was the value of any rights that he had against them arising from the insurance policy, that seems to me to have been precisely the subject-matter of the common misapprehension in *Bell* v *Lever Brothers, Ltd*.

For my part, I think that here there was a misapprehension as to rights, but no misapprehension whatsoever as to the subject-matter of the contract, namely, the

settlement of the rights of the assured with regard to the accident that happened. The insurance company was settling his rights, if he had any. He understood them to be settling his rights; but each of them, on the assumption that the county court judge's view of the facts was right, thought his rights against the insurers were very much more valuable than in fact they were, since in reality they were worthless . . .

Note

Harris (1969) 32 MLR 688, at p. 690, states that in equity it is 'enough for a common mistake materially to affect the interests of the parties', and this avoids the difficulties at common law over whether a mistake is fundamental or of the foundation of the contract.

The approach the courts should take to common mistakes as to quality was discussed in the next case.

Associated Japanese Bank (International) Ltd v *Crédit du Nord SA* [1988] 3 All ER 902

The facts of this case appear at page 425. Steyn J upheld Lord Atkin's statement in *Bell* v *Lever Brothers* (page 428), that a mistake had to be the mistake of both parties and had to be as to the existence of some quality which made the thing without the quality essentially different from the thing as it was believed to be. However, he did not discuss the limitations placed upon that principle by Lord Atkin's own examples. Steyn J confined *Bell* v *Lever Brothers* to mistake at common law but clearly stated that there was a doctrine of mistake as to quality at common law.

STEYN J: The law has not stood still in relation to mistake in equity. Today, it is clear that mistake in equity is not circumscribed by common law definitions. A contract affected by mistake in equity is not void but may be set aside on terms: see *Solle* v *Butcher* [1949] 2 All ER 1107, [1950] 1 KB 671; *Magee* v *Pennine Insurance Co Ltd* [1969] 2 All ER 891, [1969] 2 QB 507; *Grist* v *Bailey* [1966] 2 All ER 875, [1967] Ch 532. It does not follow, however, that *Bell* v *Lever Bros Ltd* is no longer an authoritative statement of mistake at common law. On the contrary, in my view the principles enunciated in that case clearly still govern mistake at common law. It is true that in *Solle* v *Butcher* [1949] 2 All ER 1107 at 1119, [1950] 1 KB 671 at 691 Denning LJ interpreted *Bell* v *Lever Bros Ltd* differently. He said that a common mistake, even on a most fundamental matter, does not make the contract void at law. That was an individual opinion. Neither Bucknill LJ (who agreed in the result) nor Jenkins LJ (who dissented) even mentioned *Bell* v *Lever Bros Ltd*. In *Magee* v *Pennine Insurance Co Ltd* [1969] 2 All ER 891 at 893, [1969] 2 QB 507 at 514 Lord Denning MR returned to the point. About *Bell* v *Lever Bros Ltd* he simply said: 'I do not propose . . . to go through the speeches in that case. They have given enough trouble to commentators already.' He then repeated his conclusion in *Solle* v *Butcher*. Winn LJ dissented. Fenton Atkinson LJ agreed in the result but it is clear from his judgment that he did not agree with Lord Denning MR's interpretation of *Bell* v *Lever Bros Ltd* (see [1969] 2 All ER 891 at 896, [1969] 2 QB 507 at 517–518). Again, Lord Denning MR's observation represented only his own view. With the profoundest respect to the former

Master of the Rolls, I am constrained to say that in my view his interpretation of *Bell* v *Lever Bros Ltd* does not do justice to the speeches of the majority.

When Lord Denning MR referred in *Magee* v *Pennine Insurance Co Ltd* to the views of commentators he may have had in mind comments in Cheshire and Fifoot *Law of Contract* (6th edn, 1964) p. 196. In substance the argument was that the actual decision in *Bell* v *Lever Bros Ltd* contradicts the language of the speeches. If the test was not satisfied there, so the argument runs, it is difficult to see how it could ever be satisfied: see the latest edition of this valuable textbook for the same argument (Cheshire, Fifoot and Furmston *Law of Contract* (11th edn, 1986) pp. 225–226). This is a point worth examining because at first glance it may seem persuasive. *Bell* v *Lever Bros Ltd* was a quite exceptional case; all their Lordships were agreed that common mistake had not been pleaded and would have required an amendment in the House of Lords if it were to succeed. The speeches do not suggest that the employees were entitled to keep both the gains secretly made and the golden handshakes. The former were clearly recoverable from them. Nevertheless, the golden handshakes were very substantial. But there are indications in the speeches that the so-called 'merits' were not all in favour of Lever Bros. The company was most anxious, because of a corporate merger, to terminate the two service agreements. There was apparently a doubt whether the voidability of the service agreements if revealed to the company *at the time of the severance contract* would have affected the company's decision. Lord Thankerton said ([1932] AC 161 at 236, [1931] All ER Rep 1 at 37):

> . . . I do not find sufficient material to compel the inference that the appellants, at the time of the contract, regarded the indefeasibility of the service agreements as an essential and integral element in the subject-matter of the bargain.

No one could fairly suggest that in this difficult area of the law there is only one correct approach or solution. But a narrow doctrine of common law mistake (as enunciated in *Bell* v *Lever Bros Ltd*), supplemented by the more flexible doctrine of mistake in equity (as developed in *Solle* v *Butcher* and later cases), seems to me to be an entirely sensible and satisfactory state of the law: see *Sheikh Bros Ltd* v *Ochsner* [1957] AC 136. And there ought to be no reason to struggle to avoid its application by artificial interpretations of *Bell* v *Lever Bros Ltd*.

It might be useful if I now summarised what appears to me to be a satisfactory way of approaching this subject. Logically, before one can turn to the rules as to mistake, whether at common law or in equity, one must first determine whether the contract itself, by express or implied condition precedent or otherwise, provides who bears the risk of the relevant mistake. It is at this hurdle that many pleas of mistake will either fail or prove to have been unnecessary. Only if the contract is silent on the point is there scope for invoking mistake. That brings me to the relationship between common law mistake and mistake in equity. Where common law mistake has been pleaded, the court must first consider this plea. If the contract is held to be void, no question of mistake in equity arises. But, if the contract is held to be valid, a plea of mistake in equity may still have to be considered: see *Grist* v *Bailey* [1966] 2 All ER 875, [1967] Ch 532 and the analysis in *Anson's Law of Contract* (26th edn, 1984) pp. 290–291. Turning now to the approach to common law mistake, it seems to me that the following propositions are valid although not necessarily all entitled to be dignified as propositions of law.

The first imperative must be that the law ought to uphold rather than destroy apparent contracts. Second, the common law rules as to a mistake regarding the quality of the subject matter, like the common law rules regarding commercial

frustration, are designed to cope with the impact of unexpected and wholly exceptional circumstances on apparent contracts. Third, such a mistake in order to attract legal consequences must substantially be shared by both parties, and must relate to facts as they existed at the time the contract was made. Fourth, and this is the point established by *Bell* v *Lever Bros Ltd*, the mistake must render the subject matter of the contract essentially and radically different from the subject matter which the parties believed to exist. While the civilian distinction between the substance and attributes of the subject matter of a contract has played a role in the development of our law (and was cited in the speeches in *Bell* v *Lever Bros Ltd*), the principle enunciated in *Bell* v *Lever Bros Ltd* is markedly narrower in scope than the civilian doctrine. It is therefore no longer useful to invoke the civilian distinction. The principles enunciated by Lord Atkin and Lord Thankerton represent the ratio decidendi of *Bell* v *Lever Bros Ltd*. Fifth, there is a requirement which was not specifically discussed in *Bell* v *Lever Bros Ltd*. What happens if the party who is seeking to rely on the mistake had no reasonable grounds for his belief? An extreme example is that of the man who makes a contract with minimal knowledge of the facts to which the mistake relates but is content that it is a good speculative risk. In my judgment a party cannot be allowed to rely on a common mistake where the mistake consists of a belief which is entertained by him without any reasonable grounds for such belief: cf *McRae* v *Commonwealth Disposals Commission* (1951) 84 CLR 377 at 408. That is not because principles such as estoppel or negligence require it, but simply because policy and good sense dictate that the positive rules regarding common mistake should be so qualified. Curiously enough this qualification is similar to the civilian concept where the doctrine of error in substantia is tempered by the principles governing culpa in contrahendo. More importantly, a recognition of this qualification is consistent with the approach in equity where fault on the part of the party adversely affected by the mistake will generally preclude the granting of equitable relief: see *Solle* v *Butcher* [1949] 2 All ER 1107 at 1120, [1950] 1 KB 671 at 693.

Notes

1. See Treitel (1988) 104 LQR 501.
2. Steyn J has added a requirement not previously mentioned, namely, that a party who is seeking to rely on a mistake must have had reasonable grounds for his belief in order for the contract to be void at common law. A similar principle operates in equity, in that the party seeking to rely on the mistake must not be at fault.
3. Steyn J made clear that before examining the law on mistake the first consideration must be whether the contract itself provides for allocation of the relevant risk. This was the determining factor in the following case:

William Sindall plc v *Cambridgeshire County Council* [1994] 3 All ER 932 (CA)

Builders agreed to purchase land from the county council on terms whereby the land was stated to be sold subject to easements, liabilities and public rights affecting it, but without prejudice to the vendor's duty to disclose all latent easements and incumbrances which it knew to affect the property. The council had stated that so far as it was aware there were none, and the sale contract was concluded in March 1989 at a price of

£5m. By the time that the builders had obtained planning permission for a residential development 18 months later, the land was worth less than half of that purchase price because of a fall in land values. In October 1990, the builders discovered that, unknown to either party, a foul sewer was buried under the land. The builders claimed that, since they had to leave a six-foot wide maintenance strip, this affected their plans for a residential development on the land, and they sought to rescind the contract for misrepresentation and common mistake and recover the purchase price. The judge at first instance held that they were entitled to rescind (exercising his discretion not to award damages in lieu of rescission under s. 2(2) of the Misrepresentation Act 1967) so that the purchase price plus interest was recoverable. Held: on appeal, it was not possible for the builders to rescind because (i) the contract terms allocated the risk of incumbrances not known to the vendor to the purchaser so that the law of mistake could not apply, and (ii) there could be no claim based on misrepresentation since the council's representation was that it had no actual knowledge of the existence of the sewer and that it had made reasonable investigations. It was held that the council had made reasonable investigations and therefore it could not be liable for a subsequently discovered defect in title. (See pages 474–527 for discussion of misrepresentation.)

HOFFMANN LJ: . . The judge found that in the absence of any actionable misrepresentations Sindall was entitled to rescind the contract for a common mistake as to the existence of a sewer. This is at first sight a startling result. As Steyn J said in *Associated Japanese Bank (International) Ltd* v *Credit du Nord SA* [1988] 3 All ER 902 at 912, [1989] 1 WLR 255 at 268:

> Logically, before one can turn to the rules as to mistake, whether at common law or in equity, one must first determine whether the contract itself, by express or implied condition precedent or otherwise, provides who bears the risk of the relevant mistake. It is at this hurdle that many pleas of mistake will either fail or prove to have been unnecessary. Only if the contract is silent on the point is there scope for invoking mistake.

When the judge speaks of the contract allocating risk 'by express or implied condition precedent or otherwise' I think he includes rules of general law applicable to the contract and which, for example, provide that, in the absence of express warranty, the law is caveat emptor. This would, in my view, allocate the risk of an unknown defect in goods to the buyer, even though it is not mentioned in the contract. Similarly, the rule in *Hill* v *Harris* [1965] 2 All ER 358, [1965] 2 QB 601 that a lessor or vendor does not impliedly warrant that the premises are fit for any particular purpose means that the contract allocates the risk of the premises being unfit for such a purpose. I should say that neither in *Grist* v *Bailey* [1966] 2 All ER 875, [1967] Ch 532, nor in *Laurence* v *Lexcourt Holdings Ltd* [1978] 2 All ER 810, [1978] 1 WLR 1128 did the judges who decided those cases at first instance advert to the question of contractual allocation of risk. I am not sure that the decisions would have been the same if they had.

In this case the contract says in express terms that it is subject to all easements other than those of which the vendor knows or has the means of knowledge. This allocates the risk of such incumbrances to the buyer and leaves no room for rescission on the grounds of mistake.

EVANS LJ: This could be a textbook case on the law of mistake in contract. . . .

There are certain circumstances in which the courts will hold that an agreement made between two parties, each labouring under a fundamental mistake, is invalid as a contract, that is to say, it has no legal effect. The judge applied the test established by the majority judgments of the House of Lords in *Bell v Lever Bros Ltd* [1932] AC 161, [1931] All ER Rep 1, as defined by Steyn J in *Associated Japanese Bank (International) Ltd v Crédit du Nord SA* [1988] 3 All ER 902, [1989] 1 WLR 255, and he reached the following conclusion:

> . . . there are undoubtedly important differences between what was contracted for and what was purchased. They do not, as it seems to me, meet the essential test of being essentially and radically different.

There is no appeal against that finding, or against the judge's conclusion that the builders failed to establish any common law remedy on the basis of mistake. I would add merely this, that the concept of a factual situation 'essentially and radically different' from that by reference to which the parties made their agreement is the same concept, in my view, as that which may lead to frustration of the contract where there has been a change in circumstances due to a supervening event. Before 1956, there was much debate as to the legal basis for the discharge of contracts by frustration, but this was authoritatively settled by the House of Lords in *Davis Contractors Ltd v Fareham UDC* [1956] 2 All ER 145, [1956] AC 696, and in particular by the speech of Viscount Radcliffe:

> . . . frustration occurs whenever the law recognises that without default of either party a contractual obligation has become incapable of being performed because the circumstances in which performance is called for would render it a thing radically different from that which was undertaken by the contract. Non haec in foedera veni. It was not this that I promised to do. (See [1956] 2 All ER 145 at 160, [1956] AC 696 at 729.)

The judge proceeded to consider the builders' claim for rescission on the ground of mutual mistake, that is to say, for the equitable remedy which is available in circumstances like those described by Denning LJ in *Solle v Butcher* [1949] 2 All ER 1107 at 1120, [1950] 1 KB 671 at 692 693. He found in this context that there was 'such a mistake as would entitle equity to order rescission'. This implies that the mistake was 'fundamental' and the question arises whether simultaneously the mistake can be fundamental, yet the land not 'essentially and radically different' from what it was supposed to be, but it is unnecessary and inappropriate, in my judgment, to consider this issue at this stage, because on any view of the matter . . . the first question is whether the contract on its true construction covers the new situation which has arisen by reason of a change of circumstances (frustration) or the emergence of a factual situation different from that which was assumed (mutual mistake). If the scope of the contract is wide enough to cover the new, or newly discovered, situation, then there is no room either for discharge by frustration or for rescission in equity on the grounds of mistake. Put another way, if the agreed terms provide for this situation, then the parties have 'allocated the risk' as between themselves, as [counsel for the council] submits that they did in the present case.

[Evans LJ construed the terms so that they allocated the risk and continued:]

Subject, therefore, to the claims for rescission based on actionable misrepresentation, the contract for sale as a matter of construction requires the builders to accept the property notwithstanding the presence of the pipeline and the city council's easement.

Equitable mistake

Logically, there remains the question whether the contract, notwithstanding that on its true construction it covers the situation which has arisen, and that it cannot be set aside for misrepresentation, nevertheless may be rescinded on the ground of equitable mistake, as defined by Denning LJ in *Solle* v *Butcher* [1949] 2 All ER 1107 at 1119, [1950] 1 KB 671 at 692. It must be assumed, I think, that there is a category of mistake which is 'fundamental' so as to permit the equitable remedy of rescission, which is wider than the kind of 'serious and radical' mistake which means that the agreement is void and of no effect in law: see *Chitty on Contracts* (26th edn, 1989) Vol 1, para 401, Treitel *The Law of Contract* (8th edn, 1991) p 276, and *Cheshire Fifoot and Furmston's Law of Contract* (11th edn, 1986) p 245. The difference may be that the common law rule is limited to mistakes with regard to the subject matter of the contract, whilst equity can have regard to a wider and perhaps unlimited category of 'fundamental' mistake. However that may be, I am satisfied that the judge's finding in the present case was vitiated by his assumption that the presence of the sewer and of the city's easement had serious consequences for the proposed development, even if the sewer was incorporated into the public sewer that was envisaged for the development itself (Option 2A). This would not involve the loss of seven houses and three flats, as the judge appears to have thought, but, at most, of one three-bedroomed house. The additional cost of the alterations to the sewer would not have exceeded about £20,000. Given the breadth of the contract terms, in particular condition No. 14, which on its face was intended to cover precisely such a situation as this, and the relatively minor consequences of the discovery of the sewer, even if some period of delay as well as additional cost was involved, it is impossible to hold, in my judgment, that there is scope for rescission here.

Notes

1. Given the finding that there was a contractual allocation of the risk, the comments made by Evans LJ are strictly *obiter* and intended to answer the findings of the judge at first instance. As an alternative ground, Evans LJ appears to consider that the mistake was not serious enough to be 'fundamental' (as the judge had found) since it could be remedied at a cost of £20,000 and therefore could not justify rescission.

2. This was a mistake as to the quality of the land as opposed to a mistake as to the existence of the subject matter of the contract, namely the land itself.

3. Evans LJ suggests that at common law mistake will need to render the land 'essentially and radically different' from the land as it was supposed to be in the sense of an event which would be sufficient to frustrate the contract. However, a remedy might be available in equity for a less serious mistake which was nevertheless 'fundamental', and that this type of mistake represented a much wider category.

Question

Do you agree with Hoffmann LJ's view on the applicability of the law of mistake to the facts of *Grist* v *Bailey*?

SECTION 2: FRUSTRATION

A contract may be automatically discharged by frustration where a frustrating event occurs without the fault of the contracting parties *after* the formation of the contract. However, the frustration doctrine has been narrowly defined and applies only where the parties have not provided for what is to happen in the circumstances which occur. Frequently there is such an express provision (*force majeure* clause) in the contract and this will govern (page 458). These clauses enable the parties to allocate the risks in the way 'they' wish.

A: THE THEORETICAL BASIS OF FRUSTRATION

(a) The implied term theory

Taylor v *Caldwell*
(1863) 3 B & S 826; 122 ER 309 (QB)

On 27 May 1862, the plaintiffs entered into a contract with the defendants by which defendants agreed to let the plaintiffs have the use of the Surrey Gardens and Music Hall on 17 June, 15 July, and 5 and 19 August for the purpose of giving a series of four grand concerts and fetes. On 11 June (before the first of these dates on which a concert was to be given), the Hall was destroyed by fire, without the fault of either party. The concerts could not be given as intended. The plaintiffs argued that the defendants were in breach of contract in failing to supply the Hall and they sought damages for their wasted advertising expenditure. Held: the continuation of the contract was subject to an implied condition that the parties would be excused if the subject matter was destroyed. Therefore, the contract was discharged by frustration and both parties were released.

BLACKBURN J (delivering the judgment of the court): . . . [W]here, from the nature of the contract, it appears that the parties must from the beginning have known that it could not be fulfilled unless when the time for the fulfilment of the contract arrived some particular specified thing continued to exist, so that, when entering into the contract, they must have contemplated such continuing existence as the foundation of what was to be done; there, in the absence of any express or implied warranty that the thing shall exist, the contract is not to be construed as a positive contract, but as subject to an implied condition that the parties shall be excused in case, before breach, performance becomes impossible from the perishing of the thing without default of the contractor.

There seems little doubt that this implication tends to further the great object of making the legal construction such as to fulfil the intention of those who entered into the contract. For in the course of affairs men in making such contracts in general would, if it were brought to their minds, say that there should be such a condition. . . .

. . . [The] excuse is by law implied, because from the nature of the contract it is apparent that the parties contracted on the basis of the continued existence of the particular person or chattel. In the present case, looking at the whole contract, we find

that the parties contracted on the basis of the continued existence of the Music Hall at the time when the concerts were to be given; that being essential to their performance.

. . . We think, therefore, that the Music Hall having ceased to exist, without fault of either party, both parties are excused, the plaintiffs from taking the gardens and paying the money, the defendants from performing their promise to give the use of the Hall and Gardens and other things. . . .

(b) The construction theory

Davis Contractors Ltd v *Fareham Urban District Council* [1956] AC 696 (HL)

On July 9 1946, the contractors entered into a building contract to build 78 houses for a local authority for £92,425 within a period of eight months. Without the fault of either party, adequate supplies of labour were not available and the work took 22 months to complete. The contractors argued that the contract was frustrated and they could therefore claim on a *quantum meruit* basis (which would be more than the contract price) for the houses they completed. Held: the contract had not been frustrated. The shortage of labour had rendered the contract more onerous than expected but had not altered the fundamental nature of the contractual performance.

LORD REID: Frustration has often been said to depend on adding a term to the contract by implication: for example, Lord Loreburn in *F. A. Tamplin Steamship Co. Ltd* v *Anglo-Mexican Petroleum Products Co. Ltd* [1916] 2 AC 397, after quoting language of Lord Blackburn, said:

> That seems to me another way of saying that from the nature of the contract it cannot be supposed the parties, as reasonable men, intended it to be binding on them under such altered conditions. Were the altered conditions such that, had they thought of them, they would have taken their chance of them, or such that as sensible men they would have said 'if that happens, of course, it is all over between us'? What, in fact, was the true meaning of the contract? Since the parties have not provided for the contingency, ought a court to say it is obvious they would have treated the thing as at an end?

I find great difficulty in accepting this as the correct approach because it seems to me hard to account for certain decisions of this House in this way. . . .

I may be allowed to note an example of the artificiality of the theory of an implied term given by Lord Sands in *James Scott and Sons Ltd* v *Del Sel* (1922) SC 592:

> A tiger has escaped from a travelling menagerie. The milkgirl fails to deliver the milk. Possibly the milkman may be exonerated from any breach of contract but, even so, it would seem hardly reasonable to base that exoneration on the ground that 'tiger days excepted' must be held as if written into the milk contract.

I think that there is much force in Lord Wright's criticism in *Denny, Mott & Dickson Ltd* v *James B. Fraser & Co. Ltd* [1944] AC 265:

> The parties did not anticipate fully and completely, if at all, or provide for what actually happened. It is not possible, to my mind, to say that, if they had thought of it, they would have said: 'Well, if that happens, all is over between us.' On the

contrary, they would almost certainly on the one side or the other have sought to introduce reservations or qualifications or compensations.

It appears to me that frustration depends, at least in most cases, not on adding any implied term, but on the true construction of the terms which are in the contract read in light of the nature of the contract and of the relevant surrounding circumstances when the contract was made. . . .

LORD RADCLIFFE: . . . This approach [implied term] is in line with the tendency of English courts to refer all the consequences of a contract to the will of those who made it. But there is something of a logical difficulty in seeing how the parties could even impliedly have provided for something which ex hypothesi they neither expected nor foresaw; and the ascription of frustration to an implied term of the contract has been criticized as obscuring the true action of the court which consists in applying an objective rule of the law of contract to the contractual obligations that the parties have imposed upon themselves. So long as each theory produces the same result as the other, as normally it does, it matters little which theory is avowed (see *British Movietonews Ltd* v *London and District Cinemas Ltd* [1952] AC 166, per Viscount Simon). But it may still be of some importance to recall that, if the matter is to be approached by way of implied term, the solution of any particular case is not to be found by inquiring what the parties themselves would have agreed on had they been, as they were not, forewarned. It is not merely that no one can answer that hypothetical question; it is also that the decision must be given 'irrespective of the individuals concerned, their temperaments and failings, their interest and circumstances' (*Hirji Mulji* v *Cheong Yue Steamship Co. Ltd* [1926] AC 497). The legal effect of frustration 'does not depend on their intention or their opinions, or even knowledge, as to the event.' On the contrary, it seems that when the event occurs 'the meaning of the contract must be taken to be, not what the parties did intend (for they had neither thought nor intention regarding it), but that which the parties, as fair, and reasonable men, would presumably have agreed upon if, having such possibility in view, they had made express provision as to their several rights and liabilities in the event of its occurrence' (*Dahl* v *Nelson* (1881) 6 App Cas 38 per Lord Watson).

By this time it might seem that the parties themselves have become so far disembodied spirits that their actual persons should be allowed to rest in peace. In their place there rises the figure of the fair and reasonable man. And the spokesman of the fair and reasonable man, who represents after all no more than the anthropomorphic conception of justice, is and must be the court itself. So perhaps it would be simpler to say at the outset that frustration occurs whenever the law recognizes that without default of either party a contractual obligation has become incapable of being performed because the circumstances in which performance is called for would render it a thing radically different from that which was undertaken by the contract. Non haec in foedera veni. It was not this that I promised to do.

There is, however, no uncertainty as to the materials upon which the court must proceed. 'The data for decision are, on the one hand, the terms and construction of the contract, read in the light of the then existing circumstances, and on the other hand the events which have occurred' (*Denny, Mott & Dickson Ltd* v *James B. Fraser & Co. Ltd* [1944] AC 265, per Lord Wright). In the nature of things there is often no room for any elaborate inquiry. The court must act upon a general impression of what its rule requires. It is for that reason that special importance is necessarily attached to the occurrence of any unexpected event that, as it were, changes the face of things. But, even so, it is not hardship or inconvenience or material loss itself which calls the principle of frustration into play. There must be as well such a change in the

significance of the obligation that the thing undertaken would, if performed, be a different thing from that contracted for.

I am bound to say that, if this is the law, the appellants' case seems to me a long way from a case of frustration. . . .

Notes

1. Lord Radcliffe's approach has since been accepted by Lord Hailsham in *National Carriers Ltd* v *Panalpina (Northern) Ltd* [1981] AC 675 (page 449).

2. Much of the difficulty in reconciling the case law in this area stems from the fact that some of it is professed to be based on the implied theory in *Taylor* v *Caldwell* (e.g., *Krell* v *Henry* [1903] 2 KB 740, see page 450).

3. In *Davis* v *Fareham UDC*, the contractors were seeking to profit from the frustration by using it to escape the contractual price they had agreed and the terms they had agreed, and instead to claim a larger sum on a *quantum meruit*. Not surprisingly, the court rejected this (although see page 131).

B: FRUSTRATING EVENTS

(a) Impossibility

(i) *Destruction of the subject matter* See *Taylor* v *Caldwell* (1863) 3 B & S 826, 122 ER 309 (page 443). This was a contract for the hire of both the Hall and Gardens. Only the Hall was destroyed but the court held the contract to be frustrated. (Compare with *Herne Bay Steam Boat Company* v *Hutton* [1903] 2 KB 683, page 452.)

In sale of goods contracts there are special rules governing the destruction of the subject matter.

Sale of Goods Act 1979

20. Risk prima facie passes with property

(1) Unless otherwise agreed, the goods remain at the seller's risk until the property in them is transferred to the buyer, but when the property in them is transferred to the buyer the goods ar at the buyer's risk whether delivery has been made or not.

7. Goods perishing before sale but after agreements to sell

Where there is an agreement to sell specific goods and subsequently the goods, without any fault on the part of the seller or buyer, perish before the risk passes to the buyer, the agreement is avoided.

Notes

1. If the goods are destroyed after the risk has passed, the contract is not frustrated. If the goods are destroyed before the risk has passed, the contract is frustrated where the goods are specific (i.e., identified and agreed on at the time the contract is made), or if under the contract they are to come from a particular source and the entire source is destroyed.

2. If, on the other hand, the goods were not specific, sellers are obliged to deliver goods of the contractual description and cannot argue that the goods they intended to use have been destroyed. In this situation the contract cannot be frustrated.

(ii) *Temporary unavailability of the subject matter* The question in each case is whether the contractual performance when resumed would amount to performance of a fundamentally different contract.

Jackson* v *Union Marine Insurance Company Ltd
(1874) LR 10 CP 125 (Exchequer Chamber)

A ship was chartered in November 1871. It was required to proceed 'with all possible dispatch (dangers and accidents of navigation excepted) from Liverpool to Newport, and there load a cargo for carriage to San Francisco'. The ship sailed from Liverpool on 2 January 1872, but ran aground on the way to Newport on 3 January. The ship was not repaired until the end of August. On 15 February, the charterers repudiated the charter and chartered another ship. The shipowner brought an action on his insurance policy. The question in the case was whether the shipowner could have maintained an action against the charterers for not loading. Only if no such action could have been maintained would this be a loss of freight by insured perils entitling the owners to recover under the policy. The jury found as facts that the delay due to the repairs was so long as to make it unreasonable for the charterers to supply a cargo in August for the voyage to San Francisco. Held: the contract was frustrated and the charterers were not bound to load. There was therefore a loss of the chartered freight by perils of the sea within the insurance policy.

BRAMWELL B: . . . (The jury have found that) the voyage the parties contemplated had become impossible; that a voyage undertaken after the ship was sufficiently repaired would have been a different voyage, not, indeed, different as to the ports of loading and discharge, but different as a different adventure, — a voyage for which at the time of the charter the plaintiff had not in intention engaged the ship, nor the charterers the cargo; a voyage as different as though it had been described as intended to be a spring voyage, while the one after the repair would be an autumn voyage.

Note
In *Bank Line Ltd* v *Arthur Capel & Co.* [1919] AC 435, a 12-month charter was to run from April 1915 to April 1916. The ship was requisitioned before delivery and not returned until September 1915. The House of Lords (Viscount Haldane dissenting) held the charterparty to have been frustrated because a September to September charter would be a substantially different charter from that which had been agreed.

(iii) *Impossibility of agreed method of performing*

Nickoll & Knight* v *Ashton, Edridge & Co.
[1901] 2 KB 126 (CA)

By a contract made in October 1899, the defendants sold the plaintiffs a cargo of cotton seed to be shipped by a steamship called 'Orlando' from

Alexandria during January 1900. In December 1899 the 'Orlando' went aground and could not reach Alexandria in January. The plaintiffs brought an action against the defendants for failure to ship the cargo. The majority of the Court of Appeal (Vaughan Williams LJ dissenting) followed the implied term approach in *Taylor* v *Caldwell*. Held: the contract must be construed as subject to an implied condition that, if at the time of performance the 'Orlando' was not fit to ship the cargo, the contract would be at an end. The use of the 'Orlando' was regarded by the majority as the contractually agreed means of performance and the only means of performing.

Note

It is not sufficient that the parties contemplated a particular method of performance which has now become impossible. It must actually have been expressly agreed that this was the exclusive method of performing so that any other method would result in the performance being radically different from that which was envisaged.

Tsakiroglou & Co. Ltd v *Noblee Thorl GmbH*
[1962] AC 93 (HL)

On 4 October 1956, a written contract was made whereby the sellers agreed to sell Sudanese groundnuts to the buyers for shipment from Port Sudan to Hamburg during November and December 1956. Both parties expected that shipment would be made via the Suez Canal but there was no express stipulation to this effect. On 2 November, the Canal was closed to navigation but the goods could have been shipped to Hamburg via the Cape of Good Hope. This route was twice as long and the freightage was far more costly. The sellers failed to ship the goods. Held: the contract was not frustrated by the closure of the Canal. The House of Lords refused to imply a term that shipment should be made via the Suez Canal. The sellers should have shipped the goods by the alternative route which was not substantially different from that envisaged by the contract.

LORD REID: . . . The question now is whether by reason of the closing of the Suez route the contract had been ended by frustration.

The appellants' first argument was that it was an implied term of the contract that shipment should be via Suez. It is found in the case that both parties contemplated that shipment would be by that route but I find nothing in the contract or in the case to indicate that they intended to make this a term of the contract or that any such term should be implied: they left the matter to the ordinary rules of law. . . .

I turn then to consider the position after the Canal was closed, and to compare the rights and obligations of the parties thereafter, if the contract still bound them, with what their rights and obligations would have been if the Canal had remained open. As regards the sellers, the appellants, the only difference to which I find reference in the case — and indeed the only difference suggested in argument — was that they would have had to pay £15 per ton freight instead of £7 10s. They had no concern with the nature of the voyage. In other circumstances that might have affected the

buyers, and it is necessary to consider the position of both parties because frustration operates without being invoked by either party and, if the market price of groundnuts had fallen instead of rising, it might have been the buyers who alleged frustration. There might be cases where damage to the goods was a likely result of the longer voyage which twice crossed the Equator, or perhaps the buyer could be prejudiced by the fact that the normal duration of the voyage via Suez was about three weeks whereas the normal duration via the Cape was about seven weeks. But there is no suggestion in the case that the longer voyage could damage the groundnuts or that the delay could have caused loss to these buyers of which they could complain. Counsel for the appellants rightly did not argue that this increase in the freight payable by the appellants was sufficient to frustrate the contract and I need not therefore consider what the result might be if the increase had reached an astronomical figure. The route by the Cape was certainly practicable. There could be, on the findings in the case, no objection to it by the buyers and the only objection to it from the point of view of the sellers was that it cost them more and it was not excluded by the contract. Where, then, is there any basis for frustration?

It appears to me that the only possible way of reaching a conclusion that this contract was frustrated would be to concentrate on the altered nature of the voyage. As I understood the argument it was based on the assumption that the voyage was the manner of performing the sellers' obligations and that therefore its nature was material. I do not think so. What the sellers had to do was simply to find a ship proceeding by what was a practicable and now a reasonable route — if perhaps not yet a usual route — to pay the freight and obtain a proper bill of lading, and to furnish the necessary documents to the buyers. That was their manner of performing their obligations, and for the reasons which I have given I think that such changes in these matters as were made necessary fell far short of justifying a finding of frustration. . . .

Note

It follows that it cannot be argued that a contract is frustrated if only one party contemplated its performance in a particular way (*Blackburn Bobbin Company Ltd* v *T. W. Allen & Sons Ltd* [1918] 2 KB 467).

(b) Supervening illegality

See *Fibrosa Spolka Akcyjna* v *Fairbairn Lawson Combe Barbour Ltd* [1943] AC 32, at page 460.

The following case concerned temporary illegality.

National Carriers Ltd v *Panalpina (Northern) Ltd*
[1981] AC 675 (HL)

A warehouse was leased to the defendants for 10 years from 1 January 1974. The lease contained a covenant that the premises should only be used as a warehouse. The only vehicular access to the warehouse was by a street which the local authority closed on 16 May 1979 in order to demolish a dangerous building. The street was likely to be closed for 20 months and the defendants were not able to use the warehouse in that period. The plaintiffs brought an action for unpaid rent but the defendants claimed that the lease was frustrated so that they were discharged.

Held: on the facts, having regard to the period of the lease which would remain after the interruption ceased compared to the 10-year term of the lease, the defendants could not rely on frustration as a defence.

(c) Frustration of the common purpose of the parties

Since this depends upon establishing that *both* parties had the same purpose in entering into the contract and that purpose can no longer be achieved, it will rarely succeed as a frustrating event.

It will not be sufficient that the purpose has become more difficult to achieve (see *Davis Contractors* v *Fareham UDC* (page 444), and *Tsakiroglou & Co. Ltd* v *Noblee Thorl* (page 448)).

Krell* v *Henry
[1903] 2 KB 740 (CA)

On 20 June 1902, the defendant agreed to hire a flat in Pall Mall from the plaintiff for £75. The hire was for 26 and 27 June (days only), which were the days on which the coronation procession of Edward VII was due to take place and pass along Pall Mall. The £25 deposit was paid and the balance was due on 24 June. The contract contained no express reference to the coronation procession or to any other purpose for which the flat was taken. It was announced on 24 June that the procession would not take place on those days because the coronation had been postponed due to the King's illness. The defendant refused to pay the balance of the agreed rent. Darling J (at first instance) relying on *Taylor* v *Caldwell*, held that there was an implied condition in the contract that the procession should take place. Held: (on appeal) from the circumstances it was clear that the procession actually taking place on these days along the advertised route was regarded by both contracting parties as being of the foundation of the contract, and hence the contract was frustrated.

VAUGHAN WILLIAMS LJ: . . . I do not think that the principle of the civil law [frustration] as introduced into the English law is limited to cases in which the event causing the impossibility of performance is the destruction or non-existence of some thing which is the subject-matter of the contract or of some condition or state of things expressly specified as a condition of it. I think that you first have to ascertain, not necessarily from the terms of the contract, but, if required, from necessary inferences, drawn from surrounding circumstances recognised by both contracting parties, what is the substance of the contract, and then to ask the question whether that substantial contract needs for its foundation the assumption of the existence of a particular state of things. If it does, this will limit the operation of the general words, and in such case, if the contract becomes impossible of performance by reason of the non-existence of the state of things assumed by both contracting parties as the foundation of the contract, there will be no breach of the contract thus limited. Now what are the facts of the present case? The contract is contained in two letters of June 20 which passed between the defendant and the plaintiff's agent, Mr Cecil Bisgood. These letters do not mention the coronation, but speak merely of the taking of Mr Krell's chambers, or, rather, of the use of them, in the daytime of June 26 and 27, for the sum of 75*l*.,

25*l.* then paid, balance 50*l.* to be paid on the 24th. But the affidavits, which by agreement between the parties are to be taken as stating the facts of the case, shew that the plaintiff exhibited on his premises, third floor, 56A, Pall Mall, an announcement to the effect that windows to view the Royal coronation procession were to be let, and that the defendant was induced by that announcement to apply to the housekeeper on the premises, who said that the owner was willing to let the suite of rooms for the purpose of seeing the Royal procession for both days, but not nights, of June 26 and 27. In my judgment the use of the rooms was let and taken for the purpose of seeing the Royal procession. It was not a demise of the rooms, or even an agreement to let and take the rooms. It is a licence to use rooms for a particular purpose and none other. And in my judgment the taking place of those processions on the days proclaimed along the proclaimed route, which passed 56A, Pall Mall, was regarded by both contracting parties as the foundation of the contract; and I think that it cannot reasonably be supposed to have been in the contemplation of the contracting parties, when the contract was made, that the coronation would not be held on the proclaimed days, or the processions not take place on those days along the proclaimed route. . . . It was suggested in the course of the argument that if the occurrence, on the proclaimed days, of the coronation and the procession in this case were the foundation of the contract, and if the general words are thereby limited or qualified, so that in the event of the non-occurrence of the coronation and procession along the proclaimed route they would discharge both parties from further performance of the contract, it would follow that if a cabman was engaged to take some one to Epsom on Derby Day at a suitable enhanced price for such a journey, say 10*l.*, both parties to the contract would be discharged in the contingency of the race at Epsom for some reason becoming impossible; but I do not think this follows, for I do not think that in the cab case the happening of the race would be the foundation of the contract. No doubt the purpose of the engager would be to go to see the Derby, and the price would be proportionately high; but the cab had no special qualifications for the purpose which led to the selection of the cab for this particular occasion. Any other cab would have done as well. Moreover, I think that, under the cab contract, the hirer, even if the race went off, could have said, 'Drive me to Epsom; I will pay you the agreed sum; you have nothing to do with the purpose for which I hired the cab,' and that if the cabman refused he would have been guilty of a breach of contract, there being nothing to qualify his promise to drive the hirer to Epsom on a particular day. Whereas in the case of the coronation, there is not merely the purpose of the hirer to see the coronation procession, but it is the coronation procession and the relative position of the rooms which is the basis of the contract as much for the lessor as the hirer; and I think that if the King, before the coronation day and after the contract, had died, the hirer could not have insisted on having the rooms on the days named. It could not in the cab case be reasonably said that seeing the Derby race was the foundation of the contract, as it was of the licence in this case. Whereas in the present case, where the rooms were offered and taken, by reason of their peculiar suitability from the position of the rooms for a view of the coronation procession, surely the view of the coronation procession was the foundation of the contract, which is a very different thing from the purpose of the man who engaged the cab — namely, to see the race — being held to be the foundation of the contract. Each case must be judged by its own circumstances. In each case one must ask oneself, first, what, having regard to all the circumstances, was the foundation of the contract? Secondly, was the performance of the contract prevented? Thirdly, was the event which prevented the performance of the contract of such a character that it cannot reasonably be said to have been in the contemplation of the parties at the date of the contract? If all these

questions are answered in the affirmative (as I think they should be in this case), I think both parties are discharged from further performance of the contract. In the present case the condition which fails and prevents the achievement of that which was, in the contemplation of both parties, the foundation of the contract, is not expressly mentioned either as a condition of the contract or the purpose of it; but I think for the reasons which I have given that the principle of *Taylor* v *Caldwell* (1863) 3 B & S 826 ought to be applied.

Question

If a coach firm advertises a coach trip with entrance tickets to see the Derby on Derby Day, and the race is cancelled, would the coach firm be able to escape liability for breach of contract by pleading frustration?

Notes

1. In *Krell* v *Henry*, the defendant had responded to an advertisement in a window of the plaintiff's flat to the effect that windows to view the coronation procession were to be let. In addition, since the flat was only at the defendant's disposal in the day-time it was easier to establish that the plaintiff's purpose was to let rooms to view the procession.
2. The decision to cancel the procession took place after the hiring contract was made, but in *Griffith* v *Brymer* (1903) 19 TLR 434, a contract to hire a room to view the procession made at 11 a.m. on 24 June was held to be void for common mistake where, unknown to both parties, the decision to cancel the procession had been taken at 10 a.m. that day. If the contract had been made at 9.30 a.m. in *Griffith* v *Brymer*, the case would have turned on frustration.
3. The result in *Krell* v *Henry* would seem perfectly acceptable since the plaintiff should not have been enriched at the defendant's expense, and assuming that the procession would be rearranged, the defendant would not have had to pay twice to view it. It was not a case where the defendant was seeking to avoid an inconvenient contract.

Herne Bay Steamboat Co. v *Hutton*
[1903] 2 KB 683 (CA)

The defendant hired a steamship from the plaintiffs which was to be at the disposal of the defendant to take passengers from Herne Bay for the purpose of viewing the naval review at Spithead on 28 and 29 June 1902, and to cruise round the fleet. The price was £250 and the defendant paid a £50 deposit. On 25 June, the review was cancelled due to the King's illness, although the fleet remained anchored at Spithead. The plaintiffs informed the defendant that the ship was ready and asked for the balance of the price. Held: the contract was not frustrated since the naval review was not the sole basis of the contract. Consequently, there was no total failure of the consideration because the cruise round the fleet could still have taken place.

VAUGHAN WILLIAMS LJ: . . . [The defendant], in hiring this vessel, had two objects in view: first, of taking people to see the naval review, and, secondly, of taking

them round the fleet. Those, no doubt, were the purposes of Mr Hutton, but it does not seem to me that because, as it is said, those purposes became impossible, it would be a very legitimate inference that the happening of the naval review was contemplated by both parties as the basis and foundation of this contract, so as to bring the case within the doctrine of *Taylor* v *Caldwell* (1863) 3 B & S 826. On the contrary, when the contract is properly regarded, I think the purpose of Mr Hutton, whether of seeing the naval review or of going round the fleet with a party of paying guests, does not lay the foundation of the contract within the authorities.

Having expressed that view, I do not know that there is any advantage to be gained by going on in any way to define what are the circumstances which might or might not constitute the happening of a particular contingency as the foundation of a contract. I will content myself with saying this, that I see nothing that makes this contract differ from a case where, for instance, a person has engaged a brake to take himself and a party to Epsom to see the races there, but for some reason or other, such as the spread of an infectious disease, the races are postponed. In such a case it could not be said that he could be relieved of his bargain. So in the present case it is sufficient to say that the happening of the naval review was not the foundation of the contract.

ROMER LJ: . . . In my opinion, . . . it is a contract for the hiring of a ship by the defendant for a certain voyage, though having, no doubt, a special object, namely, to see the naval review and the fleet; but it appears to me that the object was a matter with which the defendant, as hirer of the ship, was alone concerned, and not the plaintiffs, the owners of the ship.

The case cannot, in my opinion, be distinguished in principle from many common cases in which, on the hiring of a ship, you find the objects of the hiring stated. Very often you find the details of the voyage stated with particularity, and also the nature and details of the cargo to be carried. If the voyage is intended to be one of pleasure, the object in view may also be stated, which is a matter that concerns the passengers. But this statement of the objects of the hirer of the ship would not, in my opinion, justify him in saying that the owner of the ship had those objects just as much in view as the hirer himself. The owner would say, 'I have an interest in the ship as a passenger or cargo carrying machine, and I enter into the contract simply in that capacity; it is for the hirer to concern himself about the objects.' . . .

The view I have expressed with regard to the general effect of the contract before us is borne out by the following considerations. The ship (as a ship) had nothing particular to do with the review or the fleet except as a convenient carrier of passengers to see it: any other ship suitable for carrying passengers would have done equally as well. Just as in the case of the hire of a cab or other vehicle, although the object of the hirer might be stated, that statement would not make the object any the less a matter for the hirer alone, and would not directly affect the person who was letting out the vehicle for hire. In the present case I may point out that it cannot be said that by reason of the failure to hold the naval review there was a total failure of consideration. That cannot be so. Nor is there anything like a total destruction of the subject-matter of the contract. Nor can we, in my opinion, imply in this contract any condition in favour of the defendant which would enable him to escape liability. A condition ought only to be implied in order to carry out the presumed intention of the parties, and I cannot ascertain any such presumed intention here. It follows that, in my opinion, so far as the plaintiffs are concerned, the objects of the passengers on this voyage with regard to sight-seeing do not form the subject-matter or essence of this contract. . . .

STIRLING LJ: It is said that, by reason of the reference in the contract to the 'naval review,' the existence of the review formed the basis of the contract, and that as the review failed to take place the parties became discharged from the further performance of the contract, in accordance with the doctrine of *Taylor* v *Caldwell* (1863) 3 B & S 826. I am unable to arrive at that conclusion. It seems to me that the reference in the contract to the naval review is easily explained; it was inserted in order to define more exactly the nature of the voyage, and I am unable to treat it as being such a reference as to constitute the naval review the foundation of the contract so as to entitle either party to the benefit of the doctrine in *Taylor* v *Caldwell*. I come to this conclusion the more readily because the object of the voyage is not limited to the naval review, but also extends to a cruise round the fleet. The fleet was there, and passengers might have been found willing to go round it. It is true that in the event which happened the object of the voyage became limited, but, in my opinion, that was the risk of the defendant whose venture the taking the passengers was.

Notes

1. Arguably, in *Herne Bay Steamboat Co.* v *Hutton*, the purpose was simply to have the steamship at the defendant's disposal, whereas in *Krell* v *Henry*, it was clearly to view the procession. However, in *Krell* v *Henry* there was no express term in the contract relating to viewing the procession, whereas in *Herne Bay Steamboat Co.* v *Hutton* the contract stated that the hire was for the purpose of viewing the naval review and cruising round the fleet.

2. In *Herne Bay Steamboat Co.* v *Hutton*, although seeing the review and the fleet was the defendant's purpose, it was not that of the plaintiffs. In other words, it could be similar to the position where a taxi cab is hired to go to Epsom on Derby Day. Seeing the Derby is not the taxi owner's purpose even though it is clearly the hirer's.

This type of fine distinction is unsatisfactory in an area of the law where certainty is vital.

3. Brownsword's argument ((1985) 129 SJ 860) has much to recommend it. He argues that in *Herne Bay Steamboat Co.* v *Hutton* there was an 'imprudent commercial bargain', in that the defendant had lost the commercial benefit of cashing in on the naval review. The courts will not allow frustration to be used to avoid the consequences of what turn out to be bad bargains. On the other hand, the defendant in *Krell* v *Henry* was a consumer, and the court was being asked to prevent the unjust enrichment of the plaintiff at the defendant's request.

C: LIMITATIONS ON THE FRUSTRATION DOCTRINE

(a) Self-induced frustration

The essence of frustration is that the extraneous event is outside the control of the parties, not caused by one of them.

Maritime National Fish Ltd v *Ocean Trawlers Ltd*
[1935] AC 524 (PC)

The defendants chartered a steam trawler, the 'St Cuthbert', from the plaintiffs solely for fishing use. It could only operate as a trawler with an

otter trawl, and both parties knew that a licence was required. The defendants applied to the Minister for licences for five trawlers which they were operating (including the 'St Cuthbert'). The Minister indicated that only three would be granted and asked the defendants to name the three trawlers to which the licences would be granted. The three named by the defendants did not include the 'St Cuthbert' and licences were granted for only the three named trawlers. The plaintiffs claimed the charter hire and the defendants pleaded the charter was frustrated because it was impossible to perform. Held: it was not frustrated because the defendants' own election had prevented this trawler from having a licence to fish. Therefore the defendants were liable for the hire.

LORD WRIGHT (delivering the judgment of the court): . . . The essence of 'frustration' is that it should not be due to the act or election of the party. There does not appear to be any authority which has been decided directly on this point. There is, however, a reference to the question in the speech of Lord Sumner in *Bank Line, Ld* v *Arthur Capel & Co* [1919] AC 435. What he says is:

> . . . I think it is now well settled that the principle of frustration of an adventure assumes that the frustration arises without blame or fault on either side. Reliance cannot be placed on a self-induced frustration; indeed, such conduct might give the other party the option to treat the contract as repudiated. . . .

If it be assumed that the performance of the contract was dependent on a licence being granted, it was [the appellants'] election which prevented performance, and on that assumption it was the appellants' own default which frustrated the adventure: the appellants cannot rely on their own default to excuse them from liability under the contract.

Notes

1. If one party wishes to argue that a particular event was caused by the other's fault, he or she must prove it on the balance of probabilities (*Joseph Constantine Steamship Line Ltd* v *Imperial Smelting Corporation Ltd* [1942] AC 154). The other will then be in breach of contract.

2. The mere existence of a choice may be sufficient to establish that what follows was self-induced.

J. Lauritzen AS v *Wijsmuller BV, The Super Servant Two*
[1990] 1 Lloyd's Rep 1 (CA)

The defendants agreed to carry the plaintiffs' drilling rig and deliver it between 20 June and 20 August 1981, using either 'Super Servant One' or 'Super Servant Two' (the 'Dan King' contract). The defendants had intended to use 'Super Servant Two' for this contract and had entered into other contracts with third parties which they could only perform using 'Super Servant One'. On 29 January 1981, the 'Super Servant Two' sank, and in February 1981 the defendants informed the plaintiffs that they would not perform. When the plaintiffs alleged breach of contract the defendants argued that they were not liable because the contract had been

frustrated by the sinking of 'Super Servant Two'. Held: according to the contract terms the defendants could have satisfied their obligation by using 'Super Servant One' after 'Super Servant Two' had sunk but had elected not to do so. The frustration doctrine could only assist a party who had contracted to perform a contract with a vessel which through no fault of his own no longer existed. It therefore could not apply here since there was an alternative and the sinking of 'Super Servant Two' did not automatically bring the contract to an end.

BINGHAM LJ: . . . The argument in this case raises important issues on the English law of frustration. . . .

Certain propositions, established by the highest authority, are not open to question:

1. The doctrine of frustration was evolved to mitigate the rigour of the common law's insistence on literal performance of absolute promises (*Hirji Mulji* v *Cheong Yue Steamship Co. Ltd* (sub nom. *Dharsi Nanji* v *Cheong Yue Steamship Co. Ltd*), (1926) 24 Ll L Rep 209 at p. 213, col. 2; [1926] AC 497 at p. 510; *Denny Mott and Dickson Ltd* v *James B. Fraser & Co. Ltd* [1944] AC 265 at p. 275; *Joseph Constantine Steamship Line Ltd* v *Imperial Smelting Corporation Ltd* (1941) 70 Ll L Rep 1 at p. 12, col. 2; [1942] AC 154 at p. 171). The object of the doctrine was to give effect to the demands of justice, to achieve a just and reasonable result, to do what is reasonable and fair, as an expedient to escape from injustice where such would result from enforcement of a contract in its literal terms after a significant change in circumstances (*Hirji Mulji*, sup., at p. 213, col. 2; p. 510; *Joseph Constantine Steamship Line Ltd* (sup.), at p. 18, col, 2; p. 23, col. 1; pp. 183, 193; *National Carriers Ltd* v *Panalpina (Northern) Ltd* [1981] AC 675 at p. 701).

2. Since the effect of frustration is to kill the contract and discharge the parties from further liability under it, the doctrine is not to be lightly invoked, must be kept within very narrow limits and ought not to be extended (*Bank Line Ltd* v *Arthur Capel & Co.* [1919] AC 435 at p. 459; *Davis Contractors Ltd* sup., at pp. 715, 727; *Pioneer Shipping Ltd* v *B.T.P. Tioxide Ltd (The Nema)*, [1981] 2 Lloyd's Rep 239 at p. 253, col. 2; [1982] AC 724 at 752).

3. Frustration brings the contract to an end forthwith, without more and automatically (*Hirji Mulji*, sup. at pp. 211, 212; pp. 505, 509; *Maritime National Fish Ltd* v *Ocean Trawlers Ltd* (1935) 51 Ll L Rep 299 at p. 302; [1935] AC 524 at p. 527; *Joseph Constantine Steamship Line Ltd* sup., at pp. 9, 11, 12, 20, 25; pp. 163, 170, 171, 187 200; *Denny Mott & Dickson Ltd* sup. at p. 274).

4. The essence of frustration is that it should not be due to the act or election of the party seeking to rely on it (*Hirji Mulji*, sup., at p. 213; p. 510; *Maritime National Fish Ltd* sup., at p. 303; p. 530; *Joseph Constantine Steamship Ltd* sup., at p. 12; p. 170; *Denny Mott & Dickson Ltd* sup., at p. 274; *Davis Contractors Ltd* sup., at p. 728. A frustrating event must be some outside event or extraneous change of situation *(Paal Wilson & Co. A/S* v *Partenreederi Hannah Blumenthal (The Hannah Blumenthal)*, [1983] 1 Lloyd's Rep 103 at p. 112; [1983] 1 AC 854 at p. 909).

5. A frustrating event must take place without blame or fault on the side of the party seeking to rely on it *(Bank Line Ltd* sup., at 452; *Joseph Constantine Steamship Ltd* sup., at p. 12; p. 171; *Davis Contractors Ltd* sup., at p. 729; *The Hannah Blumenthal* [1982] 1 Lloyd's Rep 582 at p. 592; [1983] 1 Lloyd's Rep 103 at p. 112; [1983] 1 AC 854 at pp. 882, 909).

. . .

Had the *Dan King* contract provided for carriage by *Super Servant Two* with no alternative, and that vessel had been lost before the time for performance, then

They were in breach of the war clause in entering it. They cannot rely on a self-induced frustration, see *Maritime National Fish Ltd* v *Ocean Trawlers Ltd* [1935] AC 524. But they seek to rely on the fact that the canal itself was blocked. They assert that even if the *Eugenia* had never gone into the canal, but had stayed outside (in which case she would not have been in breach of the war clause), nevertheless she would still have had to go round by the Cape. And that, they say, brings about a frustration, for it makes the venture fundamentally different from what they contracted for. . . . I think the position is now reasonably clear. It is simply this: if it should happen, in the course of carrying out a contract, that a fundamentally different situation arises for which the parties made no provision — so much so that it would not be just in the new situation to hold them bound to its terms — then the contract is at an end.

It was originally said that the doctrine of frustration was based on an implied term. In short, that the parties, if they had foreseen the new situation, would have said to one another: 'If that happens, of course, it is all over between us.' But the theory of an implied term has now been discarded by everyone, or nearly everyone, for the simple reason that it does not represent the truth. The parties would not have said: 'It is all over between us.' They would have differed about what was to happen. Each would have sought to insert reservations or qualifications of one kind or another. Take this very case. The parties realised that the canal might become impassable. They tried to agree on a clause to provide for the contingency. But they failed to agree. So there is no room for an implied term.

It has frequently been said that the doctrine of frustration only applies when the new situation is 'unforeseen' or 'unexpected' or 'uncontemplated,' as if that were an essential feature. But it is not so. The only thing that is essential is that the parties should have made no provision for it in their contract. The only relevance of it being 'unforeseen' is this: If the parties did not foresee anything of the kind happening, you can readily infer they have made no provision for it: whereas, if they did foresee it, you would expect them to make provision for it. But cases have occurred where the parties have foreseen the danger ahead, and yet made no provision for it in the contract. Such was the case in the Spanish Civil War when a ship was let on charter to the republican government. The purpose was to evacuate refugees. The parties foresaw that she might be seized by the nationalists. But they made no provision for it in their contract. Yet, when she was seized, the contract was frustrated, see *W. J. Tatem Ltd* v *Gamboa* [1939] 1 KB 132. So here the parties foresaw that the canal might become impassable: it was the very thing they feared. But they made no provision for it. So there is room for the doctrine to apply if it be a proper case for it.

We are thus left with the simple test that a situation must arise which renders performance of the contract 'a thing radically different from that which was undertaken by the contract,' see *Davis Contractors Ltd* v *Fareham Urban District Council* [1956] AC 696 by Lord Radcliffe. To see if the doctrine applies, you have first to construe the contract and see whether the parties have themselves provided for the situation that has arisen. If they have provided for it, the contract must govern. There is no frustration. If they have not provided for it, then you have to compare the new situation with the situation for which they did provide. Then you must see how different it is. The fact that it has become more onerous or more expensive for one party than he thought is not sufficient to bring about a frustration. It must be more than merely more onerous or more expensive. It must be positively unjust to hold the parties bound. It is often difficult to draw the line. But it must be done. And it is for the courts to do it as a matter of law: see *Tsakiroglou & Co. Ltd* v *Noblee Thorl GmbH* [1962] AC 93 by Lord Simonds and by Lord Reid.

Applying these principles to this case, I have come to the conclusion that the blockage of the canal did not bring about a 'fundamentally different situation' such as to frustrate the venture. My reasons are these: (1) The venture was the *whole* trip from delivery at Genoa, out to the Black Sea, there load cargo, thence to India, unload cargo, and redelivery. The time for this vessel from Odessa to Vizagapatam via the Suez Canal would be 26 days, and via the Cape, 56 days. But that is not the right comparison. You have to take the whole venture from delivery at Genoa to redelivery at Madras. We were told that the time for the whole venture via the Suez Canal would be 108 days and via the Cape 138 days. The difference over the whole voyage is not so radical as to produce a frustration. (2) The cargo was iron and steel goods which would not be adversely affected by the longer voyage, and there was no special reason for early arrival. The vessel and crew were at all times fit and sufficient to proceed via the Cape. (3) The cargo was loaded on board at the time of the blockage of the canal. If the contract was frustrated, it would mean, I suppose, that the ship could throw up the charter and unload the cargo wherever she was, without any breach of contract. (4) The voyage round the Cape made no great difference except that it took a good deal longer and was more expensive for the charterers than a voyage through the canal.

Notes

1. The fact that the ship had become trapped was attributable to the actions of the charterers, and they could not rely on this as being the frustrating event. Instead they had attempted to argue that the frustrating event was the closure of the canal. However, it was held that the closure did not render performance of the contract radically different (applying *Tsakiroglou* v *Noblee Thorl* [1962] AC 93, page 448).

2. Lord Denning is advocating that the frustration doctrine will still apply where the event is foreseen as long as no provision is included to deal with it. There is a similar *obiter* statement by Goddard J in *W. J. Tatem Ltd* v *Gamboa* [1939] 1 KB 132.

Question

Is this asking the court to reallocate the risks that parties have freely, and with knowledge, entered upon?

D: THE EFFECTS OF FRUSTRATION

Frustration discharges contractual performance from the date of frustration so that the parties are excused from future performance.

(a) At common law

(i) *Recovering money paid in advance of frustration*

Fibrosa Spolka Akcyjna* v *Fairbairn Lawson Combe Barbour Ltd
[1943] AC 32 (HL)

In July 1939, the English company agreed to sell machinery to a Polish company and to deliver it three to four months later to Gdynia in Poland.

assuming no negligence by Wijsmuller (as for purposes of this question we must), I feel sure the contract would have been frustrated. The doctrine must avail a party who contracts to perform a contract of carriage with a vessel which, through no fault of his, no longer exists. But that is not this case. The *Dan King* contract did provide an alternative. When that contract was made one of the contracts eventually performed by *Super Servant One* during the period of contractual carriage of *Dan King* had been made, the other had not, at any rate finally. Wijsmuller have not alleged that when the *Dan King* contract was made either vessel was earmarked for its performance. That, no doubt, is why an option was contracted for. Had it been foreseen when the *Dan King* contract was made that *Super Servant Two* would be unavailable for performance, whether because she had been deliberately sold or accidentally sunk, Lauritzen at least would have thought it no matter since the carriage could be performed with the other . . . the present case does not fall within the very limited class of cases in which the law will relieve one party from an absolute promise he has chosen to make.

. . . I cannot, furthermore, reconcile Wijsmuller's argument with the reasoning or the decision in *Maritime National Fish Ltd* sup. In that case the Privy Council declined to speculate why the charterers selected three of the five vessels to be licensed but, as I understand the case, regarded the interposition of human choice after the allegedly frustrating event as fatal to the plea of frustration. If Wijsmuller are entitled to succeed here, I cannot see why the charterers lost there. The cases on frustrating delay do not, I think, help Wijsmuller since it is actual and prospective delay (whether or not recognized as frustrating by a party at the time) which frustrates the contract, not a party's election or decision to treat the delay as frustrating. I have no doubt that force majeure clauses are, where their terms permit, to be construed and applied as in the commodity cases on which Wijsmuller relied, but it is in my view inconsistent with the doctrine of frustration as previously understood on high authority that its application should depend on any decision, however reasonable and commercial, of the party seeking to rely on it.

Notes

1. Bingham LJ considered that the existence of a choice was fatal no matter how reasonable and commercial the decision to elect had been.

Treitel's view, that if the party acted reasonably in making the election he or she could use such means as remained available to perform some of the contracts and claim that the others were frustrated by the supervening event, was rejected by the Court of Appeal. Dillon LJ stated:

It is the view of Professor Treitel, expressed both in his own book on the Law of Contract — see the 7th ed. at pp. 674–675 and 700–701 — and in the current editions of well-known textbooks of which he is editor or an editor, that where a party has entered into a number of contracts with other parties and an uncontemplated supervening event has the result that he is deprived of the means of satisfying all those contracts, he can, provided he acts 'reasonably' in making his election, elect to use such means as remains available to him to perform some of the contracts, and claim that the others, which he does not perform, have been frustrated by the supervening event. The reasoning depends on the proposition that if it is known to those concerned that the party will have entered into commitments with others and if he acts 'reasonably' in his allocation of his remaining means to his commitments, the chain of causation between the uncontemplated supervening event and the

non-performance of those of his contracts which will not have been performed will not have been broken by the election to apply his remaining means in a 'reasonable' way. . . .

Such an approach is however inconsistent to my mind with the view expressed by Lord Wright in that passage in *Maritime National Fish* which I have already cited, where he said:

> It is immaterial to speculate why they preferred to put forward for licences the three trawlers which they actually selected.

It is also, as my Lord has pointed out, inconsistent with the long accepted view that frustration brings the contract to an end forthwith, without more ado automatically. Plainly the sinking of *Super Servant Two* did not do that, since even after that sinking the defendants could have used *Super Servant One* to perform the contract.

See Treitel's assessment in *The Law of Contract*, 9th edn, pp. 819–20 and his *Frustration and Force Majeure* (Sweet & Maxwell, 1994), para. 14-017).

2. It appears that the court considered that the risk of the defendant being over-committed had been placed on the defendant. If the defendant had wished to alter this, an appropriately drafted *force majeure* clause could have been incorporated.

It is evident that the courts prefer the risk to be placed on one of the parties to the contract, thereby avoiding the application of the frustration doctrine.

3. See Swanton (1990) 2 JCL 206 and McKendrick (1990) LMCLQ 153.

(b) Express provision and events foreseen but not provided for

If the contract contains a *force majeure* clause that clause will generally govern.

What is the position where an event is foreseen by the parties, or ought to have been foreseen, but they have made no provision to deal with it?

The basis of frustration is that the event is unexpected, so that if the parties foresaw it they must be taken to have accepted the risk of it occurring if they do not make express provision to deal with it. There are, of course, obvious problems in deciding whether an event is sufficiently predictable to be 'foreseeable'.

Ocean Tramp Tankers Corporation v *V/O Sovfracht, The Eugenia* [1964] 2 QB 226 (CA)

> '*The Eugenia*' was chartered for a voyage to India via the Black Sea. A war clause in the charterparty provided that the vessel was not to be taken into a war zone without the owner's consent. When the charterparty was negotiated both parties realised that the Suez Canal might be closed but they made no provision for it. The vessel entered the Canal when it was 'dangerous' within the war clause. The Canal was blocked and the vessel trapped. The charterers claimed that the charterparty was frustrated. Held: the charterers were in breach of the war clause. Lord Denning MR continued:

LORD DENNING MR: The second question is whether the charterparty was frustrated by what took place. One thing that is obvious is that the charterers cannot rely on the fact that the *Eugenia* was trapped in the canal: for that was their own fault.

The purchase price was £4,800, of which £1,600 was to be paid when the order was placed. In fact only £1,000 of this advance sum was paid. War broke out between Germany and Britain on 3 September 1939, and Gdynia was occupied by the German army on 23 September. Held: the contract was frustrated because performance would have amounted to trading with the enemy. The House of Lords also held that since there was a total failure of consideration (i.e., the buyer got no part of what he bargained for), the buyer could recover the £1,000 advance payment and did not have to pay the outstanding balance on the advance payment of £600.

Notes

1. *Fibrosa* v *Fairbairn* relaxed the previous common-law rule that because the obligation to make the advance payment had arisen *before* the frustrating event, it had to be fulfilled (see *Chandler* v *Webster* [1904] 1 KB 493). Instead the advance payment could be recovered, but only where there was a total failure of consideration. If some of the goods had been delivered before the frustrating event occurred, then the advance payment could not have been recovered.

2. On the facts of this case, the English sellers had already incurred expenses in making machines but were not able to keep any part of the advance payment to cover this.

(ii) *Benefit provided prior to the frustrating event*

Appleby* v *Myers
(1867) LR 2 CP 651 (Exchequer Chamber)

The plaintiff contracted to install and maintain certain machinery in the defendant's factory for two years, payment to be made on completion. After some of the work of installation had been completed, the factory and the machinery were accidentally destroyed by fire. Held: the contract was frustrated so that the defendant was discharged from his obligation to pay, but the plaintiff was not entitled to recover any sum for the work that had been completed. Blackburn J referred to the normal assumption that the contract will be severable and not 'entire' (page 287) and continued:

BLACKBURN J: . . . But, though this is the prima facie contract between those who enter into contracts for doing work and supplying materials, there is nothing to render it either illegal or absurd in the workman to agree to complete the whole, and be paid when the whole is complete, and not till then: and we think that the plaintiffs in the present case had entered into such a contract. Had the accidental fire left the defendant's premises untouched, and only injured a part of the work which the plaintiffs had already done, we apprehend that it is clear the plaintiffs under such a contract as the present must have done that part over again, in order to fulfil their contract to complete the whole and 'put it to work for the sums above named respectively.' As it is, they are, according to the principle laid down in *Taylor* v *Caldwell*

(1863) 3 B & S 826, excused from completing the work; but they are not therefore entitled to any compensation for what they have done, but which has, without any fault of the defendant, perished. The case is in principle like that of a shipowner who has been excused from the performance of his contract to carry goods to their destination, because his ship has been disabled by one of the excepted perils, but who is not therefore entitled to any payment on account of the part-performance of the voyage, unless there is something to justify the conclusion that there has been a fresh contract to pay freight pro rata.

(b) The Law Reform (Frustrated Contracts) Act 1943

See McKendrick 'The Consequences of Frustration — The Law Reform (Frustrated Contracts) Act 1943' in *Force Majeure and Frustration of Contract*, 2nd edn (Lloyd's of London, 1995) and Stewart and Carter, 'Frustrated Contracts and Statutory Adjustment: The Case for a Reappraisal' [1992] CLJ 66.

(i) *Recovering money paid in advance of frustration*

Law Reform (Frustrated Contracts) Act 1943

1. Adjustment of rights and liabilities of parties to frustrated contracts

. . . (2) All sums paid or payable to any party in pursuance of the contract before the time when the parties were so discharged (in this Act referred to as 'the time of discharge') shall, in the case of sums so paid, be recoverable from him as money received by him for the use of the party by whom the sums were paid, and, in the case of sums so payable, cease to be so payable:

Provided that, if the party to whom the sums were so paid or payable incurred expenses before the time of discharge in, or for the purpose of, the performance of the contract, the court may, if it considers it just to do so having regard to all the circumstances of the case, allow him to retain or, as the case may be, recover the whole or any part of the sums so paid or payable, not being an amount in excess of the expenses so incurred.

. . . (4) In estimating, for the purposes of the foregoing provisions of this section, the amount of any expenses incurred by any party to the contract, the court may, without prejudice to the generality of the said provisions, include such sum as appears to be reasonable in respect of overhead expenses and in respect of any work or services performed personally by the said party.

Notes

1. Money paid before the frustrating event is recoverable, and money payable before the frustrating event ceases to be payable (irrespective of whether there has been a total failure of consideration).

2. The payee *may* be permitted by the court to set off any expenses he incurred before the frustrating event in performing the contract against the advance payment.

3. The amount of expenses that can be recovered is limited in any event to the amount of the advance payment. This means that if there was no advance payment, s. 1(2) cannot be used to recover expenses. Similarly, if the expenses are more than the advance payment amount, it is only possible as a maximum to recover the advance payment amount.

Gamerco SA v *I.C.M./Fair Warning (Agency) Ltd* [1995] 1 WLR 1226

The plaintiffs, Spanish pop group promoters, had agreed in a contract with the defendants that they would promote a rock concert by the group 'Guns N' Roses' at a stadium in Madrid on 4 July 1992. However, on 1 July the permit issued for the stadium was withdrawn because of safety concerns about the cement used in its construction, and the parties became aware of these events on 2 July. No other suitable venue could be found and the concert had to be cancelled. The plaintiffs had already paid $412,000 on account and were under an obligation to pay, but had not yet paid, a further $362,500. Both parties had incurred expenses in preparation for the concert. The judge, Garland J, accepted that the defendants' expenses amounted to $50,000, and the undisputed evidence was that the plaintiffs had also incurred expenses of $450,000 prior to the cancellation. The plaintiffs claimed that the contract was frustrated and sought to recover their advance payment under s. 1(2) of the Law Reform (Frustrated Contracts) Act 1943. The defendants counterclaimed for damages for breach of contract by the plaintiffs in failing to hold the concert. Held: the plaintiffs were not in breach because the contract was frustrated when the permit for the stadium was revoked. Therefore the plaintiffs were entitled to recover the advance payment of $412,000 and did not need to make the further payment of $362,500 already due (s. 1(2)). The court had a 'broad discretion' to allow the defendants to set off their expenses under the proviso to s. 1(2). In all the circumstances, and having particular regard to the expenses incurred by the plaintiffs, no deduction for the defendants' expenses was made under the proviso.

GARLAND J: . . . The issue which I have to decide is whether and, if so, to what extent the defendants can set off against the US$412,500 expenses incurred before the time of discharge in or for the purpose of the performance of the contract. It is perhaps surprising that over a period of 50 years there is no reported case of the operation of section 1(2), although it was considered obiter by Robert Goff J in *B.P. Exploration Co. (Libya) Ltd* v *Hunt (No. 2)* [1979] 1 WLR 783, 800. The section has, of course, received the attention of textbook writers, most recently that of Professor Treitel in *Frustration and Force Majeure* (1994). . . .

The approach to the proviso

The following have to be established: (1) that the defendants incurred expenses paid or payable (2) before the discharge of the contract on 2 July (3) in performance of the contract (which is not applicable) or (4) for the purposes of the performance of the contract, and (5) that it is just in all the circumstances to allow them to retain the whole or any part of the sums so paid or payable.

The onus of establishing these matters must lie on the defendant. It is, in the broad sense, his case to be made out and I am assisted by the Victorian case of *Lobb* v *Vasey Housing Auxiliary (War Widows Guild)* [1963] VR 239 under the corresponding Victorian Act of 1959, which is in very similar terms to the Act of 1943.

I have already dealt with (1), (2) and (4) so far as the evidence allows. I turn to (5). I take the following matters into consideration. (a) My assumption that the relevant

expenses of US$50,000 was undisputed. (b) It was undisputed that the plaintiffs incurred expenses in excess of 52m. pesetas (approximately £285,000 or US$450,000). (c) Neither party conferred any benefit on the other or on a third party, so that subsections (3) and (6) did not apply. (d) The plaintiffs' expenditure was wholly wasted, as was the defendants'. (e) The plaintiffs were concerned with one contract only. The defendants were concerned with the last of 20 similar engagements, neither party being left with any residual benefit or advantage. (f) As already stated, I entirely ignore any insurance recoveries in accordance with subsection (5).

Various views have been advanced as to how the court should exercise its discretion and these can be categorised as follows.

(1) *Total retention.* This view was advanced by the Law Revision Committee in 1939 (Cmd. 6009) on the questionable ground 'that it is reasonable to assume that in stipulating for prepayment the payee intended to protect himself from loss under the contract.' As the editor of *Chitty on Contracts*, 27th ed. (1994), vol. 1, p. 1141, para. 23-060, note 5', (Mr. E G McKendrick) comments: 'He probably intends to protect himself against the possibility of the other party's insolvency or default in payment.' To this, one can add: 'and secure his own cash flow.'

In *B.P. Exploration Co. (Libya) Ltd* v *Hunt (No. 2)* [1979] 1 WLR 783 Robert Goff J considered the principle of recovery under subsections (2) and (3). He said, at pp. 799–800:

> The Act is *not* designed to do certain things: (i) It is not designed to apportion the loss between the parties. There is no general power under either section 1(2) or section 1(3) to make any allowance for expenses incurred by the plaintiff (except, under the proviso to section 1(2), to enable him to enforce pro tanto payment of a sum payable but unpaid before frustration); and expenses incurred by the defendant are only relevant in so far as they go to reduce the net benefit obtained by him and thereby limit any award to the plaintiff (ii) It is not concerned to put the parties in the position in which they would have been if the contract had been performed. (iii) It is not concerned to restore the parties to the position they were in before the contract was made. A remedy designed to prevent unjust enrichment may not achieve that result; for expenditure may be incurred by either party under the contract which confers no benefit on the other, and in respect of which no remedy is available under the Act.

He then turned to section 1(2) and said:

> There is no discretion in the court in respect of a claim under section 1(2), except in respect of the allowance for expenses; subject to such an allowance . . . the plaintiff is entitled to repayment of the money he has paid. The allowance for expenses is probably best rationalised as a statutory recognition of the defence of change of position. True, the expenses need not have been incurred by reason of the plaintiff's payments; but they must have been incurred in, or for the purpose of, the performance of the contract under which the plaintiff's payment has been made, and for that reason it is just that they should be brought into account.

I do not derive any specific assistance from the *B.P Exploration Co.* case. There was no question of any change of position as a result of the plaintiffs' advance payment.

(2) *Equal division.* This was discussed by Professor Treitel in *Frustration and Force Majeure*, pp. 555–556, paras 15-059 and 15-060. There is some attraction in splitting the loss, but what if the losses are very unequal? Professor Treitel considers statutory provisions in Canada and Australia but makes the point that unequal division is

unnecessarily rigid and was rejected by the Law Revision Committee in the 1939 report to which reference has already been made. The parties may, he suggests have had an unequal means of providing against the loss by insurers, but he appears to overlook subsection (5). It may well be that one party's expenses are entirely thrown away while the other is left with some realisable or otherwise usable benefit or advantage. Their losses may, as in the present case, be very unequal. Professor Treitel therefore favours the third view.

(3) *Broad discretion.* It is self-evident that any rigid rule is liable to produce injustice. The words, 'if it considers it just to do so having regard to all the circumstances of the case,' clearly confer a very broad discretion. Obviously the court must not take into account anything which is not 'a circumstance of the case' or fail to take into account anything that is and then exercise its discretion rationally. I see no indication in the Act, the authorities or the relevant literature that the court is obliged to incline towards either total retention or equal division. Its task is to do justice in a situation which the parties had neither contemplated nor provided for, and to mitigate the possible harshness of allowing all loss to lie where it has fallen.

I have not found my task easy. As I have made clear, I would have welcomed assistance on the true measure of the defendants' loss and the proper treatment of overhead and non-specific expenditure. Because the defendants have plainly suffered some loss, I have made a robust assumption. In all the circumstances, and having particular regard to the plaintiffs' loss, I consider that justice is done by making no deduction under the proviso.

Question

Is this decision explicable on the basis that Garland J is compensating for the inadequacies of s. 1(3), namely the fact that a s. 1(3) claim by the plaintiffs was not possible because they had conferred no benefit on the defendants at the date of the frustration, so that allowing the defendants to recover their expenses would have amounted to throwing all the loss on the plaintiffs? (See below for discussion of s. 1(3).)

Notes

1. Carter and Tolhurst (1996) 10 JCL 264 disagree with the approach adopted by Garland J and argue that, given the wording of the proviso ('the whole or any par.') and the restitutionary basis of the 1943 Act, 'there was no discretion to award a nil sum'. They appear to prefer a 'total retention' approach.

2. The decision to revoke the permit was taken on 1 July, but Garland J treats 2 July as the point at which the contract is discharged by frustration. Although on these facts it can be argued that frustration would not occur until it was clear that an alternative venue could not be found, it must be the position that where it is the decision itself that causes the contract to be frustrated, frustration will normally occur when the decision is made rather than when the parties are notified of it. See *Griffith* v *Brymer* (1903) 19 TLR 434, page 452. Although it is not clear from the judgment in *Gamerco* v *I.C.M.*, it appears that it was the decision to revoke the permit that was crucial and not merely the fact that the stadium was unsafe, thereby making performance at the agreed venue impossible, since presumably this construction problem pre-dated the contract.

(ii) *Benefit provided prior to the frustrating event*

Law Reform (Frustrated Contracts) Act 1943

1. Adjustment of rights and liabilities of parties to frustrated contracts

(3) Where any party to the contract has, by reason of anything done by any other party thereto in, or for the purpose of, the performance of the contract, obtained a valuable benefit (other than a payment of money to which the last foregoing subsection applies) before the time of discharge, there shall be recoverable from him by the said other party such sum (if any), not exceeding the value of the said benefit to the party obtaining it, as the court considers just, having regard to all the circumstances of the case and, in particular, —

(a) the amount of any expenses incurred before the time of discharge by the benefited party in, or for the purpose of, the performance of the contract, including any sums paid or payable by him to any other party in pursuance of the contract and retained or recoverable by that party under the last foregoing subsection, and

(b) the effect, in relation to the said benefit, of the circumstances giving rise to the frustration of the contract.

Notes

1. Section 1(3) applies where one party has conferred a non-monetary 'valuable benefit' on the other party before the frustrating event. The court may award him a 'just sum' to recompense him, and this sum must not exceed the value of the benefit to the party receiving it.

2. The subsection also appears to state that when calculating this 'just sum', the court must in particular consider the expenses incurred by the benefited party (i.e., the fact that an advance payment was made to the provider of the benefit which the provider of the benefit was permitted to retain as his expenses under s. 1(2)). The provider of the benefit cannot recover twice for the same expenses under both s. 1(2) and (3).

3. By s. 1(3)(b), the court must also consider 'the effect of the frustrating event on the benefit received'.

BP Exploration Co. (Libya) Ltd v *Hunt (No. 2)*
[1982] 1 All ER 925

In December 1957, the Libyan Government granted the defendant a concession to explore for, and extract, oil in a specified area in the Libyan desert. In June 1960, the defendant made an agreement with the plaintiff oil company whereby the defendant assigned a half share in the oil concession to the plaintiff and the plaintiff undertook to explore, develop and operate the whole concession at its expense and to make payments in cash and oil to the defendant. The agreement provided that if and when oil was discovered in commercial quantities, the operating expenses were to be shared and the plaintiff was to be entitled to three-eighths of the defendant's half share of the oil produced for a particular period. The plaintiff spent considerable sums of money in exploration and development

of the concession and found oil in commercially worthwhile quantities. However, following a revolution in Libya, the Libyan government first expropriated the plaintiff's half share in the concession on 7 December 1971, and then the defendant's half share on 11 June 1973. The plaintiff brought an action against the defendant alleging that the agreement was frustrated on 7 December 1971, and claimed a 'just sum' under s. 1(3) of the 1943 Act in respect of the benefit obtained by the defendant as a result of the plaintiff's performance of the contract prior to frustration. Held: the contract was frustrated and the Act applied.

ROBERT GOFF J: The principle, which is common to both s. 1(2) and (3), and indeed is the fundamental principle underlying the Act itself, is prevention of the unjust enrichment of either party to the contract at the other's expense. It was submitted by counsel, on behalf of BP that the principle common to both subsections was one of restitution for net benefits received, the net benefit being the benefit less an appropriate deduction for expenses incurred by the defendant. This is broadly correct so far as s. 1(2) is concerned; but under s. 1(3) the net benefit of the defendant simply provides an upper limit to the award: it does not measure the amount of the award to be made to the plaintiff. This is because in s. 1(3) a distinction is drawn between the plaintiff's performance under the contract, and the benefit which the defendant has obtained by reason of that performance, . . . and the net benefit obtained by the defendant from the plaintiff's performance may be more than a just sum payable in respect of such performance, in which event a sum equal to the defendant's net benefit would not be an appropriate sum to award to the plaintiff. I therefore consider it better to state the principle underlying the Act as being the principle of unjust enrichment, which underlies the right of recovery in very many cases in English law, and indeed is the basic principle of the English law of restitution, of which the Act forms part.

[Robert Goff J then considered the process of calculating a s. 1(3) award. He continued:]

. . . First, it has to be shown that the defendant has, by reason of something done by the plaintiff in, or for the purpose of, the performance of the contract, obtained a valuable benefit (other than a payment of money) before the time of discharge. That benefit has to be identified, and valued, and such value forms the upper limit of the award. Secondly, the court may award to the plaintiff such sum, not greater than the value of such benefit, as it considers just having regard to all the circumstances of the case, including in particular the matters specified in s. 1(3)(a) and (b). In the case of an award under s. 1(3) there are, therefore, two distinct stages: the identification and valuation of the benefit, and the award of the just sum. The amount to be awarded is the just sum, unless the defendant's benefit is less, in which event the award will be limited to the amount of that benefit. The distinction between the identification and valuation of the defendant's benefit, and the assessment of the just sum, is the most controversial part of the Act. It represents the solution adopted by the legislature of the problem of restitution in cases where the benefit does not consist of a payment of money; but the solution so adopted has been criticised by some commentators as productive of injustice, and it certainly gives rise to considerable problems, to which I shall refer in due course.

Identification of the defendant's benefit. In the course of the argument before me, there was much dispute whether, in the case of services, the benefit should be identified as the services themselves, or as the end product of the services. One example canvassed

(because it bore some relationship to the facts of the present case) was the example of prospecting for minerals. If minerals are discovered, should the benefit be regarded (as counsel for Mr Hunt contended) simply as the services of prospecting, or (as counsel for BP contended) as the minerals themselves being the end product of the successful exercise? Now, I am satisfied that it was the intention of the legislature, to be derived from s. 1(3) as a matter of construction, that the benefit should in an appropriate case be identified as the end product of the services. This appears, in my judgment, not only from the fact that s. 1(3) distinguishes between the plaintiff's performance and the defendant's benefit, but also from s. 1(3)(b) which clearly relates to the product of the plaintiff's performance. Let me take the example of a building contract. Suppose that a contract for work on a building is frustrated by a fire which destroys the building and which, therefore, also destroys a substantial amount of work already done by the plaintiff. Although it might be thought just to award the plaintiff a sum assessed on a quantum meruit basis, probably a rateable part of the contract price, in respect of the work he has done, the effect of s. 1(3)(b) will be to reduce the award to nil, because of the effect, in relation to the defendant's benefit, of the circumstances giving rise to the frustration of the contract. It is quite plain that, in s. 1(3)(b), the word 'benefit' is intended to refer, in the example I have given, to the actual improvement to the building, because that is what will be affected by the frustrating event; the subsection therefore contemplates that, in such a case, the benefit is the end product of the plaintiff's services, not the services themselves. This will not be so in every case, since in some cases the services will have no end product; for example, where the services consist of doing such work as surveying, or transporting goods. In each case it is necessary to ask the question: what benefit has the defendant obtained by reason of the plaintiff's contractual performance? But it must not be forgotten that in s. 1(3) the relevance of the value of the benefit is to fix a ceiling to the award. If, for example, in a building contract, the building is only partially completed, the value of the partially completed building (ie the product of the services) will fix a ceiling for the award; but the stage of the work may be such that the uncompleted building may be worth less than the value of the work and materials that have gone into it, particularly as completion by another builder may cost more than completion by the original builder would have cost. In other cases, however, the actual benefit to the defendant may be considerably more than the appropriate or just sum to be awarded to the plaintiff, in which event the value of the benefit will not in fact determine the quantum of the award. I should add, however, that, in a case of prospecting, it would usually be wrong to identify the discovered mineral as the benefit. In such a case there is always (whether the prospecting is successful or not) the benefit of the prospecting itself, ie of knowing whether or not the land contains any deposit of the relevant minerals; if the prospecting is successful, the benefit may include also the enhanced value of the land by reason of the discovery; if the prospector's contractual task goes beyond discovery and includes development and production, the benefit will include the further enhancement of the land by reason of the installation of the facilities, and also the benefit of in part transforming a valuable mineral deposit into a marketable commodity.

I add by way of footnote that all these difficulties would have been avoided if the legislature had thought it right to treat the services themselves as the benefit. In the opinion of many commentators, it would be more just to do so; after all, the services in question have been requested by the defendant, who normally takes the risk that they may prove worthless, from whatever cause. In the example I have given of the building destroyed by fire, there is much to be said for the view that the builder should be paid for the work he has done, unless he has (for example by agreeing to insure the

works) taken on himself the risk of destruction by fire. But my task is to construe the Act as it stands. On the true construction of the Act, it is in my judgment clear that the defendant's benefit must, in an appropriate case, be identified as the end product of the plaintiff's services, despite the difficulties which this construction creates, difficulties which are met again when one comes to value the benefit.

Valuing the benefit. Since the benefit may be identified with the product of the plaintiff's performance, great problems arise in the valuation of the benefit. First, how does one solve the problem which arises from the fact that a small service may confer an enormous benefit, and conversely, a very substantial service may confer only a very small benefit? The answer presumably is that at the stage of valuation of the benefit (as opposed to assessment of the just sum) the task of the court is simply to assess the value of the benefit to the defendant. For example, if a prospector after some very simple prospecting discovers a large and unexpected deposit of a valuable mineral, the benefit to the defendant (namely, the enhancement in the value of the land) may be enormous; it must be valued as such, always bearing in mind that the assessment of a just sum may very well lead to a much smaller amount being awarded to the plaintiff. But conversely, the plaintiff may have undertaken building work for a substantial sum which is, objectively speaking, of little or no value, for example, he may commence the redecoration, to the defendant's execrable taste, of rooms which are in good decorative order. If the contract is frustrated before the work is complete, and the work is unaffected by the frustrating event, it can be argued that the defendant has obtained no benefit, because the defendant's property has been reduced in value by the plaintiff's work; but the partial work must be treated as a benefit to the defendant, since he requested it, and valued as such. Secondly, at what point in time is the benefit to be valued? If there is a lapse of time between the date of the receipt of the benefit, and the date of frustration, there may in the meanwhile be a substantial variation in the value of the benefit. If the benefit had simply been identified as the services rendered, this problem would not arise; the court would simply award a reasonable remuneration for the services rendered at the time when they were rendered, the defendant taking the risk of any subsequent depreciation and the benefit of any subsequent appreciation in value. But that is not what the Act provides: s. 1(3)(b) makes it plain that the plaintiff is to take the risk of depreciation or destruction by the frustrating event. If the effect of the frustrating event on the value of the benefit is to be measured, it must surely be measured on the benefit as at the date of frustration. For example, let it be supposed that a builder does work which doubles in value by the date of frustration, and is then so severely damaged by fire that the contract is frustrated; the valuation of the residue must surely be made on the basis of the value as at the date of frustration.

. . . But there is a further problem which I should refer to, before leaving this topic. Section 1(3)(a) requires the court to have regard to the amount of any expenditure incurred before the time of discharge by the benefited party in, or for the purpose of, the performance of the contract. The question arises: should this matter be taken into account at the stage of valuation of the benefit, or of assessment of the just sum? Take a simple example. Suppose that the defendant's benefit is valued at £150 and that a just sum is assessed at £100, but that there remains to be taken into account defendant's expenses of £75: is the award to be £75 or £25? The clue to this problem lies, in my judgment, in the fact that the allowance for expenses is a statutory recognition of the defence of change of position. Only to the extent that the position of the defendant has so changed that it would be unjust to award restitution, should the court make an allowance for expenses. Suppose that the plaintiff does work for the defendant which produces no valuable end product or a benefit no greater in value

than the just sum to be awarded in respect of the work, there is then no reason why the whole of the relevant expenses should not be set off against the just sum. But suppose that the defendant has reaped a large benefit from the plaintiff's work, far greater in value than the just sum to be awarded for the work. In such circumstances it would be quite wrong to set off the whole of the defendant's expenses against the just sum. The question whether the defendant has suffered a change of position has to be judged in the light of all the circumstances of the case. Accordingly, on the Act as it stands, under s 1(3) the proper course is to deduct the expenses from the value of the benefit, with the effect that only in so far as they reduce the value of the benefit below the amount of the just sum which would otherwise be awarded will they have any practical bearing on the award. . . .

Assessment of the just sum. The principle underlying the Act is prevention of the unjust enrichment of the defendant at the plaintiff's expense. Where, as in cases under s. 1(2), the benefit conferred on the defendant consists of payment of a sum of money, the plaintiff's expense and the defendant's enrichment are generally equal; and, subject to other relevant factors, the award of restitution will consist simply of an order for repayment of a like sum of money. But where the benefit does not consist of money, then the defendant's enrichment will rarely be equal to the plaintiff's expense. In such cases, where (as in the case of a benefit conferred under a contract thereafter frustrated) the benefit has been requested by the defendant, the basic measure of recovery in restitution is the reasonable value of the plaintiff's performance: in a case of services, a quantum meruit or reasonable remuneration, and in a case of goods, a quantum valebat or reasonable price. Such cases are to be contrasted with cases where such a benefit has not been requested by the defendant. In the latter class of case, recovery is rare in restitution; but if the sole basis of recovery was that the defendant had been incontrovertibly benefited, it might be legitimate to limit recovery to the defendant's actual benefit, a limit which has (perhaps inappropriately) been imported by the legislature into s. 1(3) of the Act. However, under s. 1(3) as it stands, if the defendant's actual benefit is less than the just or reasonable sum which would otherwise be awarded to the plaintiff, the award must be reduced to a sum equal to the amount of the defendant's benefit.

Questions

1. What is the effect of the Act on the decision in *Appleby* v *Myers*?
2. Why was no s. 1(3) claim made by the plaintiffs in *Gamerco* v *I.C.M.*, page 463, in respect of their expenditure in preparing to perform?

Notes

1. See Treitel, *Law of Contract*, 9th edn, pp. 825–28.
2. It is very difficult to predict what the court will decide the reasonable value of the plaintiff's performance to be.
3. Haycroft and Waksman [1984] JBL 207 criticised Robert Goff J's identification of the benefit as the end product of the services, which Goff J insisted was inevitable given the wording of the Act. They preferred the benefit to be identified as the value of the services themselves.
4. At what point in time should the benefit be identified? The difficulty caused by identifying the benefit as the end product of the services results from s. 1(3)(b), which requires the court to consider the effect of the frustration on the benefit received. If a fire destroys that end product, then

according to Goff J, there is no benefit to value and there can be no s. 1(3) award. Thus Goff J considers both s. 1(3)(a) and (b) when valuing the benefit to the party receiving it.

However, the Act itself requires s. 1(3)(b) to be considered when assessing the 'just sum' and not when valuing the benefit. The benefit should be valued on the basis of circumstances existing *immediately before* the frustrating event, but the specified factors are to be taken into account when the court fixes the figure of the 'just sum' to award.

5. The complexity in the section is caused by the need to assess two figures — the value of the benefit to the defendant and the just sum to award the plaintiff. Robert Goff J considered that the purpose underlying the Act was to prevent unjust enrichment of one party at the expense of the other. His view is that if the frustration destroys the benefit, there is no benefit and no unjust enrichment to be remedied.

However, Haycroft and Waksman believe the real purpose of the Act is to provide a mechanism for apportioning the loss caused by frustration between two innocent parties. See also support for this view in relation to s. 1(3) in McKendrick, 'Frustration, Restitution, and Loss Apportionment' in *Essays on the Law of Restitution*, ed. Burrows, OUP (1991). But compare Stewart and Carter [1992] CLJ 66, 109–110.

SECTION 3: THE RELATIONSHIP BETWEEN COMMON MISTAKE AND FRUSTRATION

Although common mistake relates to the formation of a contract and renders it void *ab initio*, and frustration relates to its discharge, the same issue is raised, namely the allocation of the risk between two parties of an event which they did not foresee.

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

In July 1973, the plaintiffs agreed to purchase some commercial property belonging to the defendants which had been advertised as suitable for redevelopment at a price of £1,710,000. The defendants were aware that the plaintiffs wished to redevelop the property. In the pre-contractual inquiries the plaintiffs specifically asked the defendants whether the property was designated as a building of special architectural or historic interest. On 14 August, the defendants replied that it was not but, unknown to both parties, the Department of the Environment had included the property in a list of buildings proposed to be designated as being of special architectural or historical interest. The parties signed the contract of sale on 25 September, and the next day the Department of the Environment informed the defendant that the property was to be listed. The listing in fact took place on 27 September and resulted in the property being worth

£1,500,000 less than the contract price. The plaintiffs sought to have the contract set aside on the basis of mistake, or alternatively argued that the listing had frustrated the contract. Held: this was not a case to which common mistake could apply since that mistake had to exist at the date of the contract. The property was not listed at the date of the contract (25 September). Rejecting the frustration argument, the Court of Appeal held, applying *Davis Contractors* v *Fareham UDC* (page 444), that performance of the contract following the listing was not radically different from the performance contemplated by the parties. The risk of a property becoming listed was an inherent risk which was to be borne by the purchaser. The plaintiffs had even asked about this possibility.

SIR JOHN PENNYCUICK: 1. *Mistake.* At the date of the contract, namely 25th September 1973, the property had not in fact been listed. The parties were therefore under no mistake in believing that the property was not subject to any existing fetter in this respect. Counsel for the plaintiffs accepts that, but contends that there was a common mistake, that mistake arising from the belief of the parties that the property was ripe for development, ie (as he puts it) suitable for and capable of development, whereas in truth it was not ripe for development because the listing of the property was then pending and would prevent development. It is certainly true that knowledge that the listing of the property was under consideration in the office concerned would vitally affect the minds of the parties negotiating the purchase of the property. The mere possibility that the property would be listed would certainly affect the mind of anybody contemplating a purchase of the property and considering what price he was prepared to pay. I think, however, that the mere possibility or probability, be it small or great, of some future event occurring is too uncertain to be taken into account in considering whether the belief of the parties as to ripeness for development should be treated as mistaken. The purchaser of property takes subject to the risk of future events, and it is for him to evaluate these risks in considering whether to buy and at what price. The possibility of listing is inherent in any building today and represents to my mind precisely such a risk. Of course, in this connection, as in many others, future events involve present intention in the minds of someone or other — here the officials of the department concerned — but I do not think it is legitimate to treat future events as present facts on this ground. I agree that this court is bound by the decision in *Solle* v *Butcher* [1950] 1 KB 671, and I will not pursue the very interesting discussion whether that decision is or is not consistent with the decision of the House of Lords in *Bell* v *Lever Brothers Ltd* [1932] AC 161.

2. *Frustration.* The contract dated 25th September 1973 is a contract for the sale and purchase of a specified property at a specified price. Certainly the purpose of the plaintiffs was to develop the property, and the plaintiffs would not have paid a fraction of the price which they contracted to pay if they had known that the property would not be available for development. Again certainly, the defendants knew the plaintiffs' purpose and knew that the price would have been much less if the plaintiffs had known that the property would not be available for development, even if the plaintiffs had been willing to purchase at all. But, on the other hand, it was not a term or condition of the contract that the property should continue to be available for development at the date of completion; nor, I think, can such a condition be implied into the contract. The subject-matter of the contract is simply a specified piece of land described in the contract and nothing more. Can it then be said that listing before completion frustrated the contract?

We were referred to *Davis Contractors Ltd* v *Fareham Urban District Council* [1956] AC 696 in the House of Lords, in particular to the speech of Lord Radcliffe [see extract from judgment at pages 445–6]. The listing struck down the value of the property as might a fire or a compulsory purchase order or a number of other events. It seems to me, however, that the listing did not in any respect prevent the contract from being carried to completion according to its terms; that is to say, by payment of the balance of the purchase price and by conveyance of the property. The property is nonetheless the same property by reason that listing imposed a fetter on its use. It seems to me impossible to bring the circumstances of the present case within the test enunciated by Lord Radcliffe. One cannot say that the circumstances in which performance, ie completion, will be called for would render that performance a thing radically different from that which was undertaken by the contract. On the contrary, completion, according to the terms of the contract, would be exactly what the purchaser promised to do, and of course the vendor.

Notes

1. The date of the listing determined the applicable rules. If it had been a common mistake as to quality, the contract could have been set aside in equity on terms (see *Solle* v *Butcher* (page 432). This may be more flexible than a finding that the contract is frustrated followed by statutory adjustment of the parties' positions.
2. Why did the listing not take place when the decision to list was made? In *Griffith* v *Brymer* (1903) 19 TLR 434 (page 452), the relevant time was taken to be the point when the decision to cancel the procession was made.

12 MISREPRESENTATION

A statement made during contractual negotiations may be a mere puff, a mere representation or a contractual term. The essence of a representation is that the maker asserts the truth of certain facts and this operates to induce the contract. A term, on the other hand, is essentially a *promise* so that there is an obligation to fulfil it. (See page 234 for a discussion of the distinction between representations and terms.)

Since a representor does not make a promise, the most appropriate remedy in misrepresentation is for the party induced to be put into the position he would have been in had he not been induced to contract. An actionable misrepresentation therefore renders the contract voidable, i.e. liable to be set aside (rescinded). Damages may also be available with the aim of restoring the parties to their original positions.

(This area of contract law tends to overlap with tort. Factual situations which give rise to a claim in misrepresentation may also give rise to a claim in tort for negligent misstatement.)

SECTION 1: ACTIONABLE MISREPRESENTATION

An actionable misrepresentation is an unambiguous false statement of fact which induces the other party to enter into the contract.

A: UNAMBIGUOUS FALSE STATEMENT OF FACT

(a) Unambiguous

McInerny* v *Lloyds Bank Ltd
[1974] 1 Lloyd's Rep 246 (CA)

The plaintiff wished to sell some companies to Mackay and wanted payment to be guaranteed by the defendant bank. Mackay asked the bank

to give the guarantee and instructed the bank's reply to be sent to the plaintiff. The bank replied that it was not permissible under banking regulations to give the guarantee and that the only available method was to establish an irrevocable credit. The plaintiff subsequently signed a contract with Mackay, who honoured only the first two payments of the purchase price. The plaintiff claimed damages for negligent misrepresentation in respect of the bank's reply which, he argued, amounted to an assurance to make the payments. Held: the bank was not responsible for the interpretation that the plaintiff put on the reply because, on a reasonable construction, the bank had given none of the assurances requested.

(b) Statement

The courts have often interpreted 'statement' to include conduct.

Gordon* v *Sellico
(1986) 278 EG 53 (CA)

The estate agents of a flat, on behalf of the owners, instructed an independent contractor to do work to the flat 'to bring it up to a very good standard for the purpose of selling'. The contractor deliberately covered up patches of dry rot without attempting to eradicate it. The plaintiffs saw the flat with a view to purchasing it, and contracts were later exchanged incorporating a standard form clause providing 'the purchaser shall buy with full notice of the actual state and condition of the property and shall take it as it stands'. Held: the Court of Appeal agreed with Goulding J at first instance that this concealment amounted to a misrepresentation to the plaintiffs that the flat did not suffer from dry rot.

GOULDING J: . . . The law must be careful not to run ahead of popular morality by stigmatising as fraudulent every trivial act designed to make buildings or goods more readily saleable, even if a highly scrupulous person might consider it dishonest. But it is to my mind quite a different matter for an intending vendor to hide so sinister and menacing a defect as active dry rot. The case is fairly comparable, in my view, with the concealment of cracks indicating the settlement of foundations, considered in *Ridge* v *Crawley* (1958) 172 Estates Gazette 637 and, in the Court of Appeal (1959) 173 Estates Gazette 959. There the plaintiff relied on a combination of words and conduct, but I believe it to be the law that conduct alone can constitute a fraudulent misrepresentation. (See *Horsfall* v *Thomas* (1862) 1 H&C 90 and *Smith* v *Hughes* (1871) LR 6 QB 597.) In my judgment the concealment of dry rot by Mr Azzam was a knowingly false representation that Flat C did not suffer from dry rot, which was intended to deceive purchasers, and did deceive the plaintiffs to their detriment. I am satisfied that the plaintiffs would not have entered into a contract or accepted the lease had they known there was dry rot inside Flat C. . . .

Question

I wish to sell my house. I put up wood panelling in the dining room, partly because the room needs decorating and partly to hide serious cracks in a wall. You buy my house and subsequently discover that the wall is defective. Would you have a remedy in misrepresentation in these circumstances?

Notes

1. It had been argued that the plaintiffs had inspected the flat and that this meant that they were precluded by *Horsfall* v *Thomas* (1862) 1 H & C 90 from complaining of misrepresentation. However, in *Horsfall* v *Thomas*, the defect in the gun was discoverable on inspection but no inspection had taken place, so that the plaintiff could not argue that he had relied upon the misrepresentation. Here the defect was deliberately concealed and was not discovered on routine inspection. It was intended to deceive and did deceive, so there was no question of the plaintiff not having relied upon the misrepresentation.

2. *Caveat emptor* (let the buyer beware) does not apply in cases of fraudulent misrepresentation, and the standard form clause could also not apply.

Is there a duty of disclosure? Does silence amount to misrepresentation?

Keates v *The Earl of Cadogan*
(1851) 10 CB 591; 138 ER 234 (Common Pleas)

The defendant let a house to the plaintiff knowing that the plaintiff wanted it for immediate occupation but did not tell the plaintiff that the house was in fact uninhabitable. Held: in the absence of fraud, the defendant was under no implied duty to disclose the state of the house.

JERVIS CJ: . . . It is not pretended that there was any warranty, express 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: it was a mere ordinary transaction of letting and hiring. . . .

Notes

1. This case is based on the principle of *caveat emptor*. Contracting parties should not be expected to share every piece of information with one another where they deal at 'arm's length'.

2. The main difficulty with accepting a duty of disclosure is to define that duty and when it will arise.

There are a number of recognised exceptions to the general rule in *Keates* v *Cadogan*. The following case concerned misleading statements.

Dimmock v *Hallett*
(1866) LR 2 Ch App 21 (CA)

Land for sale was described as 'let to Hickson at £130 p.a.' and another farm was described as 'let to Wigglesworth at £160 p.a.'. Both tenants were yearly Lady Day tenants. No reference was made to the fact that they had

both given notice to quit which would expire on Lady Day, although there were statements that some of the other tenants had given notice to quit. Held: it was a fair inference that these tenants had not given notice to quit so that the statement that the farms were let was misleading and amounted to a misrepresentation.

What is the position regarding statements which are true when made but which become false before the contract is made?

With v *O'Flanagan*
[1936] Ch 575 (CA)

In January 1934, negotiations were entered into for the sale of a medical practice which the vendor represented as having an income of £2,000 per annum. However, by the time the contract was signed in May, the practice had declined due to the vendor's illness, but this was not disclosed. The purchasers sought rescission. Held: the representation was made to induce purchasers to enter into the contract and had to be treated as continuing until the contract was signed. Once it became false, to the knowledge of the representor, there was a misrepresentation if he failed to correct it.

ROMER LJ: . . . If A with a view to inducing B to enter into a contract makes a representation as to a material fact, then if at a later date and before the contract is actually entered into, owing to a change of circumstances, the representation then made would to the knowledge of A be untrue and B subsequently enters into the contract in ignorance of that change of circumstances and relying upon that representation, A cannot hold B to the bargain. There is ample authority for that statement and, indeed, I doubt myself whether any authority is necessary, it being, it seems to me, so obviously consistent with the plainest principles of equity.

Notes

1. The misrepresentation occurs when the change of circumstances is not disclosed.

2. It is highly unlikely that such a misrepresentation would be held to be fraudulent, since it is notoriously difficult to prove fraud. As Lord Wright MR stated in *With* v *O'Flanagan* (at p. 584):

> . . . nowadays the Court is more reluctant to use the word 'fraud' and would not generally use the word 'fraud' in that connection because the failure to disclose, though wrong and a breach of duty, may be due to inadvertence or a failure to realize that the duty rests upon the party who has made the representation not to leave the other party under an error when the representation has become falsified by a change of circumstances. . . .

In *Thomas Witter Ltd* v *TBP Industries Ltd* [1996] 2 All ER 573 (noted Beale (1995) 111 LQR 385), page 490, Jacob J held that a company selling a business had not been fraudulent in failing to disclose a change in accounting method affecting the profit estimates since there was no evidence of dishonesty on the part of the officers concerned. (See the definition of fraudulent misrepresentation at page 489.)

3. This principle does not apply to statements of intention. If the contracting party changes his declared intention before the conclusion of the contract, there is no obligation to communicate that change of intention.

Wales v *Wadham*
[1977] 1 WLR 199

In February 1973, during divorce negotiations, the husband promised to pay the wife £13,000 to finally settle the wife's claim for financial provision. The wife remarried shortly after the divorce decree was made absolute in September 1973 so that, but for the agreement, the ex-husband would have been under no obligation to make financial provision for her. The ex-husband claimed that the agreement should be rescinded for fraudulent misrepresentation, in that the ex-wife had stated on numerous occasions that she would not remarry. Held: the wife had made an honest representation of her intention, which was not a statement of fact or an intention which she did not actually hold at the time. As a result she was under no duty to inform her husband that she had changed her mind.

TUDOR EVANS J: . . . It is submitted that even if the wife's statement that she would never remarry was honestly held, she was under a duty to tell the husband of her changed circumstances, but that she failed to do so. Counsel has referred me to *With* v. *O'Flanagan* [1936] Ch 575, in the Court of Appeal. . . . Lord Wright MR, at p. 582, quoted, with approval, observations of Fry J in *Davies* v *London & Provincial Marine Insurance Co.* (1878) 8 ChD 469, 475, where he said:

> So, again, if a statement has been made which is true at the time, but which during the course of negotiations becomes untrue, then the person who knows that it has become untrue is under an obligation to disclose to the other the changed circumstances.

The representations in both of these cases related to existing fact and not to a statement of intention in relation to future conduct. A statement of intention is not a representation of existing fact, unless the person making it does not honestly hold the intention he is expressing, in which case there is a misrepresentation of fact in relation to the state of that person's mind. That does not arise on the facts as I have found them. On the facts of this case, the wife made an honest statement of her intention which was not a representation of fact, and I can find no basis for holding that she was under a duty in the law of contract to tell the husband of her change of mind.

Note
See page 481 on the distinction between a statement of fact and a statement of intention.

(c) Of fact

(i) *Statements of belief or opinion* If the maker of the statement is in no better a position to know the truth of the statement than the recipient of it, and the recipient is aware of this, then the maker's statement is likely to be

construed as a statement of opinion and, if false, will not amount to an actionable misrepresentation.

Bisset v *Wilkinson*
[1927] AC 177 (PC)

The owner of a farm told a prospective purchaser that he believed it would support 2,000 sheep. Held: on the evidence the statement was merely a statement of opinion which the vendor honestly held. The evidence was that the owner was not in any better position than the purchaser to know the farm's true capacity since the land had not been used as a sheep farm before. The purchaser was aware that the vendor could do no more than state his belief.

LORD MERRIVALE: . . . [I]t is . . . essential to ascertain whether that which is relied upon is a representation of a specific fact, or a statement of opinion, since an erroneous opinion stated by the party affirming the contract, though it may have been relied upon and have induced the contract on the part of the party who seeks rescission, gives no title to relief unless fraud is established. The application of this rule, however, is not always easy, as is illustrated in a good many reported cases, as well as in this. A representation of fact may be inherent in a statement of opinion and, at any rate, the existence of the opinion in the person stating it is a question of fact.

In ascertaining what meaning was conveyed to the minds of the now respondents by the appellant's statement as to the two thousand sheep, the most material fact to be remembered is that, as both parties were aware, the appellant had not and, so far as appears, no other person had at any time carried on sheep-farming upon the unit of land in question. That land as a distinct holding had never constituted a sheep-farm. . . . In these circumstances . . . the defendants were not justified in regarding anything said by the plaintiff as to the carrying capacity as being anything more than an expression of his opinion on the subject. . . .

Note

If, however, the statement maker is in a better position to know the facts, then his statement contains an implied assertion that he knows of facts which justify his opinion.

Smith v *Land and House Property Corporation*
(1884) 28 ChD 7 (CA)

The plaintiffs advertised a hotel for sale, stating in the particulars that it was let to 'Mr Frederick Fleck (a most desirable tenant)'. In fact Fleck was in arrears with his rent at the time and distress had been threatened. The defendant agreed to purchase the hotel but then refused to complete. The plaintiffs sued for specific performance. Held: this description was not a mere expression of opinion but contained an implied assertion that the vendors knew of no facts leading to the conclusion that Fleck was not a most desirable tenant.

BOWEN LJ: . . . It is material to observe that it is often fallaciously assumed that a statement of opinion cannot involve the statement of a fact. In a case where the facts

are equally well known to both parties, what one of them says to the other is frequently nothing but an expression of opinion. The statement of such opinion is in a sense a statement of a fact, about the condition of the man's own mind, but only of an irrelevant fact, for it is of no consequence what the opinion is. But if the facts are not equally known to both sides, then a statement of opinion by the one who knows the facts best involves very often a statement of a material fact, for he impliedly states that he knows facts which justify his opinion. Now a landlord knows the relations between himself and his tenant, other persons either do not know them at all or do not know them equally well, and if the landlord says that he considers that the relations between himself and his tenant are satisfactory, he really avers that the facts peculiarly within his knowledge are such as to render that opinion reasonable. Now are the statements here statements which involve such a representation of material facts? They are statements on a subject as to which *prima facie* the vendors know everything and the purchasers nothing. The vendors state that the property is let to a most desirable tenant, what does that mean? I agree that it is not a guarantee that the tenant will go on paying his rent, but it is to my mind a guarantee of a different sort, and amounts at least to an assertion that nothing has occurred in the relations between the landlords and the tenant which can be considered to make the tenant an unsatisfactory one. That is an assertion of a specific fact. Was it a true assertion? ... I think that it was not. ... Now could it . . . be said that nothing had occurred to make Fleck an undesirable tenant? In my opinion a tenant who had paid his last quarter's rent by driblets under pressure must be regarded as an undesirable tenant.

Notes

1. This principle was further extended in *Esso Petroleum Co. Ltd* v *Mardon* [1976] QB 801 (CA) (for full facts see page 242). The Court of Appeal stated that where a forecast is made by a person with greater skill and expertise in relation to the subject matter, that person is impliedly stating that reasonable care and skill has been used in preparing the forecast. Lord Denning MR said (at p. 818):

. . . it was a forecast made by a party — Esso — who had special knowledge and skill. It was the yardstick . . . by which they measured the worth of a filling station. They knew the facts. They knew the traffic in the town. They knew the through-put of comparable stations. They had much experience and expertise at their disposal. They were in a much better position than Mr Mardon to make a forecast. It seems to me that if such a person makes a forecast, intending that the other should act upon it — and he does act upon it, it can well be interpreted as a warranty that the forecast is sound and reliable in the sense that they made it with reasonable care and skill. It is just as if Esso said to Mr Mardon: 'Our forecast of throughput is 200,000 gallons. You can rely upon it as being a sound forecast of what the service station should do. The rent is calculated on that footing.' If the forecast turned out to be an unsound forecast such as no person of skill or experience should have made, there is a breach of warranty. . . . It is very different from the New Zealand case where the land had never been used as a sheep farm and both parties were equally able to form an opinion as to its carrying capacity: see particularly *Bisset* v *Wilkinson* [1927] AC 177, 183–184.

The decision was based alternatively on liability for negligent misstatement and breach of collateral warranty.

2. According to Adams and Brownsword, *Understanding Contract Law*, the overall effect of *Esso* v *Mardon* is that people with 'special informational advantages' are held to their representations. It is interesting to compare this with the general discussion of the duty of disclosure and *Keates* v *Cadogan*. It appears that a person with special information cannot be compelled, as a general rule, to disclose that information, but if he does disclose it he will be responsible for that disclosure.

3. If the maker of the statement has no special skill or knowledge relating to the statement, his statements of opinion will not amount to misrepresentations even if his belief is unreasonable (*Hummingbird Motors Ltd* v *Hobbs* [1986] RTR 276).

(ii) *Statements as to future conduct and intention*

Edgington* v *Fitzmaurice
(1885) 29 ChD 459 (CA)

The directors of a company issued a prospectus inviting subscriptions for debentures, and stating that money raised would be used to complete alterations in the buildings of the company, to purchase horses and vans, and to develop the trade of the company. The real object of the loan was to enable the directors to pay off pressing liabilities. The plaintiff advanced money on some of the debentures under the mistaken belief that the prospectus offered a charge upon the property of the company, and stated in his evidence that he would not have advanced his money but for such belief, but that he also relied upon the statements contained in the prospectus. Held: the misstatement of object amounted to a misstatement of fact and was a material misrepresentation.

BOWEN LJ: . . . There must be a misstatement of an existing fact: but 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. . . .

Note
The difficulty resulting from *Edgington* v *Fitzmaurice* is an evidential one, namely to prove what the maker's true intention was at the time of making the statement.

B: INDUCES THE CONTRACT

(a) Materiality

In *Pan Atlantic Co. Ltd* v *Pine Top Insurance Co. Ltd* [1994] 3 All ER 581, the House of Lords was unanimous in considering that in a misrepresentation action it was necessary to establish both that the statement was material and that it actually induced the contract. Their Lordships differed on the test of

materiality. Lord Mustill (with whose reasoning Lords Goff and Slynn agreed; Lord Templeman and Lord Lloyd dissenting on this issue) stated that the test for materiality is whether the representation relates to a matter which would have influenced the reasonable man. This is an objective test, whereas a test of actual inducement is subjective. (It had previously been generally considered that materiality was relevant only in non-disclosure cases, and that the only test in a misrepresentation case was whether the misrepresentation induced the contract. For example, in *Museprime Properties Ltd* v *Adhill Properties Ltd* (1990) 36 EG 114, it had been held that if the statement had actually induced the contract there was no need to establish that it would have influenced a reasonable man to contract, or to contract on those terms.)

Pan Atlantic was confirmed by the Court of Appeal in *St Paul Fire and Marine Insurance Co. (UK) Ltd* v *McConnell Dowell Constructors Ltd* [1996] 1 All ER 96. Evans LJ (at p. 112) appears to accept that in some cases where materiality is easily established, inducement can be inferred (subject to evidence to the contrary).

(b) Inducement

Redgrave* v *Hurd
(1881) 20 ChD 1 (CA)

The plaintiff, a solicitor who was shortly to retire, placed an advertisement offering to take a partner in the practice who would not object to purchasing the plaintiff's suburban residence. The defendant replied to the advertisement and was told by the plaintiff that the practice brought in about £300 a year. The plaintiff had shown the defendant summaries for three years, showing a business of just less than £200 a year and stated that the rest of the income was made up of business not included in the summaries which was detailed in a bundle of papers shown to the defendant. The defendant did not examine these papers, which in fact showed that there was next to no additional business so that income from the business was only £200 a year. The defendant signed an agreement to purchase the house for £1,600 and paid a deposit of £100. The defendant discovered the true facts about the business and refused to complete. The plaintiff brought an action for specific performance, and the defendant counterclaimed for rescission of the contract and damages alleging misrepresentation as to the business. Held: if a material misrepresentation is made to a party, then he must be taken to have relied on it in entering into the contract, unless it can be shown that the representee knew of the facts showing the representation to be untrue or that he either expressly stated or showed by his conduct that he did not rely on the representation. The defendant was therefore entitled to have the contract rescinded and his deposit returned. (However, he was not entitled to damages because at the time of this case damages were available only where the misrepresentation was fraudulent, and fraud had not been pleaded by the defendant in his counterclaim.)

JESSEL MR: . . . If a man is induced to enter into a contract by a false representation it is not a sufficient answer to him to say, 'If you had used due diligence you would have found out that the statement was untrue. You had the means afforded you of discovering its falsity, and did not choose to avail yourself of them.' I take it to be a settled doctrine of equity, not only as regards specific performance but also as regards rescission, that this is not an answer.

. . . Nothing can be plainer, I take it, on the authorities in equity than that the effect of false representation is not got rid of on the ground that the person to whom it was made has been guilty of negligence. One of the most familiar instances in modern times is where men issue a prospectus in which they make false statements of the contracts made before the formation of a company, and then say that the contracts themselves may be inspected at the offices of the solicitors. It has always been held that those who accepted those false statements as true were not deprived of their remedy merely because they neglected to go and look at the contracts. Another instance with which we are familiar is where a vendor makes a false statement as to the contents of a lease, as, for instance, that it contains no covenant preventing the carrying on of the trade which the purchaser is known by the vendor to be desirous of carrying on upon the property. Although the lease itself might be produced at the sale, or might have been open to the inspection of the purchaser long previously to the sale, it has been repeatedly held that the vendor cannot be allowed to say, 'You were not entitled to give credit to my statement.' It is not sufficient, therefore, to say that the purchaser had the opportunity of investigating the real state of the case, but did not avail himself of that opportunity. . . .

Notes

1. Although the normal inference is that the buyer will check all information, this was displaced in *Redgrave* v *Hurd* by the desire to make the representor responsible for his statements and prevent him shifting that responsibility to the buyer.

2. It might be argued that the buyer is negligent in failing to make inquiries where the opportunity is available to him, and his damages should consequently be reduced for contributory negligence.

The argument of apportionment is, however, incompatible with the tone of the judgment of Jessel MR in *Redgrave* v *Hurd* that the buyer has no obligation to investigate. (Although see the discussion of contributory negligence, pages 511–13.)

3. It is clear from *Horsfall* v *Thomas* (1862) 1 H & C 90, that a representation cannot induce a contract unless the representee knew of it. In that case, the defect might have been discovered by the buyer if he had inspected the gun but he did not, and the representation could not therefore have induced the contract.

Attwood v *Small*

(1838) 6 Cl & F 232; [1835-42] All ER Rep 258 (HL)

The vendor made statements about the earning capacity of mines he was selling. The prospective buyers arranged for their co-directors and experienced agents to examine the property and accounts. They reported

(incorrectly) that the vendor's statements were true. The buyers purchased the mine but later claimed to rescind, alleging fraudulent misrepresentation by the vendor. Held: first, that there was no fraud and, secondly, the buyers had not relied on the vendor's statements because they had tested their accuracy and relied on the results of their own investigations.

Notes

1. *Attwood* v *Small* is often cited as authority for the fact that if the representee carries out his own investigations, then he does not rely on the representation. However, it was stated *obiter* in *S. Pearson & Son Ltd* v *Dublin Corporation* [1907] AC 351, that even if a representee carries out his own investigations, the representor will be liable for misrepresentation if the misrepresentation is made fraudulently.

2. In addition, for *Attwood* v *Small* to preclude action based on a representation, the plaintiff must have relied *only* on the results of his investigations and not at all on the representation itself, since a representation need not be the only reason inducing a contract as long as it is one of the reasons (*Edgington* v *Fitzmaurice* (1885) 29 ChD 459, page 481). .

SECTION 2: THE REMEDY OF RESCISSION

As misrepresentation renders the contract voidable at the option of the misrepresentee, the main remedy will be rescission, which *in principle* is available for fraudulent, negligent and innocent misrepresentation, and which involves the return from each party of anything which has passed under the contract.

In *TSB Bank plc* v *Camfield* [1995] 1 All ER 951, page 568, the Court of Appeal rejected a claim for partial rescission and held that a charge had to be set aside in its entirety.

A: LIMITS TO THE RIGHT TO RESCIND

Rescission is an equitable remedy and is subject to a number of bars preventing its exercise.

(a) Affirmation

Long v *Lloyd*
[1958] 1 WLR 753 (CA)

The defendant advertised a lorry for sale in a newspaper and described it as being in 'exceptional condition'. The plaintiff saw the vehicle at the defendant's premises and the defendant stated that it was capable of a speed of 40 miles per hour. On 22 October, the plaintiff, accompanied by the defendant, took the lorry for a trial run and the defendant represented that the lorry's fuel consumption was 11 miles to the gallon. The plaintiff then bought the lorry for £750. Two days later, on 24 October, the plaintiff

attempted a journey in the lorry but the dynamo ceased to function and the plaintiff was advised to fit a reconstructed dynamo. He also noticed that an oil seal was defective, there was a crack in one of the wheels and the vehicle had consumed eight gallons of fuel when it had travelled only 40 miles. When the defendant was advised of these defects he offered to pay half the cost of the reconstructed dynamo and the plaintiff accepted this offer. The repair having taken place, on 25 October the plaintiff's brother took the vehicle on a journey, and on 26 October the plaintiff learnt that the lorry had broken down on this journey. The plaintiff brought an action for rescission of the contract on the ground of non-fraudulent misrepresentation. (Note there was no right to damages for such a misrepresentation at this time). Held: certainly by the time that the plaintiff sent the lorry on a journey on 25 October he had affirmed the misrepresentations and accepted the lorry in full knowledge of the condition and performance of the vehicle. (Thus the plaintiff was left with no remedy at all.)

PEARCE LJ: . . . [A] strict application to the facts of the present case of Denning LJ's view to the effect that the right (if any) to rescind after completion on the ground of innocent misrepresentation is barred by acceptance of the goods must necessarily prove fatal to the plaintiff's case. Apart from special circumstances, the place of delivery is the proper place for examination and for acceptance. It was open to the plaintiff to have the lorry examined by an expert before driving it away, but he chose not to do so. It is true, however, that the truth of certain of the representations, for example, that the lorry would do 11 miles to the gallon — could not be ascertained except by user and, therefore — the plaintiff should have a reasonable time to test it. Until he had had such an opportunity it might well be said that he had not accepted the lorry, always assuming, of course that he did nothing inconsistent with the ownership of the seller. An examination of the facts, however, shows that on any view he must have accepted the lorry before he purported to reject it.

Thus, to recapitulate the facts, after the trial run the plaintiff drove the lorry home from Hampton Court to Sevenoaks, a not inconsiderable distance. After that experience he took it into use in his business by driving it on the following day to Rochester and back to Sevenoaks with a load. By the time he returned from Rochester he knew that the dynamo was not charging, that there was an oil seal leaking, that he had used 8 gallons of fuel for a journey of 40 miles, and that a wheel was cracked. He must also, as we think, have known by this time that the vehicle was not capable of 40 miles per hour. As to oil consumption, we should have thought that, if it was so excessive that the sump was practically dry after 300 miles, the plaintiff could have reasonably been expected to discover that the rate of consumption was unduly high by the time he had made the journey from Hampton Court to Sevenoaks and thence to Rochester and back.

On his return from Rochester the plaintiff telephoned to the defendant and complained about the dynamo, the excessive fuel consumption, the leaking oil seal and the cracked wheel. The defendant then offered to pay half the cost of the reconstructed dynamo which the plaintiff had been advised to fit, and the plaintiff accepted the defendant's offer. We find this difficult to reconcile with the continuance of any right of rescission which the plaintiff might have had down to that time.

But the matter does not rest there. On the following day the plaintiff, knowing all that he did about the condition and performance of the lorry, dispatched it, driven by

his brother, on a business trip to Middlesbrough. That step, at all events, appears to us to have amounted, in all the circumstances of the case, to a final acceptance of the lorry by the plaintiff for better or for worse, and to have conclusively extinguished any right of rescission remaining to the plaintiff after completion of the sale.

Note

Pearce LJ also suggested that rescission might well have been lost much earlier. He appears to have relied upon Denning LJ's comments in *Leaf* v *International Galleries*, seeking to equate this area of law with the rules in the Sale of Goods Act 1979 on the right to reject for breach of condition (see below). At this time there was also no available remedy in damages for such a misrepresentation, although damages were clearly available for breach of contract even where the right to reject had been lost.

(b) Lapse of time

Leaf* v *International Galleries
[1950] 2 KB 86 (CA)

In 1944, the defendants sold the plaintiff a picture which they represented to have been painted by Constable. In 1949, the plaintiff tried to sell it and discovered it was not by Constable. He sought rescission and repayment of the purchase price. Held: this remedy had been lost because it had not been exercised within a reasonable time.

DENNING LJ: . . . The question is whether the plaintiff is entitled to rescind the contract on the ground that the picture in question was not painted by Constable. I emphasize that it is a claim to rescind only: there is no claim in this action for damages for breach of condition or breach of warranty. The claim is simply one for rescission. At a very late stage before the county court judge counsel did ask for leave to amend by claiming damages for breach of warranty, but it was not allowed. No claim for damages is before us at all. The only question is whether the plaintiff is entitled to rescind.

The way in which the case is put by [counsel], on behalf of the plaintiff, is this: he says that this was an innocent misrepresentation and that in equity he is, or should be, entitled to claim rescission even of an executed contract of sale on that account. He points out that the judge has found that it is quite possible to restore the parties to their original position. It can be done by simply handing back the picture to the defendants.

In my opinion, this case is to be decided according to the well known principles applicable to the sale of goods. This was a contract for the sale of goods. There was a mistake about the quality of the subject-matter, because both parties believed the picture to be a Constable; and that mistake was in one sense essential or fundamental. But such a mistake does not avoid the contract: there was no mistake at all about the subject-matter of the sale. It was a specific picture, 'Salisbury Cathedral.' The parties were agreed in the same terms on the same subject-matter, and that is sufficient to make a contract: see *Solle* v *Butcher* [1950] 1 KB 671.

There was a term in the contract as to the quality of the subject-matter: namely, as to the person by whom the picture was painted — that it was by Constable. That term of the contract was, according to our terminology, either a condition or a warranty. If it was a condition, the buyer could reject the picture for breach of the condition at any time before he accepted it, or is deemed to have accepted it; whereas, if it was only a warranty, he could not reject it at all but was confined to a claim for damages.

I think it right to assume in the buyer's favour that this term was a condition, and that, if he had come in proper time he could have rejected the picture; but the right to reject for breach of condition has always been limited by the rule that, once the buyer has accepted, or is deemed to have accepted, the goods in performance of the contract, then he cannot thereafter reject, but is relegated to his claim for damages: see s. 11, sub-s. 1 (c), of the Sale of Goods Act, 1893, and *Wallis, Son & Wells* v *Pratt & Haynes* [1911] AC 394.

The circumstances in which a buyer is deemed to have accepted goods in performance of the contract are set out in s. 35 of the Act, which says that the buyer is deemed to have accepted the goods, amongst other things, 'when, after the lapse of a reasonable time, he retains the goods without intimating to the seller that he has rejected them.' In this case the buyer took the picture into his house and, apparently, hung it there, and five years passed before he intimated any rejection at all. That, I need hardly say, is much more than a reasonable time. It is far too late for him at the end of five years to reject this picture for breach of any condition. His remedy after that length of time is for damages only, a claim which he has not brought before the court.

Is it to be said that the buyer is in any better position by relying on the representation, not as a condition, but as an innocent misrepresentation? I agree that on a contract for the sale of goods an innocent material misrepresentation may, in a proper case, be a ground for rescission even after the contract has been executed. . . .

Although rescission may in some cases be a proper remedy, it is to be remembered that an innocent misrepresentation is much less potent than a breach of condition; and a claim to rescission for innocent misrepresentation must at any rate be barred when a right to reject for breach of condition is barred. A condition is a term of the contract of a most material character, and if a claim to reject on that account is barred, it seems to me a fortiori that a claim to rescission on the ground of innocent misrepresentation is also barred.

So, assuming that a contract for the sale of goods may be rescinded in a proper case for innocent misrepresentation, the claim is barred in this case for the self-same reason as a right to reject is barred. The buyer has accepted the picture. He had ample opportunity for examination in the first few days after he had bought it. Then was the time to see if the condition or representation was fulfilled. Yet he has kept it all this time. Five years have elapsed without any notice of rejection. In my judgment he cannot now claim to rescind. His only claim, if any, as the county court judge said, was one for damages, which he has not made in this action. . . .

Notes

1. The damages claim to which Denning LJ was referring was that for breach of contract. Nowadays there is a right to *claim* damages in misrepresentation, but only if the misrepresentation was at least negligent.

2. Since *Leaf* v *International Galleries* was a case of non-fraudulent misrepresentation, time ran from the date of the contract. One of the advantages in alleging fraudulent misrepresentation is that time runs from the date when the fraud was, or could with reasonable diligence have been, discovered.

(c) Restitution is impossible

Clarke v *Dickson*
(1858) EB & E 148; 120 ER 463 (Queen's Bench)

In 1853, the plaintiff purchased shares in a mining company as a result of representations made by the defendants who were directors of this company. The company was later wound up. The plaintiff then discovered that the representations made to him had been fraudulent. He wanted to give up the shares and recover the purchase price. Held: he could not.

ERLE J: . . . The plaintiff claims to repudiate the contract under which shares were allotted to him, to give up the shares, and recover back the price. There are several grounds of objection, all falling under the same principle: the plaintiff cannot avoid the contract under which he took the shares, because he cannot restore them in the same state as when he took them. In 1853 the plaintiff accepted the shares; and from that time he was, in point of law, in possession of the mine, and worked it by his agent the purser. After three years working of the mine, and trying to make a profit, he cannot restore the shares as they were before this was done. But, further, he not only had the chance of profit, but dividends were declared, and received by him. They were not received in money, it is true; but the receipt of money's worth has the same effect in law. Then he has also changed the nature of the article: the shares he received were shares in a company on the cost book principle; the plaintiff offers to restore them after he has converted them into shares in a joint stock corporation. Lastly, the offer to restore these shares is not made till after the Company is in the course of being wound up, when all chance of profit is over, and the shares can only be a source of loss. . . .

In *Thomas Witter* v *TBP Industries Ltd* [1996] 2 All ER 573 (for facts see page 490) Jacob J held that rescission was not available:

[Counsel for the plaintiff] tied is claim to rescission to the claim in fraud. I never was quite sure why, since rescission is available also for innocent misrepresentation. Even if I had found fraud, however, I would not have granted rescission. This remedy is not available where it is not possible to restore the parties to their position before the contract. Although Melton Medes kept the Witter business separate, it is unrealistic to regard it as the same as the business conveyed. There have been numerous changes to staff and personnel (including the departure of Mr Francis who had exceptional sales skills). Those personnel who have stayed have been in different pension schemes, there are mortgagees of the business and so on. Time has moved on and third parties would, I think, be affected.

[Counsel's] actual submission was that it was not shown that third parties would be affected. So he was suggesting that the onus was on the defendants to avoid rescission by showing innocent third parties would be affected. I cannot think that is right. The Thomas Witter business has been in the hands of Melton Medes for four years. It is they who would know who or what might be affected by a transfer back to Tarmac.

(d) Where a bona fide third-party purchaser has acquired the goods before rescission

See the discussion of mistake as to identity, at page 83.

(e) Where the court exercises its discretion under s. 2(2) to award damages instead of rescission
See page 513.

SECTION 3: TYPES OF MISREPRESENTATION AND DAMAGES

The nature of the damages for misrepresentation are dependent on the type of misrepresentation, but it is no longer the case that damages can only be claimed for fraudulent misrepresentations. Note: Rescission alone may have the effect of restoring the parties to their original positions, but may not do so where, for example, the representee has incurred consequential expenses. In such cases, damages may be available *in addition* to rescission for fraudulent and negligent misrepresentations.

Where rescission is not available the only remedy will be damages for misrepresentation.

A: FRAUDULENT MISREPRESENTATION: THE TORT OF DECEIT

Derry* v *Peek
(1889) 14 App Cas 337 (HL)

An Act incorporating a tram company provided that the carriages might be moved by steam power with the consent of the Board of Trade. The directors of the company issued a prospectus containing a statement that by the Act the company had the right to use steam power. The plaintiff bought shares relying on this statement, but the Board of Trade refused to approve the use of steam power by the company and it was later wound up. The plaintiff brought an action against the directors in deceit based upon the false statement. Held: the directors were not liable since the statement in the prospectus had been made by them in the honest belief that it was true.

LORD HERSCHELL: . . . I think the authorities establish the following propositions: 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. To prevent a false statement being fraudulent, there must, I think, always be an honest belief in its truth. And this probably covers the whole ground, for one who knowingly alleges that which is false, has obviously no such honest belief. Thirdly, if fraud be proved, the motive of the person guilty of it is immaterial. It matters not that there was no intention to cheat or injure the person to whom the statement was made.

Thomas Witter Ltd v *TBP Industries Ltd*
[1996] 2 All ER 573

The defendants owned a carpet manufacturing business which the plaintiff wished to purchase. During the negotiations the defendants provided the plaintiff with audited accounts and management accounts for 1988 and estimated profit figures for 1989. They also allowed the plaintiff to see the October 1989 management accounts, which included a special one-off expense of £120,000 in respect of problems with carpets supplied to one customer. However, the defendants did not indicate that these accounts were prepared on a different basis to the audited accounts and contained deferred pattern book expenditure. The parties concluded the contract for the sale of the business.

Within six months the plaintiff claimed that it had been induced by representations made in the accounts, namely (i) the statement that they included the special one-off expense of £120,000 (thereby implying that general profits would otherwise be higher) when the actual amount of this expense would be no more than £50,000, and (ii) by not disclosing the change in accounting basis, i.e. that the accounts included deferred pattern book expenditure. The allegation was that these representations had been made recklessly (and so were fraudulent). Alternatively it was alleged that they were negligent. Held: these misrepresentations were not made fraudulently. Recklessness for the purposes of fraudulent misrepresentation required the statements to have been made dishonestly. Although there was no evidence of dishonesty since there was a belief that these statements were true, the misrepresentations were made negligently.

JACOB J: . . .

The legal test for fraudulent misrepresentation

First then deceit. [Counsel for the plaintiff] relied upon part of the classic speech of Lord Herschell in *Derry* v *Peek* (1889) 14 App Cas 337 at 375–376, [1886–90] All ER Rep 1 at 22–23:

> The ground upon which an alleged belief was founded is a most important test of its reality. I can conceive many cases where the fact that an alleged belief was destitute of all reasonable foundation would suffice of itself to convince the Court that it was not really entertained, and that the representation was a fraudulent one. So, too . . . if I thought that a person making a false statement had shut his eyes to the facts, or purposely abstained from inquiring into them, I should hold that honest belief was absent, and that he was just as fraudulent as if he had knowingly stated that which was false.

He further submitted that where a person has made a representation of fact and, before the contract is concluded, comes to learn of its falseness, that person comes under a duty to correct the representation and, if he fails to do so, then is taken to be fraudulent. [Counsel] relied upon the speech of Lord Blackburn in *Brownlie* v *Campbell* (1880) 5 App Cas 925 at 950:

> I quite agree in this, that whenever a man in order to induce a contract says that which is in his knowledge untrue with the intention to mislead the other side, and

induce them to enter into the contract, that is downright fraud; in plain English, and Scotch also, it is a downright lie told to induce the other party to act upon it, and it should of course be treated as such. I further agree in this: that when a statement or representation has been made in the *bona fide* belief that it is true, and the party who has made it afterwards comes to find out that it is untrue, and discovers what he should have said, he can no longer honestly keep up that silence on the subject after that has come to his knowledge, thereby allowing the other party to go on, and still more, inducing him to go on, upon a statement which was honestly made at the time when it was made, but which he has not now retracted when he has become aware that it can be no longer honestly persevered in. That would be fraud too, I should say, as at present advised.

This argument related to the changed basis of profit forecast point. It was argued that Mr Simpson, having given to Mr Puri profit forecasts on one basis of pattern book expenditure, knew his later forecast was on a different basis and should be taken as fraudulent for not disclosing that fact.

In my judgment [counsel for the plaintiff's] argument is wrong in law. He takes the reference to 'recklessness' out of context — divorcing it from the heart of the tort of deceit, namely dishonesty. One only has to read earlier in the speech of Lord Herschell to see that this is so:

> . . . there has always been present, and regarded as an essential element, that the deception was wilful either because the untrue statement was known to be untrue, or because belief in it was asserted without such belief existing . . . I cannot assent to the doctrine that a false statement made through carelessness, and which ought to have been known to be untrue, of itself renders the person who makes it liable to an action for deceit.' (See (1889) 14 App Cas 337 at 369, 373, [1886–90] All ER Rep 1 at 19, 21.)

Findings of fact in relation to fraudulent misrepresentation

So what I have to decide is whether Mr Simpson or Mr Lloyd deliberately set out to mislead Mr Puri, not by a deliberate untruth (for that is not alleged) but by its equivalent, such recklessness as to amount to a disregard for the truth. I have no difficulty in acquitting these witnesses of any such intent. I must explain why.

So far as pattern book expenditure deferrals in the October management accounts are concerned, I accept Mr Simpson's evidence that he did not know of these right up until the time of the contract. Nor did Mr Lloyd. By the time of the contract both thought that until November pattern book expenditure was written off as it was incurred. No one had ever suggested that the management accounts sometimes had ad hoc deferrals for 'smoothing' purposes.

In relation to the Allied problem . . . it is clear that by the time of the contract the representation had been defined as set out in the disclosure letter, namely £120,000 charged to the September and October accounts.

What does matter is whether Mr Simpson was so reckless in the estimate that he should be regarded as fraudulent. He says he was given the figure of £120,000 by Mr Hogarth as a 'fag packet' calculation at a Witter board meeting on 21 November. Mr Hogarth has no recollection whatever of the cost of the Allied problem being discussed. There appears never to have been a detailed estimate of the figure being worked out. Now I accept Mr Simpson's evidence that he got a rough estimate from Mr Hogarth. It was obviously important. So I think he was negligent not to get a proper estimate, or to tell Mr Puri that he had not got a proper estimate. But it was not dishonest of him to give that rough estimate to Mr Puri. He believed it, but knowing there was no proper check, his belief was not reasonable.

Notes

1. This case clarifies the distinction between recklessness and negligence. In order to be reckless the statement maker would need to be in a position where he does not know whether a statement is true or false but takes the risk and asserts that it is true. There is no such dishonesty involved in a statement which is negligent since the statement maker honestly believes that his statement is true, even if he ought to have known it was false and was careless in not checking first.

2. Since an action based on fraudulent misrepresentation is in the tort of deceit, the measure of damages is tortious.

3. The proper measure of damages for deceit was held by the Court of Appeal in *Doyle* v *Olby (Ironmongers) Ltd* [1969] 2 QB 158, to be 'all the damage directly flowing from the tortious act of fraudulent inducement which was not rendered too remote by the plaintiff's own conduct, whether or not the defendant could have foreseen the loss'.

Doyle v *Olby* was approved and applied in the following case:

Smith New Court Securities Ltd v *Scrimgeour Vickers (Asset Management) Ltd*
[1996] 4 All ER 769 (HL)

In July 1989, the plaintiff company had purchased a parcel of shares in FIS Inc. at the price of 82.25 pence per share as a result of representations by the vendors of the shares that there were two other bidders involved. In fact this was not the case. However, before this was discovered it was announced in the September that FIS Inc. had been the victim of a major fraud by a third party. This resulted in a considerable fall in the share price and the plaintiff was eventually able to sell the shares for only 30–40 pence per share. The plaintiff sought damages for fraudulent misrepresentation. The trial judge assessed the damages as being the difference between the price paid and the real value of the shares at the date of the sale taking into account the then undiscovered fraud, i.e. the difference between 82.25p and 44p. This resulted in a damages award of £10.7 million. On appeal the Court of Appeal reversed this award and held that the correct measure was the difference between the price paid and the market value at the date of the sale, i.e. the difference between 82.25p and 78p. The damages award was therefore reduced to £1,196,000. On appeal it was argued that the plaintiff had caused the loss by retaining the shares rather than selling them on immediately. Held: the victim of fraud was entitled to compensation for all actual loss, including consequential loss, which flowed directly from the transaction irrespective of whether it was foreseeable loss. Although the normal method of calculating such loss would be the difference between the price paid and the real value of the shares as at the date of the share purchase, on these facts that would not compensate the plaintiff for loss suffered. The fraudulent misrepresentation had led the plaintiff to pay too high a price for the shares and, given that the shares had been purchased

with a view to retaining them and selling later, the plaintiff was locked into the transaction. Therefore the damages award was the difference between 82.25p and 44p.

LORD BROWNE-WILKINSON: . . . *Doyle* v *Olby (Ironmongers) Ltd* establishes four points. First, that the measure of damages where a contract has been induced by fraudulent misrepresentation is reparation for all the actual damage directly flowing from (i.e. caused by) entering into the transaction. Second, that in assessing such damages it is not an inflexible rule that the plaintiff must bring into account the value as at the transaction date of the asset acquired: although the point is not adverted to in the judgments, the basis on which the damages were computed shows that there can be circumstances in which it is proper to require a defendant only to bring into account the actual proceeds of the asset provided that he has acted reasonably in retaining it. Third, damages for deceit are not limited to those which were reasonably foreseeable. Fourth, the damages recoverable can include consequential loss suffered by reason of having acquired the asset.

In my judgment *Doyle* v *Olby (Ironmongers) Ltd* was rightly decided on all these points. It is true, as to the second point, that there were not apparently cited to the Court of Appeal the nineteenth century cases which established the 'inflexible rule' that the asset acquired has to be valued as at the transaction date: the successful appellant was not legally represented. But in my judgment the decision on this second point is correct. The old 'inflexible rule' is both wrong in principle and capable of producing manifest injustice. The defendant's fraud may have an effect continuing after the transaction is completed, eg if a sale of gold shares was induced by a misrepresentation that a new find had been made which was to be announced later it would plainly be wrong to assume that the plaintiff should have sold the shares before the announcement should have been made. Again, the acquisition of the asset may, as in *Doyle* v *Olby (Ironmongers) Ltd* itself, lock the purchaser into continuing to hold the asset until he can effect a resale. To say that in such a case the plaintiff has obtained the value of the asset as at the transaction date and must therefore bring it into account flies in the face of common sense: how can he be said to have received such a value if, despite his efforts, he has been unable to sell.

Doyle v *Olby (Ironmongers) Ltd* has subsequently been approved and followed by the Court of Appeal in *East* v *Maurer* [1991] 2 All ER 733, [1991] 1 WLR 461 and *Downs* v *Chappell* [1996] 3 All ER 344. In both cases the plaintiffs had purchased a business as a going concern in reliance on the defendant's fraudulent misrepresentation. In each case after discovery of the fraud they sold the business at a loss and recovered by way of damages the difference between the original purchase price and the price eventually realised on a resale, ie the old date of transaction rule was not applied. In *South Australia Asset Management Corp* v *York Montague Ltd, United Bank of Kuwait* v *Prudential Property Services Ltd, Nykredit Mortgage Bank plc* v *Edward Erdman Group Ltd* [1996] 3 All ER 365, [1996] 3 WLR 87 your Lordships treated the measure of damages for fraud as being in a special category regulated by the principles *Doyle* v *Olby (Ironmongers) Ltd.*

. . . In many cases, even in deceit, it will be appropriate to value the asset acquired as at the transaction date if that truly reflects the value of what the plaintiff has obtained. Thus, if the asset acquired is a readily marketable asset and there is no special feature (such as a continuing misrepresentation or the purchaser being locked into a business that he has acquired) the transaction date rule may well produce a fair result. The plaintiff has acquired the asset and what he does with it thereafter is entirely up to him, freed from any continuing adverse impact of the defendant's

wrongful act. The transaction date rule has one manifest advantage, namely that it avoids any question of causation. One of the difficulties of either valuing the asset at a later date or treating the actual receipt on realisation as being the value obtained is that difficult questions of causation are bound to arise. In the period between the transaction date and the date of valuation or resale other factors will have influenced the value or resale price of the asset. It was the desire to avoid these difficulties of causation which led to the adoption of the transaction date rule. But in cases where property has been acquired in reliance on a fraudulent misrepresentation there are likely to be many cases where the general rule has to be departed from in order to give adequate compensation for the wrong done to the plaintiff, in particular where the fraud continues to influence the conduct of the plaintiff after the transaction is complete or where the result of the transaction induced by fraud is to lock the plaintiff into continuing to hold the asset acquired.

Finally, it must be emphasised that the principle in *Doyle* v *Olby (Ironmongers) Ltd* [1969] 2 All ER 119, [1969] 2 QB 158, strict though it is, still requires the plaintiff to mitigate his loss once he is aware of the fraud. So long as he is not aware of the fraud, no question of a duty to mitigate can arise. But once the fraud has been discovered, if the plaintiff is not locked into the asset and the fraud has ceased to operate on his mind, a failure to take reasonable steps to sell the property may constitute a failure to mitigate his loss requiring him to bring the value of the property into account as at the date when he discovered the fraud or shortly thereafter.

In sum, in my judgment the following principles apply in assessing the damages payable where the plaintiff has been induced by a fraudulent misrepresentation to buy property.

(1) The defendant is bound to make reparation for all the damage directly flowing from the transaction.

(2) Although such damage need not have been foreseeable, it must have been directly caused by the transaction.

(3) In assessing such damage, the plaintiff is entitled to recover by way of damages the full price paid by him, but he must give credit for any benefits which he has received as a result of the transaction.

(4) As a general rule, the benefits received by him include the market value of the property acquired as at the date of acquisition; but such general rule is not to be inflexibly applied where to do so would prevent him obtaining full compensation for the wrong suffered.

(5) Although the circumstances in which the general rule should not apply cannot be comprehensively stated, it will normally not apply where either (a) the misrepresentation has continued to operate after the date of the acquisition of the asset so as to induce the plaintiff to retain the asset or (b) the circumstances of the case are such that the plaintiff is, by reason of the fraud, locked into the property.

(6) In addition, the plaintiff is entitled to recover consequential losses caused by the transaction.

(7) The plaintiff must take all reasonable steps to mitigate his loss once he has discovered the fraud. . . .

How then do those principles apply in the present case? First, there is no doubt that the total loss incurred by Smith was caused by the Roberts fraud, unless it can be said that Smith's own decision to retain the shares until after the revelation of the Guerin fraud was a causative factor. The Guerin fraud had been committed before Smith acquired the shares on 21 July 1989. Unknown to everybody, on that date the shares were already pregnant with disaster. Accordingly when, pursuant to the Roberts fraud, Smith acquired the Ferranti shares they were induced to purchase a flawed asset. This

is not a case of the difficult kind that can arise where the depreciation in the asset acquired between the date of acquisition and the date of realisation may be due to factors affecting the market which have occurred after the date of the defendant's fraud. In the present case the loss was incurred by reason of the purchasing of the shares which were pregnant with the loss and that purchase was caused by the Roberts fraud.

Can it then be said that the loss flowed not from Smith's acquisition but from Smith's decision to retain the shares? In my judgment it cannot. The judge found that the shares were acquired as a market making risk and at a price which Smith would only have paid for an acquisition as a market making risk. As such, Smith could not dispose of them on 21 July 1989 otherwise than at a loss. Smith were in a special sense locked into the shares having bought them for a purpose and at a price which precluded them from sensibly disposing of them. It was not alleged or found that Smith acted unreasonably in retaining the shares for as long as they did or in realising them in the manner in which they did.

In the circumstances, it would not in my judgment compensate Smith for the actual loss they have suffered (i.e. the difference between the contract price and the resale price eventually realised) if Smith were required to give credit for the shares having a value of 78p on 21 July 1989. Having acquired the shares at 82¼p for stock Smith could not commercially have sold on that date at 78p. It is not realistic to treat Smith as having received shares worth 78p each when in fact, in real life, they could not commercially have sold or realised the shares at that price on that date. In my judgment, this is one of those cases where to give full reparation to Smith, the benefit which Smith ought to bring into account to be set against its loss for the total purchase price paid should be the actual resale price achieved by Smith when eventually the shares were sold.

Notes

1. Lord Mustill suggested that 'in the future when faced with situations such as the present, courts would do well to be guided by the seven propositions set out by . . . Lord Browne-Wilkinson'.

2. Although the remoteness rules in an action for deceit and in that for negligent misrepresentation under s. 2(1) of the Misrepresentation Act 1967 allow recovery of all direct losses (see, e.g., *Naughton* v *O'Callaghan* [1990] 3 All ER 191, page 509, where Waller J allowed recovery under s. 2(1) of the difference between the price paid and the value of the horse at the time the misrepresentation was discovered, on the basis that retaining the horse in order to train it was precisely the action to be expected in the circumstances), Lord Steyn made one distinction clear by stating that 'in an action for deceit the plaintiff is entitled to recover all his loss directly flowing from the fraudulently induced *transaction*. In the case of a negligent misrepresentation the rule is narrower: the recoverable loss does not extend beyond the consequences flowing from the negligent *misrepresentation* (see *Banque Bruxelles Lambert SA* v *Eagle Star Insurance Co. Ltd* [1995] 2 All ER 769, [1995] QB 375)'.

Can loss of profits be recovered if fraudulent misrepresentation induced the purchase of a business? If so, how will those lost profits be calculated?

East v *Maurer*
[1991] 2 All ER 733 (CA)

In 1979, the plaintiffs bought one of the two hair salon businesses belonging to the defendant in Bournemouth for £20,000, and were induced to do so in part by a representation by the defendant that he did not intend to work in the other salon except in emergencies. In fact he continued to work full-time at the other salon, and this had such an effect on the plaintiffs' business that it was never profitable. They eventually sold it in 1989 for £7,500 and brought an action alleging fraudulent misrepresentation. The trial judge assessed damages so as to include an award of £15,000 for loss of profits, which was based on the profit that the defendant would have made in the salon if he had not sold it, less a deduction of 25 per cent for the fact that the plaintiffs were not as experienced. The defendant appealed against this assessment of loss of profits. Held: relying on *Doyle* v *Olby*, that loss of profits, which is normally claimed in contract as part of the expectation, could be recovered in an action for deceit on the basis that it was actual damage directly flowing from the misrepresentation. However, this loss of profits had to be calculated using tortious principles so as to compensate the plaintiffs for the profit they might have made had the misrepresentation not been made (the profit they might have expected to make in another hairdressing business bought for a similar sum), rather than on the contractual basis of the profits that this business might have made if the representation had been true and the defendant had not worked in the other salon. Consequently, the award for loss of profits was reduced to £10,000.

BELDAM LJ: [Counsel] for the defendants, submits that there is a difference in the manner in which damages are assessed for breach of contract and for the tort of deceit. He says that the authorities show that no damages at all are recoverable for loss of profits in an action of deceit. Although there is no express decision which states that to be the case, in no case which has dealt with the proper measure of damage in an action of deceit has there been an award for loss of profits, although one would have expected to see one. . . . Finally, he submits that, even if damages for loss of profit are recoverable, the learned judge assessed the figure at too high a level, and on an incorrect basis.

That the measure of damages for the tort of deceit and for breach of contract are different no longer needs support from authority. Damages for deceit are not awarded on the basis that the plaintiff is to be put in as good a position as if the statement had been true; they are to be assessed on a basis which would compensate the plaintiff for all the loss he has suffered, so far as money can do it.

This was confirmed in *Doyle* v *Olby (Ironmongers) Ltd* [1969] 2 All ER 119, [1969] 2 QB 158, to which both the learned judge and this court were referred, in which the facts were similar to those of the present case.

. . . it seems to me clear that there is no basis upon which one could say that loss of profits incurred whilst waiting for an opportunity to realise to its best advantage a business which has been purchased are irrecoverable. It is conceded that losses made in the course of running the business of a company are recoverable. If in fact the

plaintiffs lost the profit which they could reasonably have expected from running a business in the area of a kind similar to the business in this case I can see no reason why those do not fall within the words of Lord Atkin in *Clark* v *Urquhart, Stracey* v *Urquhart* [1930] AC 28 at 68: '. . . actual damage directly flowing from the fraudulent inducement.'

So I consider that on the facts found by the learned judge in the present case, the plaintiffs did establish that they had suffered a loss due to the defendants' misrepresentation which arose from their inability to earn the profits in the business which they hoped to buy in the Bournemouth area.

However, I am not satisfied that in arriving at the figure of £15,000 the learned judge approached the quantification of those damages on the correct basis. It seems to me that he was inclined to base his award on an assessment of the profits which the business actually bought by the plaintiffs might have made if the statement made by the first defendant had amounted to a warranty that customers would continue to patronise the salon in Exeter Road; further, that he left out of account a number of significant factors. What he did was to found his award on an evaluation which he made of the profits of the business at Exeter Road made by the first defendant in the year preceding the purchase of the business by the plaintiffs. Basing himself on figures which had been given to him by an accountant, and making an allowance for inflation he arrived at a figure for the profits which might have been made if the first defendant had continued to run the business at Exeter Road during the three and a quarter years. He then made an allowance only for the fact that the second plaintiff's experience in hair styling and hairdressing was not as extensive or as cosmopolitan as that of the first defendant. Thus he based his award on an assessment of what the profits would have been, less a deduction of 25% for the second plaintiff's lack of experience.

It seems to me that he should have begun by considering the kind of profit which the second plaintiff might have made if the representation which induced her to buy the business at Exeter Road had not been made, and that involved considering the kind of profits which *she* might have expected to make in another hairdressing business bought for a similar sum . . .

The learned judge, . . . had two clear starting points; first, that any person investing £20,000 in a business would expect a greater return than if the sum was left safely in the bank or in a building society earning interest, and a reasonable figure for that at the rates then prevailing would have been at least £6,000; secondly, that the salary of a hairdresser's assistant in the usual kind of establishment was at this time £40 per week and that the assistant could expect tips in addition. That would produce a figure of over £2,000, but the proprietor of a salon would clearly expect to earn more, having risked his money in the business. It seems to me that those are valid points from which to start to consider what would be a reasonable sum to award for loss of profits of a business of this kind. As was pointed out by Winn LJ in *Doyle* v *Olby*, this is not a question which can be considered on a mathematical basis. It has to be considered essentially in the round, making what he described as a 'jury assessment' (see [1969] 2 All ER 119 at 124, [1969] 2 QB 158 at 169).

Taking all the factors into account, I think that the learned judge's figure was too high; for my part I would have awarded a figure of £10,000 for that head of damage, and to this extent I would allow the appeal.

Notes

1. This is an example of a statement of intention amounting to a statement of fact, because it was found as a fact that the defendant did not actually have

this intention when he made the statement. See *Edgington* v *Fitzmaurice* (page 481).

2. Although in *East* v *Maurer* the Court of Appeal was prepared to assess profits based upon a hypothetical identical salon without evidence that any such salon existed, in *Davis* v *Churchward* (unreported, 6 May 1993, noted Chandler (1994) 100 LQR 35) the Court of Appeal looked at actual similar public houses which could have been purchased for the same amount and held that because the weekly turnover on these public houses would have been the same as the actual weekly turnover on the public house purchased (£1,500), there could be no recovery for lost profits. In particular, unlike Beldam LJ in *East* v *Maurer,* Nourse LJ refused to take account of the profit that would have been made had the purchase money instead been invested in a building society, on the basis that this was hypothetical since it had been found as a fact that another public house would have been purchased.

Nevertheless, this is an example of a contract induced by a fraudulent misrepresentation of weekly turnover, and it must be asked whether it is likely that the plaintiff would indeed have purchased a similar public house knowing that the actual turnover of that public house was only £1,500.

3. On the basis of *East* v *Maurer,* it will not be possible to recover damages for loss of profit where a profit is in fact being made, albeit not at the level anticipated in reliance on the misrepresentation. To award damages for loss of profit in such circumstances would amount to treating the representation as if it were a contractual promise.

Downs v *Chappell*
[1996] 3 All ER 344 (CA)

In 1988, the plaintiffs were interested in purchasing a bookshop business owned by Chappell, the first defendant. The sale particulars represented that in 1987 the business had a turnover of approximately £109,000 and a gross profit of £33,500. The plaintiffs asked the first defendant for independent verification, and at the first defendant's request the second defendant, accountants, wrote to the plaintiffs broadly confirming these figures. The plaintiffs therefore purchased the business for £120,000 considering that, on the basis of these figures, and with a mortgage of £60,000, they could still generate an adequate income. However, they later discovered that the figures had been overstated and that the business would not generate sufficient income to cover their costs. They therefore sought to sell it. Up until March 1990 the business was making a profit, although it did not accord with the profit level that had been represented. In March 1990 the plaintiffs refused two offers of £76,000 for the business in the belief that they could get more if they held out. However, they eventually sold the business for less than £60,000 and claimed damages in the tort of deceit against the first defendant and damages in negligence against the second defendant. They also claimed an annual alleged loss of £5,000 profit by comparing the actual profitability of the business with that

represented. Held: since the plaintiffs had been induced by fraudulent and negligent misrepresentations relating to profitability to purchase a business, the damages recoverable were their income and capital losses to the date when they discovered the misrepresentations and had the opportunity to avoid further losses. They could not recover for income losses because they were still trading at a profit up to March 1990. In addition, as far as the capital loss was concerned, they could not recover the difference between the £120,000 price paid and the price at which they eventually sold the business. The capital loss was £44,000 (£120,000 less £76,000).

HOBHOUSE LJ (with whose judgment Butler-Sloss LJ and Roch LJ agreed): . . . It is not in dispute that it was possible for the plaintiffs to sell out in the first quarter of 1990. If necessary they would have had to abandon the business. Indeed, one or more of those expressing an interest in buying the shop and the flat in the early part of 1990 were not doing so for the purpose of running a bookshop. Since the business was unlikely to be capable of covering the cost of servicing its capital, it is not suggested that its goodwill had then a significant market value. It follows that any losses which the plaintiffs suffered after the spring of 1990 were not caused by the defendants' torts; but by the plaintiffs' decision not to sell out at that date for a figure of about £75,000. The only basis upon which the plaintiffs might have been able to recover any later loss would have been that they had been reasonably but unsuccessfully attempting to mitigate their loss further and had unhappily increased their loss. (See *McGregor on Damages* (15th edn, 1988) paras 323–324.) On the facts of this case the plaintiffs are unable to make such a claim and have not sought to do so. They have argued that they did not act unreasonably in rejecting the offers of £76,000 in March 1990. Even accepting that they acted reasonably, the fact remains that it was their choice, freely made, and they cannot hold the defendants responsible if the choice has turned out to have been commercially unwise. They were no longer acting under the influence of the defendants' representations. The causative effect of the defendants' faults was exhausted; the plaintiffs' right to claim damages from them in respect of those faults had likewise crystallised. It is a matter of causation.

The correct finding of fact is that the plaintiffs suffered a loss of £44,000 as a result of entering into the contract with Mr Chappell.

Notes

1. This demonstrates the dangers of such voluntary action in trying to avoid the consequences of such a purchase. The causal link with the defendants' misrepresentations had ended. It would therefore appear sensible to accept the first reasonable offer to purchase after discovering the misrepresentation or, in preference, seek to rescind (assuming this to be possible). In both *Downs* v *Chappell* and *Smith* v *Scrimgeour Vickers* there appears to have been no attempt to rescind. (In *Smith* v *Scrimgeour Vickers* an argument to rescind after the sale of the shares was not pursued at the trial and, it is submitted, would not have succeeded because it would not have been possible to return the shares.)

2. The trial judge had held that although there were false statements made by the defendants, the plaintiffs had not established on the balance of probabilities that they would not have purchased the business had the true

figures been quoted. However, not surprisingly the Court of Appeal rejected this and held that an actionable misrepresentation required only that the plaintiffs establish that the figures induced the transaction.

3. Hobhouse LJ stated that damages for fraudulent misrepresentation should not be greater than the loss which would have been suffered 'had the represented, or supposed, state of affair actually existed'. In other words, the defendant should not be liable for loss that would have been suffered by the purchaser of the business even if the representation had been true, e.g., a general fall in market price. It was therefore necessary to compare the loss suffered with the hypothetical position had the representation in fact been true. However, *Downs* v *Chappell* has now been overruled on this point by the House of Lords in *Smith* v *Scrimgeour Vickers* [1996] 4 All ER 769. No such check is necessary.

B: NEGLIGENT MISREPRESENTATION

Negligent misrepresentation involves a statement made honestly but without reasonable grounds for the belief.

(a) At common law

Hedley Byrne & Co. Ltd* v *Heller & Partners Ltd
[1964] AC 465 (HL)

Hedley Byrne, who were advertising agents, asked their bank to inquire as to the financial standing of Easipower Ltd. Heller & Partners, who were Easipower's bankers, replied 'without responsibility' that Easipower was 'considered good for its ordinary business engagements'. Relying on this reference, Hedley Byrne booked advertising time for Easipower on terms under which they were personally responsible for payment. Easipower went into liquidation and Hedley Byrne lost £17,000 on these contracts. They bought an action against Heller & Partners for damages for negligence. Held: such a statement could give rise to an action for damages for financial loss in tort (there being no contractual relationship between the parties concerned). This was because a duty of care would be owed where there was a special relationship between the parties. However, on these facts that duty had been expressly excluded by the disclaimer of responsibility.

LORD MORRIS OF BORTH-Y-GEST: . . . [I]rrespective of any contractual or fiduciary relationship and irrespective of any direct dealing, a duty may be owed by one person to another. It is said, however, that where careless (but not fraudulent) misstatements are in question there can be no liability in the maker of them unless there is either some contractual or fiduciary relationship with a person adversely affected by the making of them or unless, through the making of them, something is created or circulated or some situation is created which is dangerous to life, limb or property. In logic I can see no essential reason for distinguishing injury which is caused by a reliance upon words from injury which is caused by a reliance upon the

safety of the staging to a ship or by a reliance upon the safety for use of the contents of a bottle of hair wash or a bottle of some consumable liquid. It seems to me, therefore, that if A claims that he has suffered injury or loss as a result of acting upon some misstatement made by B who is not in any contractual or fiduciary relationship with him, the inquiry that is first raised is whether B owed any duty to A: if he did the further inquiry is raised as to the nature of the duty. There may be circumstances under which the only duty owed by B to A is the duty of being honest: there may be circumstances under which B owes to A the duty not only of being honest but also a duty of taking reasonable care. The issue in the present case is whether the bank owed any duty to Hedleys and if so what the duty was. . . .

My Lords, I consider that it follows and that it should now be regarded as settled that if someone possessed of a special skill undertakes, quite irrespective of contract, to apply that skill for the assistance of another person who relies upon such skill, a duty of care will arise. The fact that the service is to be given by means of or by the instrumentality of words can make no difference. Furthermore, if in a sphere in which a person is so placed that others could reasonably rely upon his judgment or his skill or upon his ability to make careful inquiry, a person takes it upon himself to give information or advice to, or allows his information or advice to be passed on to, another person who, as he knows or should know, will place reliance upon it, then a duty of care will arise.

Note

Liability under *Hedley Byrne* v *Heller* turns on whether there was a special relationship between the plaintiff and the defendant. To establish the special relationship, the defendant must arguably either have or profess to have some special skill in relation to the subject matter or, at the very least, must have taken it upon himself to make representations and, secondly, it must have been reasonable for the plaintiff to rely upon the defendant's statement. As a third requirement, the defendant must either know that the plaintiff will rely on the statement or it must be reasonably foreseeable that he will rely on it. Finally, it appears from the decision of the House of Lords in *Caparo Industries plc* v *Dickman* [1990] 2 AC 605, that the defendant must have some knowledge of the type of transaction for which the information is required.

Hedley Byrne v *Heller* can apply to pre-contractual statements where a contract finally resulted between the parties.

Esso Petroleum Co. Ltd v *Mardon*
[1976] QB 801 (CA)

The facts of this case appear at page 242.

LORD DENNING MR:

Negligent misrepresentation

. . . [T]he question arises whether Esso are liable for negligent misstatement under the doctrine of *Hedley Byrne & Co. Ltd* v *Heller & Partners Ltd* [1964] AC 465. It has been suggested that *Hedley Byrne* cannot be used so as to impose liability for negligent pre-contractual statements: and that, in a pre-contract situation the remedy (at any rate before the Act of 1967) was only in warranty or nothing. . . .

In arguing this point, [counsel for Esso] took his stand in this way. He submitted that when the negotiations between two parties resulted in a contract between them,

their rights and duties were governed by the law of contract and not by the law of tort. There was, therefore, no place in their relationship for *Hedley Byrne* [1964] AC 465, which was solely on liability in tort. He relied particularly on *Clark* v *Kirby-Smith* [1964] Ch 506 where Plowman J held that the liability of a solicitor for negligence was a liability in contract and not in tort, following the observations of Sir Wilfrid Greene MR in *Groom* v *Crocker* [1939] 1 KB 194, 206. [Counsel for Esso] might also have cited *Bagot* v *Stevens Scanlan & Co. Ltd* [1966] 1 QB 197, about an architect; and other cases too. But I venture to suggest that those cases are in conflict with other decisions of high authority which were not cited in them. These decisions show that, in the case of a professional man, the duty to use reasonable care arises not only in contract, but is also imposed by the law apart from contract, and is therefore actionable in tort. . . . A professional man may give advice under a contract for reward; or without a contract, in pursuance of a voluntary assumption of responsibility, gratuitously without reward. In either case he is under one and the same duty to use reasonable care: see *Cassidy* v *Ministry of Health* [1951] 2 KB 343, 359–360. In the one case it is by reason of a term implied by law. In the other, it is by reason of a duty imposed by law. For a breach of that duty he is liable in damages: and those damages should be, and are, the same, whether he is sued in contract or in tort.

It follows that I cannot accept [counsel for Esso's] proposition. It seems to me that *Hedley Byrne & Co. Ltd* v *Heller & Partners Ltd* [1964] AC 465, properly understood, covers this particular proposition: if a man, who has or professes to have special knowledge or skill, makes a representation by virtue thereof to another — be it advice, information or opinion — with the intention of inducing him to enter into a contract with him, he is under a duty to use reasonable care to see that the representation is correct, and that the advice, information or opinion is reliable. If he negligently gives unsound advice or misleading information or expresses an erroneous opinion, and thereby induces the other side to enter into a contract with him, he is liable in damages. . . .

Applying this principle, it is plain that Esso professed to have — and did in fact have — special knowledge or skill in estimating the throughput of a filling station. They made the representation — they forecast a throughput of 200,000 gallons — intending to induce Mr Mardon to enter into a tenancy on the faith of it. They made it negligently. It was a 'fatal error.' And thereby induced Mr Mardon to enter into a contract of tenancy that was disastrous to him. For this misrepresentation they are liable in damages.

Notes

1. To establish this cause of action the plaintiff has the burden of proving the existence of the special relationship.
2. It will be the only available cause of action where, as in *Hedley Byrne* v *Heller* itself, the misrepresentor is not a party to the contract, or where no contract results following the negotiations in which the statement was made.
3. Damages are tortious, in that the aim is to put the plaintiff into the position that he would have been in had the misrepresentation not been made. Lord Denning in *Esso* v *Mardon* explained it as follows (at pp. 820–1):

The measure of damages

Mr Mardon is not to be compensated here for 'loss of a bargain.' He was given no bargain that the throughput *would* amount to 200,000 gallons a year. He is only to be

compensated for having been induced to enter into a contract which turned out to be disastrous for him. Whether it be called breach of warranty or negligent misrepresentation, its effect was *not* to warrant the throughput, but only to induce him to enter the contract. So the damages in either case are to be measured by the loss he suffered. Just as in *Doyle* v *Olby (Ironmongers) Ltd* [1969] 2 QB 158. 167 he can say: '. . . I would not have entered into this contract at all but for your representation. Owing to it, I have lost all the capital I put into it. I also incurred a large overdraft. I have spent four years of my life in wasted endeavour without reward: and it will take me some time to re-establish myself.'

For all such loss he is entitled to recover damages. It is to be measured in a similar way as the loss due to a personal injury. You should look into the future so as to forecast what would have been likely to happen if he had never entered into this contract: and contrast it with his position as it is now as a result of entering into it. The future is necessarily problematical and can only be a rough-and-ready estimate. But it must be done in assessing the loss.

Recovery is not as wide as in the case of fraudulent misrepresentation, since the plaintiff can only recover for loss which was reasonably foreseeable at the time of the statement.

(b) Under statute

Misrepresentation Act 1967

2. Damages for misrepresentation

(1) 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.

Note

The normal burden of proof is reversed so that the representor has to disprove negligence.

Howard Marine and Dredging Co. Ltd* v *A. Ogden & Sons (Excavations) Ltd
[1978] QB 574 (CA)

During negotiations between the defendants, civil engineering contractors, and the plaintiffs, owners of two sea barges, for the hire of barges the plaintiffs' marine manager stated that the capacity of each barge was '850 cubic metres' and that this was equivalent to about 1,600 tonnes deadweight carrying capacity. He based this figure on his recollection of an entry in *Lloyd's Register* which gave the capacity of the barges as 1,800 tonnes. The register was in fact incorrect and the correct figure was 1,055

tonnes. This correct figure could have been ascertained from the ship's documents which were in the plaintiffs' possession. The defendants agreed to take the barges. Six months after taking delivery the defendants discovered the correct capacity and refused to pay the full hire. The plaintiffs claimed the outstanding hire charges and the defendants counterclaimed, *inter alia*, for damages under s. 2(1) of the Misrepresentation Act 1967 on the basis of the misrepresentation as to the barges' capacity. Held: (Bridge and Shaw LJJ) the plaintiffs had failed to prove that their marine manager had had reasonable grounds to believe and did believe up to the time the contract was made that the facts he represented were true, since the correct figure was contained in the ships' documents and they had failed to show any 'objectively reasonable ground' for relying instead on the figure in Lloyd's Register.

BRIDGE LJ: The first question then is whether Howards would be liable in damages in respect of Mr O'Loughlin's misrepresentation if it had been made fraudulently, that is to say, if he had known that it was untrue. An affirmative answer to that question is inescapable. The judge found in terms that what Mr O'Loughlin said about the capacity of the barges was said with the object of getting the hire contract for Howards, in other words, with the intention that it should be acted on. This was clearly right. Equally clearly the misrepresentation was in fact acted on by Ogdens. It follows, therefore, on the plain language of the statute that, although there was no allegation of fraud, Howards must be liable unless they proved that Mr O'Loughlin had reasonable ground to believe what he said about the barges' capacity.

. . . If the representee proves a misrepresentation which, if fraudulent, would have sounded in damages, the onus passes immediately to the representor to prove that he had reasonable ground to believe the facts represented. In other words the liability of the representor does not depend upon his being under a duty of care the extent of which may vary according to the circumstances in which the representation is made. In the course of negotiations leading to a contract the statute imposes an absolute obligation not to state facts which the representor cannot prove he had reasonable ground to believe.

. . . [I]t is to be assumed that Mr O'Loughlin was perfectly honest throughout. But the question remains whether his evidence, however benevolently viewed, is sufficient to show that he had an objectively reasonable ground to disregard the figure in the ship's documents and to prefer the Lloyd's Register figure. I think it is not. Accordingly I conclude that Howards failed to prove that Mr O'Loughlin had reasonable ground to believe the truth of his misrepresentation to Mr Redpath.

Lord Denning MR (dissenting) thought that the burden of disproving negligence had been discharged.

LORD DENNING MR, *dissenting*: This enactment imposes a new and serious liability on anyone who makes a representation of fact in the course of negotiations for a contract. If that representation turns out to be mistaken — then however innocent he may be — he is just as liable as if he made it fraudulently. But how different from times past! For years he was not liable in damages at all for innocent misrepresentation: see *Heilbut, Symons & Co.* v *Buckleton* [1913] AC 30. Quite recently he was made liable if he was proved to have made it negligently: see *Esso*

Petroleum Co. Ltd v *Mardon* [1976] QB 801. But now with this Act he is made liable — unless he proves — and the burden is on him to prove — that he had reasonable ground to believe and did in fact believe that it was true.

Section 2(1) certainly applies to the representation made by Mr O'Loughlin on July 11, 1974, when he told Ogdens that each barge could carry 1,600 tonnes. The judge found that it was a misrepresentation: that he said it with the object of getting the hire contract for Howards. They got it: and, as a result, Ogdens suffered loss. But the judge found that Mr O'Loughlin was not negligent: and so Howards were not liable for it.

The judge's finding was criticised before us: because he asked himself the question: was Mr O'Loughlin negligent? Whereas he should have asked himself: did Mr O'Loughlin have reasonable ground to believe that the representation was true? I think that criticism is not fair to the judge. By the word 'negligent' he was only using shorthand for the longer phrase contained in section 2(1) which he had before him. And the judge, I am sure, had the burden of proof in mind: for he had come to the conclusion that Mr O'Loughlin was not negligent. The judge said in effect: 'I am satisfied that Mr O'Loughlin was not negligent': and being so satisfied, the burden need not be further considered.

It seems to me that when one examines the details, the judge's view was entirely justified. He found that Mr O'Loughlin's state of mind was this: Mr O'Loughlin had examined Lloyd's Register and had seen there that the deadweight capacity of each barge was 1,800 tonnes. That figure stuck in his mind. The judge found that 'the 1,600 tonnes was arrived at by knocking off what he considered a reasonable margin for fuel, and so on, from the 1,800 tonnes summer deadweight figure in Lloyd's Register, which was in the back of his mind.' The judge said that Mr O'Loughlin had seen at some time the German shipping documents and had seen the deadweight figure of 1,055-135 tonnes: but it did not register. All that was in his mind was the 1,800 tonnes in Lloyd's Register which was regarded in shipping circles as the Bible. That afforded reasonable ground for him to believe that the barges could each carry 1,600 tonnes pay load: and that is what Mr O'Loughlin believed.

So on this point, too, I do not think we should fault the judge. It is not right to pick his judgment to pieces — by subjecting it — or the shorthand note — to literal analysis. Viewing it fairly, the judge (who had section 2(1) in front of him) must have been of opinion that the burden of proof was discharged.

Notes

1. The decision of the majority is that in order to escape liability under s. 2(1) the representor must positively prove reasonable grounds for his belief in addition to disproving negligence. Bridge LJ went as far as stating that s. 2(1) imposed an absolute obligation on the representor not to state facts which he could not prove he had reasonable grounds to believe.

Inevitably, this means that liability to pay damages for negligent misrepresentation will more easily be established under s. 2(1) than at common law.

2. The members of the Court of Appeal in *Howard Marine* v *Ogden* also had different opinions on whether there was liability for negligent misstatement at common law. Only Shaw LJ considered that this liability was established.

3. Section 2(1) only applies where the misrepresentation induces the representee to enter into a contract with the representor, and this is the most important limitation on its application.

4. The effect of the exemption clause is discussed at page 524.

(i) *The measure of damages under s. 2(1)* The section itself does not make clear how damages are to be assessed. The drafting of the section rests upon the 'fiction of fraud', in that liability in damages is said to exist where it would exist had the misrepresentation been fraudulent even though it is not fraudulent.

Royscot Trust Ltd v *Rogerson*
[1991] 3 All ER 294 (CA)

A customer agreed to buy a car for £7,600 from a dealer. The deposit was £1,200 with the balance of £6,400 on hire-purchase terms. In order to satisfy a 20 per cent deposit requirement, the dealer represented to the finance company that the purchase price was £8,000 and that a deposit of £1,600 had been paid (leaving the same balance of £6,400). The hire-purchase contract was made on this basis. When £2,775 of instalments had been paid, the customer dishonestly sold the car for £7,200 to an innocent purchaser. The company recovered damages of £1,600 against the dealer, i.e., the extra amount that the company had been induced to pay as a result of the misrepresentation (if the deposit actually paid — £1,200 — had been correctly stated the true price of the car would have been £6,000 and the company would have paid the dealer £4,800, not £6,400). The finance company claimed that the damages against the dealer should be £3,625 (which was the difference between the amount paid to the dealer and the amount received from the customer). Therefore, the first issue was whether damages under s. 2(1) were tortious, so as to put the representee into the position that he would have been in had he never entered into the contract. The dealer contended that he should pay no damages because the customer's sale of the car during the continuance of the hire-purchase agreement was not a reasonably foreseeable loss. Held: the measure of damages under s. 2(1) was tortious, in that the measure had to be the same as for fraudulent misrepresentation because of the fiction of fraud. It followed that the finance company could recover for all losses directly flowing from the misrepresentation, even if that loss was unforeseeable (although on the facts it was foreseeable). The finance company was therefore entitled to recover the £3,625, being the tortious measure of damages.

BALCOMBE LJ: The finance company's cause of action against the dealer is based on s. 2(1) of the Misrepresentation Act 1967. . . .

As a result of some dicta by Lord Denning MR in two cases in the Court of Appeal — *Gosling* v *Anderson* [1972] EGD 709 and *Jarvis* v *Swans Tours Ltd* [1973] 1 All ER 71 at 73, [1973] QB 233 at 237 — and the decision at first instance in *Watts* v *Spence* [1975] 2 All ER 528, [1976] Ch 165, there was some doubt whether the measure of damages for an innocent misrepresentation giving rise to a cause of action under the 1967 Act was the tortious measure, so as to put the representee in the position in which he would have been if he had never entered into the contract, or the contractual measure, so as to put the representee in the position in which he would have been if

the misrepresentation had been true, and thus in some cases give rise to a claim for damages for loss of bargain. Lord Denning MR's remarks in *Gosling* v *Anderson* were concerned with an amendment to a pleading, while his remarks in *Jarvis* v *Swans Tours Ltd* were clearly obiter. *Watts* v *Spence* was disapproved by this court in *Sharneyford Supplies Ltd* v *Edge (Barrington Black Austin & Co (a firm), third party)* [1987] 1 All ER 588 at 598, [1987] Ch 305 at 323. However, there is now a number of decisions which make it clear that the tortious measure of damages is the true one. Most of these decisions are at first instance and will be found in *Chitty on Contract* (26th edn, 1989) para 439, note 63 and in *McGregor on Damages* (15th edn, 1988) para 1745. One at least, *Chesneau* v *Interhome Ltd* (1983) 134 NLJ 341 is a decision of this court. The claim was one under s. 2(1) of the 1967 Act and the appeal concerned the assessment of damages. In the course of his judgment Eveleigh LJ said . . . :

> . . . [damages] should be assessed in a case like the present one on the same principles as damages are assessed in tort. The subsection itself says: '. . . 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 . . .' By 'so liable' I take it to mean liable as he would be if the misrepresentation had been made fraudulently.

In view of the wording of the subsection it is difficult to see how the measure of damages under it could be other than the tortious measure and, despite the initial aberrations referred to above, that is now generally accepted. Indeed counsel before us did not seek to argue the contrary.

The first main issue before us was: accepting that the tortious measure is the right measure, is it the measure where the tort is that of fraudulent misrepresentation, or is it the measure where the tort is negligence at common law? The difference is that in cases of fraud a plaintiff is entitled to any loss which flowed from the defendant's fraud, even if the loss could not have been foreseen: see *Doyle* v *Olby (Ironmongers) Ltd* [1969] 2 All ER 119, [1969] 2 QB 158. In my judgement the wording of the subsection is clear: the person making the innocent misrepresentation shall be 'so liable', i.e. liable to damages as if the representation had been made fraudulently. This was the conclusion to which Walton J came in *F & B Entertainments Ltd* v *Leisure Enterprises Ltd* (1976) 240 EG 455 at 461 (see also the decision of Sir Douglas Franks QC sitting as a deputy judge of the High Court in *McNally* v *Welltrade International Ltd* [1978] IRLR 497). In each of these cases the judge held that the basis for the assessment of damages under s. 2(1) of the 1967 Act is that established in *Doyle* v *Olby (Ironmongers) Ltd.*

This was also the original view of the academic writers. In Atiyah and Treitel 'Misrepresentation Act 1967' (1967) 30 MLR 369 at 373–374 it says:

> The measure of damages in the statutory action will apparently be that in an action of deceit . . . But more probably the damages recoverable in the new action are the same as those recoverable in an action of deceit . . .

Professor Treitel has since changed his view. In *Law of Contract* (7th edn, 1987) p. 278 he says:

> Where the action is brought under section 2(1) of the Misrepresentation Act, one possible view is that the deceit rule will be applied by virtue of the fiction of fraud. But the preferable view is that the severity of the deceit rule can only be justified in cases of actual fraud and that remoteness under section 2(1) should depend, as in actions based on negligence, on the test of foreseeability.

The only authority cited in support of the 'preferable' view is *Shepheard* v *Broome* [1904] AC 342, a case under s. 38 of the Companies Act 1867, which provided that in certain circumstances a company director, although not in fact fraudulent, should be 'deemed to be fraudulent'. As Lord Lindley said ([1904] AC 342 at 346): '. . . To be compelled by Act of Parliament to treat an honest man as if he were fraudulent is at all times painful', but he went on to say: 'but the repugnance which is naturally felt against being compelled to do so will not justify your Lordships in refusing to hold the appellant responsible for acts for which an Act of Parliament clearly declares he is to be held liable . . . ' The House of Lords so held.

It seems to me that that case, far from supporting Professor Treitel's view, is authority for the proposition that we must follow the literal wording of s. 2(1), even though that has the effect of treating, so far as the measure of damages is concerned, an innocent person as if he were fraudulent. *Chitty on Contracts* (26th edn, 1989) para 439 says:

> . . . it is doubtful whether the rule that the plaintiff may recover even unforeseeable losses suffered as the result of fraud would be applied; it is an exceptional rule which is probably justified only in cases of actual fraud.

No authority is cited in support of that proposition save a reference to the passage in Professor Treitel's book cited above.

Professor Furmston in *Cheshire Fifoot and Furmston's Law of Contract* (11th edn, 1986) p. 286 says:

> It has been suggested [and the reference is to the passage in Atiyah and Treitel's article cited above] that damages under section 2(1) should be calculated on the same principles as govern the tort of deceit. This suggestion is based on a theory that section 2(1) is based on a 'fiction of fraud'. We have already suggested that this theory is misconceived. On the other hand the action created by section 2(1) does look much more like an action in tort than one in contract and it is suggested that the rules for negligence are the natural ones to apply.

The suggestion that the 'fiction of fraud' theory is misconceived occurs in a passage which includes the following (p. 271):

> Though it would be quixotic to defend the drafting of the section, it is suggested that there is no such 'fiction of fraud' since the section does not say that a negligent misrepresentor shall be treated for all purposes as if he were fraudulent. No doubt the wording seeks to incorporate by reference some of the rules relating to fraud but, for instance, nothing in the wording of the subsection requires the measure of damages for deceit to be applied to the statutory action.

With all respect to the various learned authors whose works I have cited above, it seems to me that to suggest that a different measure of damage applies to an action for innocent misrepresentation under the section than that which applies to an action for fraudulent misrepresentation (deceit) at common law is to ignore the plain words of the subsection and is inconsistent with the cases to which I have referred. In my judgment, therefore, the finance company is entitled to recover from the dealer all the losses which it suffered as a result of its entering into the agreements with the dealer and the customer, even if those losses were unforeseeable, provided that they were not otherwise too remote.

Notes

1. See Wadsley (1992) 55 MLR 698 and Hooley (1991) 107 LQR 547.

2. The application of the fiction of fraud has drawn a clear distinction between fraudulent and negligent misrepresentation under s. 2(1), and negligent misstatement at common law.

It is difficult to see why there should be a more generous measure of damages under s. 2(1) than that available for negligent misstatement in tort when both causes of action could arise on the same facts. Not only does the burden of proof favour the representee under s. 2(1) but the representee can also recover for a much wider category of loss.

Royscot Trust v *Rogerson* is likely to result in infrequent use of *Hedley Byrne* v *Heller* where s. 2(1) is available (namely where there is a contract between the representor and representee). It may also mean that there is little point in a representee seeking to establish fraudulent misrepresentation when the same measure of damages can be obtained under s. 2(1) with the advantage of the reversal of the burden of proof.

3. It is difficult to justify a decision which will result in an honest but negligent representor being held liable as if he were fraudulent. In principle some distinction should persist.

4. In *Smith New Court Securities Ltd* v *Scrimgeour Vickers (Asset Management) Ltd* [1996] 4 All ER 769, page 492, Lord Steyn (at p. 793) raised the question of whether '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'. However, since the issue did not arise directly on the facts of that case, Lord Steyn did not express any concluded view on this matter. Lord Browne-Wilkinson also stated that he was not expressing any view on the correctness of the decision in *Royscot Trust*.

The crucial question will now be: Does the loss flow directly from the misrepresentation, i.e., did the misrepresentation *cause* this loss?

Naughton v *O'Callaghan*
[1990] 3 All ER 191

The plaintiffs bought a thoroughbred yearling colt for 26,000 guineas and put the colt for training for two seasons. The colt was unplaced in all of its six races and its value fell to £1,500. The plaintiffs then discovered that the pedigree had not been correctly described, and sought to recover the purchase price and training fees. If the colt had originally been correctly described it would have fetched 23,500 guineas. There was a breach of contract but the contractual measure of damages was only the difference in value at the date of the contract. The plaintiffs therefore formulated their claim in misrepresentation and sought the difference between the price paid and the fall in value at the time the misrepresentation was discovered, on the basis that the fall in value was a direct loss. Waller J awarded the difference between 26,000 guineas and £1,500, accepting that the aim of damages under s. 2(1) was tortious and based on the fiction of fraud so that all direct loss flowing from the misrepresentation was recoverable. Training and racing was exactly the conduct to be expected and was reasonable in the circumstances.

WALLER J: [Quoting Winn LJ in *Doyle* v *Olby* [1969] 2 QB 158:]

> It appears to me that in a case where there has been a breach of warranty of authority, and still more clearly where there has been a tortious wrong consisting of a fraudulent inducement, the proper starting point for any court called on to consider what damages are recoverable by the defrauded person is to compare his position before the representation was made to him with his position after it, brought about by that representation, always bearing in mind that no element in the consequential position can be regarded as attributable loss and damage if it be too remote a consequence: it will be too remote not necessarily because it was not contemplated by the representor but in any case where the person deceived has not himself behaved with reasonable prudence, reasonable common sense or can in any true sense be said to have been the author of his own misfortune. The damage that he seeks to recover must have flowed directly from the fraud perpetrated on him.

Winn LJ then assessed the damages in that case by reference to precisely what the plaintiff had done after acquiring the business including selling the business at some later time and giving credit for that sale price. (I should perhaps make clear that *Doyle* v *Olby (Ironmongers) Ltd* was concerned with fraud, but in relation to a claim for damages under the Misrepresentation Act 1967 the approach is the same. . . .)

What, as it seems to me, makes this case different from the norm is, first, that what the plaintiffs in fact purchased in reliance on the representation in the catalogue was a different animal altogether; second, if they had known of the misrepresentation within a day or so they could, and as I have found would, have sold Fondu for its then value; third, their decision to keep Fondu and race it was precisely what the sellers would have expected: Fondu was not a commodity like, for example, rupee paper, which it would be expected that the defendants would go out and sell; fourth, the fall in Fondu's value if it did not win races was not due to a general fall in the market in racehorses, but was special to Fondu and to be expected if Fondu did not win. It might well not have happened if Fondu had been the different animal as it had been originally described.

Accordingly, in my judgment it would be unjust if the plaintiffs were not entitled to recover the difference between 26,000 guineas and £1,500, and on that aspect of the case accordingly I award that sum.

Waller J also awarded the training fees and costs of upkeep of the horse up to the date when the misrepresentation was discovered.

WALLER J: . . . It seems to me that in relation to this particular horse, applying Winn LJ's test in *Doyle* v *Olby (Ironmongers) Ltd* [1969] 2 All ER 119 at 123–124, [1969] 2 QB 158 at 168, the cost of training and keeping Fondu should be recoverable. But is it right to apply blinkers and consider the purchase of this particular animal and the expenditure on him? The defendant says that expenditure would have been incurred anyway on some yearling purchased at those September sales. To which the plaintiffs retort that that may be so, but if they bought the horse described by the defendant it *might* have paid for its keep and reaped for them rich rewards.

I have concluded that the plaintiffs are entitled to ask the court to look simply at the contract they made in reliance on the representation which induced them to enter into that bargain. They are entitled to say that there must be no speculation one way or the other about what would have happened if they had not purchased this horse and if no misrepresentation had been made to them. They are entitled to say (putting it in broad terms) we bought one horse and we spent money training it and entering

it for races. We discovered two years after the purchase that it was not the horse we thought we had bought; it is not the horse on which we would have spent any money training or keeping, and therefore that is money only spent in reliance on the representation made.

Notes

1. This case illustrates that in future many misrepresentation cases will turn on proving the direct loss, i.e., that the loss was caused by the misrepresentation. The representee's acts must be reasonable in the circumstances or the chain of causation may be broken.

In *Hussey* v *Eels* [1990] 1 All ER 449, the Court of Appeal held that a profit on the sale of a bungalow which the plaintiffs had been induced to buy as a result of the defendants' misrepresentation did not have to be taken into account in assessing the damages since it was not *caused* by the misrepresentation but by the independent act of the plaintiffs in securing planning permission. Mustill LJ said (at p. 459):

> Did the negligence which caused the damage also cause the profit, if profit there was? I do not think so. It is true that in one sense there was a casual link between the inducement of the purchase by misrepresentation and the sale two and a half years later, for the sale represented a choice of one of the options with which the plaintiffs had been presented by the defendants' wrongful act. But only in that sense. To my mind the reality of the situation is that the plaintiffs bought the house to live in, and did live in it for a substantial period. It was only after two years that the possibility of selling the land and moving elsewhere was explored, and six months later still that this possibility came to fruition. It seems to me that when the plaintiffs unlocked the development value of their land they did so for their own benefit, and not as part of a continuous transaction of which the purchase of land and bungalow was the inception.

2. Can the damages awarded to the representee under s. 2(1) be reduced for contributory negligence?

Gran Gelato Ltd v *Richcliff (Group) Ltd*
[1992] 1 All ER 865

Gran Gelato had been granted a 10-year underlease by Richcliff in 1984. The headlease contained a redevelopment break clause which was exercisable by 12 months' notice expiring on or after June 1989. Gran Gelato and their solicitors had no notice of this restriction, and in reply to an inquiry Richcliff's solicitors had stated that 'to the lessor's knowledge' there were no such rights affecting the headlease which would inhibit the tenant's enjoyment of the property. In November 1988, the head lessor exercised the break clause and Gran Gelato brought an action claiming damages for negligent misstatement at common law and damages under s. 2(1) of the Misrepresentation Act 1967 for negligent misrepresentation. In answer to Richcliff's claim that Gran Gelato were contributorily negligent in

proceeding without first seeing the headlease. Gran Gelato argued that s. 1 of the Law Reform (Contributory Negligence) Act 1945 did not apply to a damages claim under the Misrepresentation Act 1967. Held: since there were concurrent claims for damages for negligence at common law and under the 1967 Act, apportionment for contributory negligence under the 1945 Act applied to both claims. On the facts, however, it was not just and equitable to make a reduction in the damages.

SIR DONALD NICHOLLS VC: . . . Richcliff has advanced a defence of contributory negligence. Clearly, this is available as a defence to the claim against Richcliff for damages for breach of the common law duty of care; but is it available to the claim against Richcliff under s. 2(1) of the Misrepresentation Act 1967? In other words, does s. 1 of the Law Reform (Contributory Negligence) Act 1945 apply to a claim by a plaintiff for damages under the 1967 Act? So far as is material, s. 1(1) of the 1945 Act provides:

> Where any person suffers damage as the result partly of his own fault and partly of the fault of any other person or persons, a claim in respect of that damage shall not be defeated by reason of the fault of the person suffering the damage, but the damages recoverable in respect thereof shall be reduced to such extent as the court thinks just and equitable having regard to the claimant's share in the responsibility for the damage . . .'

Fault is defined in s. 4 as—

> negligence, breach of statutory duty or other act or omission which gives rise to a liability in tort or would, apart from this Act, give rise to the defence of contributory negligence.

[He referred to s. 2(1) of the Misrepresentation Act 1967 and continued:] Thus, in short, liability under the 1967 Act is essentially founded on negligence, in the sense that the defendant, the representor, did not have reasonable grounds to believe that the facts represented were true. (Of course, if he did not believe the facts represented were true he will be liable for fraud.) This being so, it would be very odd if the defence of contributory negligence were not available to a claim under that Act. It would be very odd if contributory negligence were available as a defence to a claim for damages based on a breach of a duty to take care in and about the making of a particular representation, but not available to a claim for damages under the 1967 Act in respect of the same representation.

In my view, the answer to this point is provided by the decision of the Court of Appeal in *Forsikringsaktieselskapet Vesta* v *Butcher* [1988] 2 All ER 43, [1989] AC 852. There the court held that the 1945 Act applies to a case where there is a claim for damages for negligence at common law even if, in addition, there is a claim in contract to the same effect. O'Connor LJ adopted the view expressed by Prichard J in *Rowe* v *Turner Hopkins & Partners* [1980] 2 NZLR 550 at 555–556 regarding the equivalent section of the New Zealand legislation:

> I therefore conclude, in the absence of any clear authority to the contrary, that the first limb of the definition of s. 2 determines the meaning of the word 'fault' as it relates to the plaintiff's cause of action: that accordingly, the Contributory Negligence Act cannot apply unless the cause of action is founded on some act or omission on the part of the defendant which gives rise to liability in tort: that

if the defendant's conduct meets that criterion, the Act can apply — whether or not the same conduct is also actionable in contract.

Neill LJ agreed with this approach, and I do not read Sir Roger Ormrod's judgment as differing on this point (see [1988] 2 All ER 43 at 52, 59, [1989] AC 852 at 866, 875).

In the present case the conduct of which Gran Gelato complains founds a cause of action both in negligence at common law and under the 1967 Act. As already noted, under the 1967 Act liability is essentially founded on negligence. By parity of reasoning with the conclusion in *Forsikringsaktieselskapet Vesta* v *Butcher* regarding concurrent claims in negligence in tort and contract, the 1945 Act applies in the present case where there are concurrent claims against Richcliff in negligence in tort and under the 1967 Act.

Note

It is submitted that this should also be the case where only a s. 2(1) claim is made. Otherwise it would be possible to avoid apportionment by framing the claim only under the Misrepresentation Act 1967. Given that the 1945 Act applies to 'fault' on the part of the innocent party, it is wide enough to cover the 1967 Act.

However, in *Alliance & Leicester Building Society* v *Edgestop Ltd* [1994] 2 All ER 38, Mummery J held that contributory negligence could not apply to apportion damages in an action in the tort of deceit. (See also *Corporacion Nacional del Cobre de Chile* v *Sogemin Metals Ltd* [1997] CLC 435.) In so doing he reaffirmed the principle enunciated by Jessel MR in *Redgrave* v *Hurd* and distinguished *Gran Gelato Ltd* v *Richcliff (Group) Ltd*. In this respect it appears that if the fiction of fraud were applied to assessing damages in an action under s. 2(1) of the Misrepresentation Act 1967 (*Royscot Trust* v *Rogerson*, page 506) then contributory negligence should not apply since it would not be applicable in an action for fraudulent misrepresentation. This would be highly unsatisfactory given that negligent misstatement in tort is clearly covered by the 1945 Act. Some clarification and reform in this area is urgently required. (See Chandler & Higgins (1994) LMCLQ 326 and Oakley [1994] CLJ 218.)

(ii) *Damages in lieu of rescission*

Misrepresentation Act 1967

2. Damages for misrepresentation

(2) 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.

Notes

1. In the context of negligent or wholly innocent misrepresentations (i.e. honest and based on reasonable grounds) it is for the court in its discretion to decide to award damages instead of rescission if it feels that in the circumstances it would be fair to do so. In particular, if the misrepresentation was wholly innocent, then rescission may be an overreaction where damages would adequately compensate the misrepresentee, especially if the misrepresentation is on a trivial matter.

2. It has traditionally been considered that if the right to the remedy of rescission has been lost (see bars to rescission, page 484), then the court has no discretion to award damages in lieu of it under s. 2(2). In such cases there would be no remedy at all for innocent misrepresentation, and it must be doubtful that this is what Parliament intended. In *Thomas Witter Ltd* v *TBP Industries Ltd* [1996] 2 All ER 573, page 490, Jacob J *obiter* (because on the facts negligence was established) considered the issue and stated that:

> The defendants here argued that they had a defence of innocence both in relation to pattern book expenditure and in relation to the Allied problem, and so escaped s. 2(1). I reject that on the facts . . . . But even if the 'innocence defence' applies, then s. 2(2) comes into play. [Counsel for the defendants] argued that it could not do so because rescission is no longer available. He argued that the discretion under s. 2(2) to award damages crucially depends upon the rescission remedy remaining extant at the time the court comes to consider the question. Whether that argument is right has been a moot point since the Act was passed. The leading article of the time, Atiyah and Treitel 'Misrepresentation Act 1967' [1967] MLR 369, noticed the point at once. I found the argument unattractive: rescission might or might not be available at the time of trial depending on a host of factors which have nothing to do with behaviour of either party. I was not surprised to find that the authors of *Chitty on Contracts* (27th edn, 1994) para 6-058, p. 372 found the suggested construction 'strange' even though Mustill J had apparently accepted it *obiter* in *Atlantic Lines and Navigation Co. Inc.* v *Hallam Ltd, The Lucy* [1983] 1 Lloyd's Rep 188 and one of the plaintiffs conceded it in *Aiman* v *Associated Newspapers Ltd* (20 June 1980, unreported).
>
> The argument assumes that the Act is referring to the remedy of 'rescission', though this is not clear. If it were only the remedy referred to then it is difficult to understand the reference to 'has been rescinded' in the section. It seemed to me that the reference might well be to a claim by the representee that he was entitled to rescission, in which case it would be enough for the court to find that the agreement was 'rescissionable' at least by the date when the representee first claimed rescission or at any time. There was enough ambiguity here to look to see what was said in Parliament at the time of the passing of the Act, pursuant to the limited new-found freedom given by *Pepper (Inspector of Taxes)* v *Hart* [1993] 1 All ER 42, [1993] AC 593. [Counsel for the defendants] found what the Solicitor General of the time said in the House of Commons. Even though it was against his . . . case, in the usual fine tradition of the Bar, he drew it to my attention. The Solicitor General said (741 HC Official Report (5th series) cols 1388–1389, 20 February 1967):
>
> > . . . the hon. Gentleman put to me the case of the sale of a house. He asked me to suppose that there had been the sale of a house, some defect was discovered afterwards, it might be that a third party had come into the matter, and it might be entirely unjust or inequitable to insist on rescission in such a case. I suggest that in

such a case, as the Lord Chancellor said, the conveyance is unlikely to be rescinded because of the impossibility of restitution. My answer is that a case of that sort would be covered by Clause 2(2) which says [here the material words of the present section were read]. That is the option which is given to the court, and in the sort of case which has been put to me . . . it would follow that the court or arbitrator would almost certainly award damages in lieu of rescission. Therefore that matter is really fully covered.

So the Solicitor General told the House of Commons that it was his view that damages could be awarded under s. 2(2) when there was an impossibility of restitution. Accordingly, I hold that the power to award damages under s. 2(2) does not depend upon an extant right to rescission — it only depends upon a right having existed in the past. Whether it depends upon such a right existing at any time, or depends upon such a right subsisting at the time when the representee first claims rescission, I do not have to decide. It was here first claimed by letter of 25 April 1990 which is only some four months from the contract date. In principle, however, I would have thought that it is enough that at any time a right to rescind subsisted. It is damages in lieu of that right (even if barred by later events or lapse of time) which can be awarded.

(See Beale's comments (1995) 111 LQR 385, 387–8.)

3. In *Thomas Witter* v *TBP Industries*, Jacob J also sought (*obiter*) to identify the differences between damages under s. 2(1) and s. 2(2):

. . . what is the difference between s. 2(2) and s. 2(1)? In particular, since s. 2(1) has a defence of 'innocence' is that in practical terms useless because damages can be had under s. 2(2)? There is, of course, overlap between the two subsections on any construction and s. 2(3) explicitly recognises this. But if my construction covered all the cases covered by s. 2(1) then the latter would be pointless and my construction would probably be wrong. However, I do not think there is complete overlap. First, under s. 2(1) damages can be awarded in addition to rescission. So if there is 'innocence' the representor cannot have both remedies and never could, whatever the date of the decision. Secondly, the question of an award of damages under s. 2(2) is discretionary and the court must take into account the matters referred to in the concluding words of the subsection. Thirdly, the measure of damages under the two subsections may be different — s. 2(3) certainly contemplates that this may be so and moreover contemplates that s. 2(1) damages may be more than s. 2(2) damages and not the other way round. . . .

4. Although there is some assistance in the Act identifying the factors relevant to the decision to award damages in lieu of rescission, the section does not identify the measure of damages under s. 2(2).

Some further assistance on both of these questions is provided by the helpful *obiter* discussions of the Court of Appeal in the next case.

William Sindall plc v *Cambridgeshire County Council* [1994] 3 All ER 932 (CA)

For facts see page 439. Held: there was no misrepresentation so that rescission was not available and therefore no question of damages in lieu of rescission arose.

HOFFMANN LJ: . . . My conclusion that there are no grounds for rescission, either for misrepresentation or mistake, means that it is unnecessary to consider whether the judge correctly exercised his discretion under s. 2(2) of the Misrepresentation Act 1967 not to award damages in lieu of rescission. But in case this case goes further, I should say that in my judgment the judge approached this question on a false basis, arising from his mistake about the seriousness of the defect. . . .

The discretion conferred by s. 2(2) is a broad one, to do what is equitable. But there are three matters to which the court must in particular have regard.

The first is the nature of the misrepresentation. It is clear from the Law Reform Committee's Report that the court was meant to consider the importance of the representation in relation to the subject matter of the transaction. I have already said that in my view, in the context of a £5m sale of land, a misrepresentation which would have cost £18,000 to put right and was unlikely seriously to have interfered with the development or resale of the property was a matter of relatively minor importance.

The second matter to which the court must have regard is 'the loss that would be caused by it [the misrepresentation] if the contract were upheld'. The section speaks in terms of loss suffered rather than damages recoverable, but clearly contemplates that if the contract is upheld such loss will be compensated by an award of damages. Section 2(2) therefore gives a power to award damages in circumstances in which no damages would previously have been recoverable. Furthermore, such damages will be compensation for loss caused by the misrepresentation, whether it was negligent or not. This is made clear by s. 2(3), which reads as follows:

> Damages may be awarded under subsection (2) of this section whether or not he is liable to damages under subsection (1) thereof, but where he is so liable any award under subsection (2) shall be taken into account in assessing his liability under the said subsection (1).

Damages under s. 2(2) are therefore damages for the misrepresentation as such. What would be the measure of such damages? This court is not directly concerned with quantum, which would be determined at an inquiry. But since the court, in the exercise of its discretion, needs to know whether damages under s. 2(2) would be an adequate remedy and to be able to compare such damages with the loss which rescission would cause to Cambridgeshire, it is necessary to decide in principle how the damages would be calculated. . . .

Under s. 2(1), the measure of damages is the same as for fraudulent misrepresentation i.e. all loss caused by the plaintiff having been induced to enter into the contract: *Gemp Properties (UK) Ltd* v *Dentsply Research and Development Corp (Denton Hall & Burgin, third party)* [1991] 2 EGLR 197. This means that the misrepresentor is invariably deprived of the benefit of the bargain (e.g. any difference between the price paid and the value of the thing sold) and may have to pay additional damages for consequential loss suffered by the representee on account of having entered into the contract. In my judgment, however, it is clear that this will not necessarily be the measure of damages under s. 2(2).

First, s. 2(1) provides for damages to be awarded to a person who 'has entered into a contract after a misrepresentation has been made to him by another party and as a result thereof [of having entered into the contract] he has suffered loss'. In contrast s. 2(2) speaks of 'the loss which would be caused by it [the misrepresentation] if the contract were upheld'. In my view, s. 2(1) is concerned with the damage flowing from having entered into the contract, while s. 2(2) is concerned with damage caused by the property not being what it was represented to be.

Secondly, s. 2(3) contemplates that damages under s. 2(2) may be less than damages under s. 2(1) and should be taken into account when assessing damages under the latter subsection. This only makes sense if the measure of damages may be different.

Thirdly, the Law Reform Committee Report makes it clear that s. 2(2) was enacted because it was thought that it might be a hardship to the representor to be deprived of the whole benefit of the bargain on account of a minor misrepresentation. It could not possibly have intended the damages in lieu to be assessed on a principle which would invariably have the same effect.

The Law Reform Committee drew attention to the anomaly which already existed by which a minor misrepresentation gave rise to a right of rescission whereas a warranty in the same terms would have grounded no more than a claim for modest damages. It said that this anomaly would be exaggerated if its recommendation for abolition of the bar on rescission after completion were to be implemented. I think that s. 2(2) was intended to give the court a power to eliminate this anomaly by upholding the contract and compensating the plaintiff for the loss he has suffered on account of the property not having been what it was represented to be. In other words, damages under s. 2(2) should never exceed the sum which would have been awarded if the representation had been a warranty. It is not necessary for present purposes to discuss the circumstances in which they may be less.

If one looks at the matter when Sindall purported to rescind, the loss which would be caused if the contract were upheld was relatively small: the £18,000 it would have cost to divert the sewer, the loss of a plot and interest charges on any consequent delay at the rate of £2,000 a day. If one looks at the matter at the date of trial, the loss would have been nil because the sewer had been diverted.

The third matter to be taken into account under s. 2(2) is the loss which would be caused to Cambridgeshire by rescission. This is the loss of the bargain at the top of the market (cf *Atlantic Lines and Navigation Co. Inc v Hallam Ltd, The Lucy* [1983] 1 Lloyd's Rep 188) having to return about £8m in purchase price and interest in exchange for land worth less than £2m.

Having regard to these matters, and in particular the gross disparity between the loss which would be caused to Sindall by the misrepresentation and the loss which would be caused to Cambridgeshire by rescission, I would have exercised my discretion to award damages in lieu of rescission.

EVANS LJ: . . . Section 2(3) makes it clear that the statutory power to award damages under s. 2(2) is distinct from the plaintiff's right to recover damages under s. 2(1). Quoting from s. 2(2) itself, such damages are awarded 'in lieu of rescission' and the court has to have regard to three factors in particular, namely, the nature of the misrepresentation, the loss that would be caused by it (sc the misrepresentation) if the contract was upheld, and the loss that rescission would cause to the other party (sc the non-fraudulent author of the misrepresentation).

It has not been suggested that these three are the only factors which the court may take into account. The discretion is expressed in broad terms — 'If of opinion that it would be equitable to do so'. The three factors, however, in all but an exceptional case, are likely to be the ones to which most weight would be given, even if the subsection was silent in this respect.

No real difficulty arises in the present case as regards the nature of the misrepresentation, if any was made, nor as regards the loss which would be caused to the council, if rescission was upheld. There was no blameworthiness, on the judge's findings, so far as the council's officers in 1988-89 were concerned. . . . The consequences of the

misrepresentation were not negligible, but they were small in relation to the purchase and the project as a whole. The loss caused to the council by rescission would be very great. They would repay in excess of £5m, together with interest, and would have restored to them land worth only a fraction of that amount. In other words, they would suffer the decline in market values which has occurred since 1988. And, even if the easement had been discovered immediately and the contract had been rescinded then, the council would have suffered significant loss, simply by reason of the need to repeat the tendering process and find another buyer.

There is, however, much room for debate as to the 'loss that would be caused if the contract were upheld'. The subsection assumes, as I read it, that this loss will be compensated by the damages awarded, if the contract is upheld. But if the measure is the same as those awarded in respect of a fraudulent misrepresentation (*Doyle* v *Olby (Ironmongers) Ltd* [1969] 2 All ER 119, [1969] 2 QB 158), or under s. 2(1) (*Camp Properties (UK) Ltd* v *Dentsply Research and Development Corp (Denton Hall & Burgin, third party)* [1991] 2 EGLR 197; cf *Royscot Trust Ltd* v *Rogerson* [1991] 3 All ER 294, [1991] 2 QB 297), in cases where the contract continues in force, then two consequences seem to follow. First, damages under s. 2(2) are co-extensive with those under s. 2(1), whereas s. 2(3) suggests that they are, or may be, different. Secondly, an innocent and non-negligent defendant will be liable under s. 2(2) for damages which he is specifically excused under s. 2(1). Furthermore, if the plaintiff recovers full compensation under s. 2(2), if the contract is upheld, then he will not suffer any net loss, assuming that the damages are paid.

The cost of remedying the defect in the land was almost insignificant, and any delay and inconvenience suffered by the builders can be compensated by a relatively small additional sum. The real issue is whether account should be taken of the decline in market values which affects the builders if the contract stands, just as it would affect the council if rescission was upheld.

[Counsel for Sindall's] argument is that the builders are entitled to recover the whole of the loss which they have suffered as a result of entering into the transaction, inducing the fall in market values from 1988 until at least the time of purported rescission in December 1990. . . .

In my judgment, it is not correct that the measure of damages under s. 2(2) for the loss that would be caused by the misrepresentation if the contract were upheld is the same measure as under s. 2(1). The latter is established by the common law, and it is the amount required to compensate the party to whom the misrepresentation was made for all the losses which he has sustained by reason of his acting upon it at the time when he did. But the damages contemplated by s. 2(2) are damages in lieu of rescission. The starting point for the application of the subsection is the situation where a plaintiff has established a right to rescind the contract on grounds of innocent misrepresentation; its object is to ameliorate for the innocent misrepresentor the harsh consequences of rescission for a wholly innocent (meaning, non-negligent as well as non-fraudulent) misrepresentor, in a case where it is fairer to uphold the contract and award damages against him. Such an award of damages was not permitted in law or equity before 1967. The court, therefore, exercises a statutory jurisdiction, and it does so having regard to the circumstances at the date of the hearing, when otherwise rescission would be ordered. . . . When there has been a decline in market values since the date of the contract, then one party or the other will suffer that loss, depending on whether rescission is ordered or not. But that loss is not caused by the misrepresentation, except in the sense that the decline has occurred since the representation was made, and it does not measure the loss caused by the misrepresentation either when the representation was acted upon, or when the court decides whether to order

rescission or not. The 'loss caused by it', in my judgment, can be measured by the cost of remedying the defect, or alternatively by the reduced market value attributable to the defect, together with additional compensation, if appropriate . . .

When the court is required to form its own view of what is equitable between the parties at the date of the hearing, it is dangerous to lay down any hard-and-fast rule to the effect that no account can be taken of changed market values . . . Moreover, if it is right to take account of the current market value in assessing the loss which would be sustained by the council, if rescission was ordered, then it would be 'inequitable' not to have regard to this factor in the case of the builders also. But the effect of doing so is merely to re-state the issue which the court has to decide: in the circumstances of the case, should the loss of market remain where it presently lies?

Viewed in this way, it would be substantially unjust, in my judgment, to deprive the county council of the bargain which it made in 1988, albeit that the bargain was induced by a misrepresentation innocently made, but which was of little importance in relation to the contract as a whole. That misrepresentation apart, the builders made what has proved to be so far an unfortunate bargain for them (although they remain owners of an important potential development site in what is a notoriously cyclical market). To permit them to transfer the financial consequences to the council, in the circumstances of this case, could properly be described as a windfall for them.

For the above reasons, and taking into account the nature of the alleged representation and the history of the matter generally, including the builders' deliberate failure to make any serious attempt to find a solution to the difficulty which arose when the sewer was discovered, the equitable balance, in my judgment, lies in favour of upholding the contract and awarding damages in lieu of rescission in this case. If there was a live issue under s. 2(2) I would award damages in lieu of rescission and order the amount of such damages to be assessed.

There remains the question of whether these damages should include the decline in the market value of the land since the contract was made. As indicated above, in my judgment they should not. This conclusion may be inconsistent with the view expressed in *McGregor on Damages* (15th edn, 1988) para. 1752, and in defence to the distinguished author I should explain my reasons briefly. He suggests that the measure to be adopted is:

> the same as the normal measure of damages in tort where the plaintiff has been induced to contract by fraudulent or negligent misrepresentation . . . the overall result, therefore, is that the damages will be held to be the difference between the value transferred and the value received . . . no recovery being possible for consequential losses.'

If the 'value transferred' (meaning the price paid by the plaintiff, to whom the representation was made) was the market value of the property, then there is no difference between this formula and what *McGregor* para. 1718 calls the contract measure, that is to say the difference between the actual value received and the value which the property would have had, if the representation was true. By adopting the tort measure, therefore, as he does in para. 1752, the author impliedly rejects the contract measure, whereas in my judgment that becomes the correct measure in circumstances where the plaintiff is entitled to an order for rescission, but rescission is refused under s. 2(2) of the Act. This is because the difference in value between what the plaintiff was misled into believing that he was acquiring and the value of what he in fact received seems to me to be the measure of the loss caused to him by the misrepresentation in a case where he cannot rescind the contract and therefore retains the property which he received.

As *McGregor* points out, the tortious measure benefits a plaintiff who made a bad bargain, that is to say who agreed to pay more than the market value of the property in the state in which he believed it to be, more so than the contract measure would do. Conversely, it disbenefits one who paid less than the market value, because it disentitles him from recovering the whole of the difference which the contract measure would otherwise produce. Likewise, the right to rescind benefits a plaintiff who has paid, or agreed to pay more than, with hindsight, he should have done. The period of hindsight may be short or long; where it is long, and the value has fallen in line with the market and therefore for reasons unconnected with the misrepresentation, there is no justification, in my view, for holding that the author of the misrepresentation is liable to compensate the plaintiff for that loss, in a case where rescission is refused.

It is unnecessary to explore the wider questions whether a tortious measure should ever include damages for a fall in market values, and whether this measure, as described by Lord Denning MR in *Doyle* v *Olby (Ironmongers) Ltd* [1969] 2 All ER 119 at 121, [1969] 2 QB 158 at 166, is necessarily exclusive of, or inconsistent with, the contractual measure to the extent which has been suggested. The recovery of such damages in the present case, even if the tortious measure under s. 2(2) applies, appears to be barred by the following three obstacles: (1) such damage was caused, not by the misrepresentation, but by the subsequent fall in market values, an extraneous cause; (2) the authorities suggest that the plaintiff's loss has to be assessed at the date when the property was transferred (see *McGregor* para. 1727, citing *Waddell* v *Blockey* (1879) 4 QBD 678); and (3) if a subsequent rise, or fall, in market values is relevant at the date of trial, then a chance element enters into the calculation, whether the contract is rescinded or not.

I should add, however, that the reported authorities are sparse, as *McGregor* emphasises, and as I read them they do not purport to decide the question whether a decline in value until the time of discovery of the true facts is necessarily excluded.

It is sufficient for present purposes to say that an award of damages in lieu of rescission under s. 2(2) should in my view be calculated as I have described above.

Notes

1. See Beale (1995) 111 LQR 60.

2. Hoffmann LJ discusses the three factors identified in the subsection as relevant to the exercise of the court's discretion to award damages in lieu of rescission, namely the nature of the misrepresentation, the loss caused by the misrepresentation if the contract is upheld (i.e. damages to award to the representee instead of rescission) and the loss which would be caused to the non-fraudulent representor by rescission. The discussion of the measure of damages under s. 2(2) is relevant to the second of these factors. Significantly, unlike s. 2(1) damages which are concerned with damages resulting from making the contract, s. 2(2) damages are to be assessed on the basis of losses caused by the misrepresentation if the contract is upheld, i.e. losses due to the subject matter of the contract not being what it was represented to be. It follows that whereas consequential loss can be recovered under s. 2(1), such loss cannot be recovered under s. 2(2). (See Jacob J (*obiter*) in *Thomas Witter* v *TBP Industries Ltd* [1996] 2 All ER 573.)

3. The difficulty on the facts with the measure of damages concerned whether the builders could recover for the fall in the value of the land. However, as the Court of Appeal pointed out, that loss is not actually caused

by the misrepresentation but by the general fall in land values. Evans LJ argues that the loss caused by the misrepresentation is 'measured by the cost of remedying the defect, or alternatively by the reduced market value attributable to the defect'.

4. In *Thomas Witter v TBP Industries*, Jacob J concluded that 'The constant and justified academic criticism of the [Misrepresentation] Act indicates a subject well worth the attention of the Law Commission'.

SECTION 4: EXCLUDING LIABILITY FOR NON-FRAUDULENT MISREPRESENTATION

Misrepresentation Act 1967 (as amended)

3. **Liability arising in contract**

If a contract contains a term which would exclude or restrict —

(a) any liability to which a party to a contract may be subject by reason of any misrepresentation made by him before the contract was made; or

(b) any remedy available to another party to the contract by reason of such a misrepresentation,

that term shall be of no effect except 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.

Notes

1. Under the original s. 3 (before it was amended by s. 8 of the Unfair Contract Terms Act 1977), reasonableness was judged at the time of the judgment; it is now judged, according to the Unfair Contract Terms Act 1977, s. 11, at the time that the contract was made.

Much of the case law, such as there is, is based on the unamended version of s. 3, and therefore it is important to be aware of this difference.

2. If a misrepresentation is made by an agent on behalf of a party, then any term excluding or limiting that agent's authority operates to protect the principal and is outside the scope of s. 3.

Overbrooke Estates Ltd v *Glencombe Properties Ltd*
[1974] 3 All ER 511

The conditions of sale at an auction stated that: 'The vendors do not make or give and neither the Auctioneers nor any person in the employment of the Auctioneers has any authority to make or give any representation or warranty in relation to [the property]'. On 5 November, in response to an inquiry from the defendants, the auctioneers, who were agents for the plaintiffs, informed the defendants that no local authority had schemes or plans for the property or were interested in it for compulsory purchase. At the auction on 8 November the defendants successfully bid for the property and paid a deposit, and the auctioneers signed a memorandum of contract. The defendants later learnt that the property might well be included in a

slum clearance programme, so they stopped payment on the deposit cheque and informed the plaintiffs that they would not now be proceeding. The plaintiffs claimed specific performance, and the defendants alleged in their defence that the clause relied on had to be fair and reasonable within s. 3. Held: this was not a clause which excluded or restricted liability for misrepresentation. It amounted only to a public limitation on the ostensible authority of this agent. The plaintiffs knew about this limitation before they bid, since it was contained in the conditions of sale that they received in advance. As a result, s. 3 did not apply.

Notes

1. This limitation on the ostensible authority of the agent was defining the contractual duty itself rather than excluding or restricting liability for its breach. Section 3, it appears, has not therefore been extended by the Unfair Contract Terms Act 1977, s. 13 (page 318), to cover provisions which exclude or restrict the duty or obligation itself.

2. Ostensible authority occurs where an agent's usual authority to bind the principal has been restricted but the third party has no notice of this restriction and deals with the agent on the basis that there is no restriction. The principal will be bound to the third party. (Here the third party had notice of the restriction so that the principal could not be liable.)

3. The Unfair Terms in Consumer Contracts Regulations 1994, sch. 3(1)(n), provides that clauses 'limiting the seller's or supplier's obligation to respect commitments undertaken by his agents or making his commitments subject to compliance with a particular formality in consumer contracts' may be regarded as unfair. Such clauses are generally referred to as 'entire agreement' clauses. The Director-General of Fair Trading appears to be taking a broad view of this provision and has been able to achieve deletion of clauses stating that an agent or a salesman has no authority to make legally binding representations (see OFT *Bulletin* 2, September 1996, 'Unfair Contract Terms' (Part 4, Group 11).

4. In any event, the decision of Jacob J in *Thomas Witter v TBP Industries Ltd* [1996] 2 All ER 573, has proved controversial in its assessment of a previously typical entire agreement clause. The clause in question provided that the agreement was the entire agreement and that 'the purchaser acknowledges that it has not been induced to enter into this Agreement by any representation or warranty' other than the warranties in sch. 6. Jacob J rejected the claim by the defendants that this excluded them from liability for misrepresentation, whether pre-contractual or incorporated into the contract. First, it was not sufficiently clear that the purchaser was agreeing only to a remedy for breach of warranty and excluding liability for misrepresentations. He stated that a party seeking such protection cannot be 'mealy-mouthed in his clause' and this clause was not sufficiently explicit since it might be interpreted as merely setting out those representations that the purchaser thinks he is relying on at the time. Secondly, where a statement had become a warranty, an exclusion clause excluding liability for misrepresentation was ineffective because the remedy for misrepresentation in such a case is preserved by s. 1 of the Misrepresentation Act 1967.

It is not possible to avoid the 1977 Act by a clause purporting to alter the statement to one of opinion.

Cremdean Properties Ltd v *Nash*
(1977) 244 EG 547 (CA)

The plaintiffs claimed rescission of contracts for the sale of two properties, alleging misrepresentation in the particulars of the invitation to tender as to the area of lettable office space which was within the planning permission with which the property was sold. The defendants relied in their defence on a footnote clause in the conditions of sale by tender which provided that:

> (a) 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 be grounds on which compensation may be claimed and neither do they constitute any part of an offer of a contract (b) 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.

As a preliminary point it had to be decided whether this footnote could operate as a disclaimer.

BRIDGE LJ: . . . In effect what [counsel for the defendants] says is this. The terms of the footnote are not simply, if contractual at all, a contractual exclusion either of any liability to which the defendant would otherwise be subject for any misrepresentation in the document, or of any remedy otherwise available on that ground to the plaintiff. The footnote is effective, so the argument runs, to nullify any representation in the document altogether; it is effective, so it is said, to bring about a situation in law as if no representation at all had ever been made. For my part, I am quite unable to accept that argument. I reject it primarily on the simple basis that on no reading of the language of the footnote could it have the remarkable effect contended for. . . .

[After referring to *Overbrooke Estates Ltd* v *Glencombe Properties Ltd* [1974] 3 All ER 511, Bridge LJ continued:] It is one thing to say that section 3 does not inhibit a principal from publicly giving notice limiting the ostensible authority of his agents; it is quite another thing to say that a principal can circumvent the plainly intended effect of section 3 by a clause excluding his own liability for a representation which he has undoubtedly made.

I am quite content to found my judgment in this case on the proposition that the language of the footnote relied upon . . . simply does not, on its true interpretation, have the effect contended for. But I would go further and say that if the ingenuity of a draftsman could devise language which would have that effect, I am extremely doubtful whether the court would allow it to operate so as to defeat section 3. Supposing the vendor included a clause which the purchaser was required to, and did, agree to in some such terms as 'notwithstanding any statement of fact included in these particulars the vendor shall be conclusively deemed to have made no representation within the meaning of the Misrepresentation Act 1967,' I should have thought that that was only a form of words the intended and actual effect of which was to exclude or restrict liability, and I should not have thought that the courts would have

been ready to allow such ingenuity in forms of language to defeat the plain purpose at which section 3 is aimed.

I should add that on this part of the case we heard a further argument . . . purporting to draw a distinction between giving information or making a statement of opinion or belief on the one hand, and making a representation on the other. For my part, the distinction seems to be one without a difference. The word 'representation' is an extremely wide term; I cannot see why one should not be making a representation when giving information or when stating one's opinion or belief. To my mind it would be a retrograde step if the court were to give the word 'representation,' when it appears in the Misrepresentation Act 1967, any narrow or limited construction, less wide than the perfectly natural meaning of the word.

SCARMAN LJ: . . . [T]he case for the [defendants] does have an audacity and a simple logic which I confess I find attractive. It runs thus: a statement is not a representation unless it is also a statement that what is stated is true. If in context a statement contains no assertion, express or implied, that its content is accurate, there is no representation. *Ergo*, there can be no misrepresentation; *ergo*, the Misrepresentation Act 1967 cannot apply to it. Humpty Dumpty would have fallen for this argument. If we were to fall for it, the Misrepresentation Act would be dashed to pieces which not all the King's lawyers could put together again.

. . . [Counsel for the defendants] submits that a note, or postscript, to the special conditions of sale by tender qualify the statement by removing from it any representation that its content was accurate. According to his argument, the statement went no further than to imply that the defendant believed it to be accurate. In my judgement it is not possible so to read the statement or the note. The statement was a plain representation that under the outline planning consent approximately 17,900 sq ft would be available for offices. The note, fairly construed, was a warning to the would-be purchaser to check the facts; that is to say, not to rely on it. Such a warning does not destroy the representation; indeed, it is wholly consistent with the statement being a representation. It is because the statement contains the representation that the warning is given. Since the statement was false, there was a false representation; the Act therefore applies.

Note

In *South Western General Property Company Ltd* v *Marton* (1982) 263 EG 1090, Croom-Johnson J had to decide on the reasonableness of a clause where the representation related to planning permission. He stated that it was a question of judging the particular clause in the contract with the particular buyer. He found the clause to be unreasonable because the facts on which the representation was based were only within the knowledge of the vendor and related to matters which were central to the contract. In addition, the particular buyer was a householder, buying the site for his own residence, as opposed to a property speculator.

Howard Marine & Dredging Co. Ltd v *A. Ogden & Sons (Excavations) Ltd*
[1978] QB 574 (CA)

The facts of this case appear at page 503. The relevant clause stated: '. . . the charterers acceptance of handing over the vessel shall be conclusive

that they have examined the vessel and found her in all respects seaworthy, in good order and condition and in all respects fit for the intended and contemplated use by the charterers and in every other way satisfactory to them.'

BRIDGE LJ: A clause of this kind is to be narrowly construed. It can only be relied on as conclusive evidence of the charterers' satisfaction in relation to such attributes of the vessel as would be apparent on an ordinary examination of the vessel. I do not think deadweight capacity is such an attribute. It can only be ascertained by an elaborate calculation or by an inspection of the ship's documents. But even if, contrary to this view, the clause can be read as apt to exclude liability for the earlier misrepresentation, Howards still have to surmount the restriction imposed by section 3 of the Misrepresentation Act 1967. . . .

What the judge said in this matter was: 'If the wording of the clause is apt to exempt from responsibility for negligent misrepresentation as to carrying capacity, I hold that such exemption is not fair and reasonable.'. . . .

Note

1. The factor influencing the majority (Bridge and Shaw LJJ) is that it cannot be reasonable to exclude liability for misrepresentation in respect of information to which the representor had access and the representee did not. (See also *South Western General Property Co. Ltd* v *Marton*, page 524.)
2. However, Lord Denning, applying the original s. 3, considered that the question which had to be asked was whether 'reliance on the clause was fair and reasonable in the circumstances of the case', and on that basis he considered that it was reasonable. He said (at p. 594):

If the clause itself is reasonable, that goes a long way towards showing that reliance on it is fair and reasonable. It seems to me that the clause was itself fair and reasonable. The parties here were commercial concerns and were of equal bargaining power. The clause was not foisted by one on the other in a standard printed form. It was contained in all the drafts which passed between them, and it was no doubt given close consideration by both sides, like all the other clauses, some of which were amended and others not. It was a clause common in charterparties of this kind: and is familiar in other commercial contracts, such as construction and engineering contracts, see, for instance, *S. Pearson & Son Ltd* v *Dublin Corporation* [1907] AC 351, 356, and the useful observations in *Hudson on Building Contracts*, 10th ed. (1970), pp. 39, 48. It is specially applicable in cases where the contractor has the opportunity of checking the position for himself. It tells him that he should do so: and that he should not rely on any information given beforehand, for it may be inaccurate. Thus it provides a valuable safeguard against the consequences of innocent misrepresentation.

Even if the clause were somewhat too wide (I do not think it is), nevertheless this is, I think, a case where it would be fair and reasonable to allow reliance on it. Here is a clause by which Ogdens accepted that the barges were 'in all respects fit for the intended and contemplated use by the charterers.' Ogdens had had full inspection and examination of the barges. They had had an on-hire survey by their surveyors. Any expert could have given them a reliable estimate as to the deadweight capacity. Yet they seek to say that the barges were not fit for the use for which they intended them — in that they were of too low carrying capacity. And in support of this case they have

no written representation to go upon. They only have two telephone conversations and one interview — as to which there is an acute conflict of evidence. It is just such conflicts which commercial men seek to avoid by such a clause as this. I would do nothing to impair its efficacy. I would allow Howards to rely on it.

Lord Denning considered that the representee should have checked the information he was given.

3. It is more difficult to conclude that a clause is reasonable when applying the amended s. 3 so that reasonableness is judged at the time that the contract is made.

Walker v *Boyle*
[1982] 1 All ER 634

In answer to a preliminary inquiry before the sale of land, the vendor negligently stated that to the vendor's knowledge there were no boundary disputes. Contracts were exchanged using the National Conditions of Sale (19th edn). Condition 17(1) provided that 'no error, misstatement or omission in any preliminary answer concerning the property shall annul the sale'. When the purchaser discovered the boundary dispute he sought rescission, but the vendor claimed that this was precluded by condition 17(1). The purchaser argued, *inter alia*, that condition 17(1) was an exclusion clause that fell within s. 3 of the Misrepresentation Act 1967 and had to be shown to be reasonable. Held: this condition did not apply to misrepresentations where the true facts were within the vendor's knowledge and, in any event, it was an exclusion clause within s. 3 which the vendor had not established to be reasonable. The mere fact that it was a common clause in standard conditions of sale, or that both parties had experienced solicitors acting for them, did not make it reasonable.

Notes

1. Again, the vital factor was that the vendor alone had the information and therefore could not exclude liability in misrepresentation in respect of that information.

2. In *Thomas Witter* v *TBP Industries* [1996] 2 All ER 573, page 490, Jacob J went on to consider that, in any event, the entire agreement clause was unreasonable within s. 3 of the Misrepresentation Act 1967:

> . . . But I have to say that even if cl. 17.2 had exclusionary effect it would to my mind be neither fair nor reasonable. The problem is its scope. The 1967 Act calls for consideration of the *term* as such. And it refers to 'any liability' and 'any misrepresentation'. It does not call for consideration of the term so far as it applies to the misrepresentation in question or the kind of misrepresentation in question. The term is not severable: it is either reasonable as a whole or not. So one must consider its every potential effect. The clause does not distinguish between fraudulent, negligent, or innocent misrepresentation. If it excludes liability for one kind of misrepresentation it does so for all. I cannot think it reasonable to exclude liability for fraudulent

misrepresentation — indeed [counsel for the defendants] accepted it would not work in the case of fraud. It may well be, with a different clause, reasonable to exclude liability for innocent misrepresentation or even negligent misrepresentation. But since the width of this clause is too great I would have held it failed the requirement of reasonableness and so was of no effect.

A possible route around this latter objection would be to construe the clause so that it did not apply to a fraudulent misrepresentation. This approach is artificial. It is unnecessary now that the 1977 Act exists to destroy unreasonable exclusion clauses. The construction involves creating an implied exception in the case of fraud. What about an implied exclusion of negligence? Or gross negligence? It is not for the law to fudge a way for an exclusion clause to be valid. If a party wants to exclude liability for certain sorts of misrepresentations, it must spell those sorts out clearly.

In coming to this conclusion the judge expressly rejected the argument that the clause was reasonable because it was in common use.

In future it will therefore be important to draft such a clause so as to remove its potential to apply to fraudulent misrepresentations because it will not be possible to sever objectionable parts (which accords with the approach taken in *Stewart Gill Ltd* v *Horatio Myer & Co. Ltd* [1992] 2 All ER 257, page 319).

13 DURESS, UNDUE INFLUENCE AND INEQUALITY OF BARGAINING POWER

Traditionally the law has not been concerned with the fairness of the bargain reached by the parties. However, Parliament has intervened to regulate contracts in situations where one party needs protection against the contractual power of the other party, e.g., Consumer Credit Act 1974 and the Unfair Terms in Consumer Contracts Regulations 1994, pages 344–6. At common law and in equity the doctrines of duress and undue influence allow a contract to be set aside if one party has put unfair and improper pressure on the other in the negotiations leading up to the contract.

SECTION 1: DURESS

A: DURESS TO THE PERSON

Barton v *Armstrong*
[1975] 2 All ER 465 (PC)

B, the managing director of a public company, resented the interference of the company's chairman, A. A was removed as chairman and B was informed by the company's principal lender that they would not advance further money. B believed that if the money owed to A was paid, the lender would agree to provide further finance. It was established that A had threatened to kill B and had made threatening telephone calls to B. B also genuinely believed that A had hired a criminal to kill him. B executed a deed, which was favourable to A, whereby the company agreed to pay $140,000 in cash to A and to purchase A's shares in the company for $180,000. The lender still refused to advance any money to the company

which was soon in financial difficulties. B claimed that the deed was void as it had been executed under duress. The trial judge, Street J, had considered that the sole reason why B had executed the deed was commercial necessity. The Court of Appeal of the Supreme Court of New South Wales held that the onus was on B to show that, but for the threats, he would not have signed the agreement, and B had failed to discharge that onus. The Privy Council by a majority of 3:2 (Lord Wilberforce and Lord Simon of Glaisdale dissenting) overturned this decision. Held: duress had to be treated in the same way as fraudulent misrepresentation, so that as long as A's threats were *one* of the reasons why B executed the deed, B was entitled to relief (see *Edgington* v *Fitzmaurice* (1885) 29 ChD 459, page 481). Once unlawful pressure was established, it was for A to establish that the threats and unlawful pressure exerted on B had in no way affected B's decision to enter the agreement. The majority of the Privy Council held that A had not established this, and therefore the deed was 'void' for duress.

LORD CROSS OF CHELSEA: It is hardly surprising that there is no direct authority on the point, for if A threatens B with death if he does not execute some document and B, who takes A's threats seriously, executes the document it can be only in the most unusual circumstances that there can be any doubt whether the threats operated to induce him to execute the document. But this is a most unusual case and the findings of fact made below do undoubtedly raise the question whether it was necessary for Barton in order to obtain relief to establish that he would not have executed the deed in question but for the threats. . . . There is an obvious analogy between setting aside a disposition for duress or undue influence and setting it aside for fraud. . . . Had Armstrong made a fraudulent misrepresentation to Barton for the purpose of inducing him to execute the deed of 17th January 1967 the answer to the problem which has arisen would have been clear. If it were established that Barton did not allow the representation to affect his judgment then he could not make it a ground for relief even though the representation was designed and known by Barton to be designed to affect his judgment. If on the other hand Barton relied on the misrepresentation Armstrong could not have defeated his claim to relief by showing that there were other more weighty causes which contributed to his decision to execute the deed, for in this field the court does not allow an examination into the relative importance of contributory causes. 'Once make out that there has been anything like deception, and no contract resting in any degree on that foundation can stand' (per Lord Cranworth LJ in *Reynell* v *Sprye* (1852) 1 De GM & G 660). . . . Their Lordships think that the same rule should apply in cases of duress and that if Armstrong's threats were 'a' reason for Barton's executing the deed he is entitled to relief even though he might well have entered into the contract if Armstrong had uttered no threats to induce him to do so. . . . If Barton had to establish that he would not have made the agreement but for Armstrong's threats then their Lordships would not dissent from the view that he had not made out his case. But no such onus lay on him. On the contrary it was for Armstrong to establish, if he could, that the threats which he was making and the unlawful pressure which he was exerting for the purpose of inducing Barton to sign the agreement and which Barton knew were being made and exerted for this purpose in fact contributed nothing to Barton's decision to sign. The judge has found that during the ten days or so before the documents were

executed Barton was in genuine fear that Armstrong was planning to have him killed if the agreement was not signed. His state of mind was described by the judge as one of 'very real mental torment' and he believed that his fears would be at an end when once the documents were executed. . . . The proper inference to be drawn from the facts found is, their Lordships think, that though it may be that Barton would have executed the documents even if Armstrong had made no threats and exerted no unlawful pressure to induce him to do so the threats and unlawful pressure in fact contributed to his decision to sign the documents and to recommend their execution by Landmark and the other parties to them.

In the result therefore the appeal should be allowed and a declaration made that the deeds in question were executed by Barton under duress and are void so far as concerns him. . . .

The dissenting judgment of Lord Wilberforce and Lord Simon of Glaisdale does not differ from the majority on the law applicable to duress to the person. However, the minority considered that they could not overturn Street J's findings of fact and found the contract to be valid.

LORD WILBERFORCE and LORD SIMON OF GLAISDALE, *dissenting*: The action is one to set aside an apparently complete and valid agreement on the ground of duress. The basis of the plaintiff's claim is, thus, that though there was apparent consent there was no true consent to the agreement: that the agreement was not voluntary.

This involves consideration of what the law regards as voluntary, or its opposite; for in life, including the life of commerce and finance, many acts are done under pressure, sometimes overwhelming pressure, so that one can say that the actor had no choice but to act. Absence of choice in this sense does not negate consent in law: for this the pressure must be one of a kind which the law does not regard as legitimate. Thus, out of the various means by which consent may be obtained — advice, persuasion, influence, inducement, representation, commercial pressure — the law has come to select some which it will not accept as a reason for voluntary action: fraud, abuse of relation of confidence, undue influence, duress or coercion. In this the law, under the influence of equity, has developed from the old common law conception of duress — threat to life and limb — and it has arrived at the modern generalisation expressed by Holmes J — 'subjected to an improper motive for action' (*Fairbanks* v *Snow* (1887) 13 NE 596).

In an action such as the present, then, the first step required of the plaintiff is to show that some illegitimate means of persuasion was used. That there were threats to Barton's life was found by the judge, though he did not accept Barton's evidence in important respects. . . .

The next necessary step would be to establish the relationship between the illegitimate means used and the action taken. For the purposes of the present case (reserving our opinion as to cases which may arise in other contexts) we are prepared to accept, as the formula most favourable to Barton, the test proposed by the majority, namely that the illegitimate means used was *a* reason (not *the* reason, nor the *predominant* reason nor the *clinching* reason) why the complainant acted as he did. We are also prepared to accept that a decisive answer is not obtainable by asking the question whether the contract would have been made even if there had been no threats because, even if the answer to this question is affirmative, that does not prove that the contract was not made because of the threats.

Assuming therefore that what has to be decided is whether the illegitimate means used was a reason why the complainant acted as he did, it follows that his reason for acting must (unless the case is one of automatism which this is not) be a conscious reason so that the complainant can give evidence of it: 'I acted because I was forced'. If his evidence is honest and accepted, that will normally conclude the issue. . . .

We think it important to notice how little of Barton's case was accepted: how much of it — indeed almost the whole of his essential contentions — failed. In general the judge found that his case was reconstructed after the event; it was not until nearly a year after signing the agreement in January 1967 that he brought forward his claim of duress. . . .

Street J had found that Barton was motivated to enter into the agreement by sheer commercial necessity. By this he meant that the company would survive and be profitable without Armstrong, but not with him, and that the likelihood and extent of such profit justified the price to be paid to get rid of Armstrong. He meant also, as his judgment shows, that Barton was motivated by a desire for uncontested control over the business, rather than a sharing of it with Armstrong. . . .

The judge's findings were . . . accepted, after careful examination by Taylor A-JA: '. . . the conclusion', he finds, 'that Barton entered into this agreement because he wanted to and from commercial motives only is, I think, undoubtedly correct.'

The appeal cannot succeed unless these most explicit findings are overturned. We consider that no basis exists for doing so. . . .

Notes

1. Although Lord Cross refers to duress as rendering a contract void *ab initio*, it is only voidable. If Lord Cross was stating the consequence *after* avoidance, his statement can be reconciled with accepted principle. (As duress renders a contract voidable, the bars to rescission apply so that the remedy can, for example, be lost by affirmation, see page 484.)
2. The Privy Council held that absence of choice is not sufficient on its own to negate consent, since the pressure must be illegitimate, and *Barton v Armstrong* has clearly confirmed that threats to life are illegitimate. In other categories of duress the definition of 'illegitimate threats' is not as obvious.
3. The burden of proof is placed upon the pressurising party to establish that the threats in no way influenced the contract. This will be very difficult to establish.
4. In their dissenting judgment, Lords Wilberforce and Simon stress the delay of a year in bringing the claim of duress. This has proved to be a vital factor affecting the ability to set aside a contract for economic duress, page 532.

B: DURESS TO PROPERTY

Duress to property occurs when there is a threat to seize the owner's property or to damage it. In *Occidental Worldwide Investment Corp v Skibs A/S Avanti, The Siboen and the Sibotre* [1976] 1 Lloyd's Rep 293, Kerr J considered that a contract could be avoided in such cases.

. . . First, [counsel] submitted that English law only knows duress to the person and duress to goods, and that a case like the present falls into neither category, with the

result that this defence must fail in limine. Secondly, he submitted that although money paid under duress to goods is recoverable, a contract can only be set aside for duress to the person but not in any other case of duress. He said that in every case in which a party enters into a contract otherwise than under duress to the person, any payment or forbearance pursuant to such contract is regarded as voluntary, whatever may have been the nature or degree of compulsion, short of violence to the person, which may have caused him to enter into the contract. He relied mainly on a line of authority in which *Skeate* v *Beale*, (1841) 11 Ad. & E. 983 is the leading case.

I do not think that English law is as limited . . . though there are statements in some of the cases which support his submissions. For instance, if I should be compelled to sign a lease or some other contract for a nominal but legally sufficient consideration under an imminent threat of having my house burnt down or a valuable picture slashed, though without any threat of physical violence to anyone, I do not think that the law would uphold the agreement. I think that a plea of coercion or compulsion would be available in such cases. . . .

This is also confirmed by Lord Goff in *Dimskal Shipping Co. SA* v *International Transport Workers' Federation, The Evia Luck* [1991] 4 All ER 871, 878. See also *The 'Alev'* [1989] 1 Lloyd's Rep 138, page 541.

C: ECONOMIC DURESS

It is only comparatively recently that the courts have accepted that a contract can be set aside where illegitimate commercial pressure is exerted by one party on another. The previous mechanism to prevent such promises being enforceable was the doctrine of consideration (*Stilk* v *Myrick* (1809) 2 Camp 317, 6 Esp 129 (page 123) and *Atlas Express* v *Kafco Ltd* [1989] 1 All ER 641).

Following the Court of Appeal's decision in *Williams* v *Roffey Brothers & Nicholls (Contractors) Ltd* [1990] 1 All ER 512 (page 125), the emphasis has shifted, so that economic duress will be vitally important in preventing extortion in the future. The limits of the doctrine therefore need to be clearly defined, and in the view of academic commentators it needs to be given a sounder conceptual basis.

(a) Coercion of the will which vitiates consent

Occidental Worldwide Investment Corporation v *Skibs AlS Avanti, The Siboen and the Sibotre*
[1976] 1 Lloyd's Rep 293

In 1970, the defendants agreed to let two tankers for three years to Concord, a subsidiary company of Occidental Petroleum, at a rate of hire of $4.40 per ton per month. In the autumn of 1971, Occidental had financial problems and sought to renegotiate the charter to reduce the rates of hire. The impression given was that Concord, the charterer, did not have any substantial assets and that it required the continuing support of its

parent company. If the hire was not reduced the charterer threatened cancellation of the charters, and alleged that the parent company would allow the charterer to go bankrupt so that the owners would not even be able to seek a remedy for breach of the charter. This was a gross distortion of the truth. The defendants agreed to reduce the hire to $4.10 but later they withdrew both vessels. The charterer sought damages for wrongful repudiation, and the defendants counterclaimed arguing that they had only agreed to the alteration because of duress. Held: the duress argument failed, because although the defendants had acted under great pressure in agreeing to the altered rate, it could not be regarded in law as a coercion of their will so as to vitiate their consent.

KERR J: But even assuming, as I think, that our law is open to further development in relation to contracts concluded under some form of compulsion not amounting to duress to the person, the Court must in every case at least be satisfied that the consent of the other party was overborne by compulsion so as to deprive him of any animus contrahendi. This would depend on the facts of each case. One relevant factor would be whether the party relying on duress made any protest at the time or shortly thereafter. Another would be to consider whether or not he treated the settlement as closing the transaction in question and as binding upon him, or whether he made it clear that he regarded the position as still open. The question whether or not there was any intention to close the transaction is referred to in the judgments of Lord Reading, CJ, and Lord Justice Buckley in *Maskell* v *Horner*, [1915] 3 KB 106. But the facts of the present case fall a long way short of the test which would in law be required to make good a defence of compulsion or duress. Believing the statements about the charterers' financial state to be true, as must for this purpose be assumed, Captain Tschudi made no protest about having to conclude the addenda, either at the Paris meeting on Mar. 26, 1972, or at any time before the telex of Apr. 28, 1973. He repeatedly said in his evidence that he regarded the agreement then reached as binding and sought to uphold it in the subsequent arbitration. He was acting under great pressure, but only commercial pressure, and not under anything which could in law be regarded as a coercion of his will so as to vitiate his consent. I therefore hold that the plea of duress fails.

Notes

1. A line was drawn on the facts between acceptable commercial pressure and illegitimate pressure, but there are no guidelines to assist in drawing that line in the future.
2. It is incorrect to argue that duress is based upon consent being vitiated so that the act is not voluntary, because the victim of duress undoubtedly submits intentionally and knows what he is doing. The more extreme the pressure the more real the consent will be. Duress, it is argued, does not deprive a person of all choice; rather, it presents him with a choice between evils. Lord Scarman clearly accepts this in *The Universe Sentinel* [1983] 1 AC 366 (page 538), when he stresses that it is intentional submission by a victim of duress because the victim realises there is no other practical choice available. In *The Evia Luck* [1991] 4 All ER 871, Lord Goff doubted whether it was helpful to speak of the plaintiff's will having been coerced.

Atiyah severely criticised this concept of consent being vitiated by duress ((1982) 98 LQR 197) and considered that it was likely to lead to irrelevant inquiries into the psychological motivations of the party pleading duress. In reality it is not any absence of consent which determines duress but the nature of the threat which has been made.

North Ocean Shipping Co. Ltd v *Hyundai Construction Co. Ltd, The Atlantic Baron*
[1979] QB 705

The plaintiffs entered into a contract with the defendant shipbuilding company to build a tanker for a fixed price, payable in five instalments. The defendant agreed to open a letter of credit to provide security for the repayment of the instalments if there was any default in performance of the contract. After the plaintiffs had paid the first instalment, the US dollar was devalued by 10 per cent and the defendant claimed an increase of 10 per cent in the remaining instalments, threatening not to complete the contract if this increase was not paid. Since the plaintiffs were negotiating a very lucrative contract for the charter of the tanker, they agreed in June 1973 to make the additional payments 'without prejudice' to their rights and asked the company to make a corresponding increase in the letter of credit, which the company did. The tanker was delivered in November 1974 without protest, but in July 1975 the plaintiffs sought the return of the extra 10 per cent paid on the last four instalments. There were two issues in the case: first, had the defendant provided consideration for the plaintiffs' promise to pay more (page 124) and, secondly, if it had, was it nevertheless an agreement entered into under duress and so voidable? Held: this threat to breach the contract without any legal justification amounted to duress by means of economic pressure, and therefore the agreement was voidable. However, as a result of the delay between November 1974 and July 1975, the plaintiffs must be taken to have affirmed the contract so that the claim failed.

MOCATTA J: . . . First, I do not take the view that the recovery of money paid under duress other than to the person is necessarily limited to duress to goods falling within one of the categories hitherto established by the English cases . . . Secondly, from this it follows that the compulsion may take the form of 'economic duress' if the necessary facts are proved. A threat to break a contract may amount to such 'economic duress.' Thirdly, if there has been such a form of duress leading to a contract for consideration, I think that contract is a voidable one which can be avoided and the excess money paid under it recovered.

I think the facts found in this case do establish that the agreement to increase the price by 10 per cent reached at the end of June 1973 was caused by what may be called 'economic duress.' The Yard were adamant in insisting on the increased price without having any legal justification for so doing and the owners realised that the Yard would not accept anything other than an unqualified agreement to the increase. The owners might have claimed damages in arbitration against the Yard with all the inherent unavoidable uncertainties of litigation, but in view of the position of the Yard

vis-à-vis their relations with Shell it would be unreasonable to hold that this is the course they should have taken: see *Astley* v *Reynolds* (1731) 2 Str. 915. The owners made a very reasonable offer of arbitration coupled with security for any award in the Yard's favour that might be made, but this was refused. They then made their agreement, which can truly I think be said to have been made under compulsion, by the telex of June 28 without prejudice to their rights. I do not consider the Yard's ignorance of the Shell charter material. It may well be that had they known of it they would have been even more exigent.

If I am right in the conclusion reached with some doubt earlier that there was consideration for the 10 per cent increase agreement reached at the end of June 1973, and it be right to regard this as having been reached under a kind of duress in the form of economic pressure, then what is said in *Chitty on Contracts*, 24th ed. (1977), vol. 1, para. 442, p. 207, to which both counsel referred me, is relevant, namely, that a contract entered into under duress is voidable and not void:

> . . . consequently a person who has entered into a contract under duress, may either affirm or avoid such contract after the duress has ceased; and if he has so voluntarily acted under it with a full knowledge of all the circumstances he may be held bound on the ground of ratification, or if, after escaping from the duress, he takes no steps to set aside the transaction, he may be found to have affirmed it.

. . . There was . . . a delay between November 27, 1974, when the *Atlantic Baron* was delivered and July 30, 1975, before the owners put forward their claim.

. . . I have come to the conclusion that the important points here are that since there was no danger at this time in registering a protest, the final payments were made without any qualification and were followed by a delay until July 31, 1975, before the owners put forward their claim, the correct inference to draw, taking an objective view of the facts, is that the action and inaction of the owners can only be regarded as an affirmation of the variation in June 1973 of the terms of the original contract by the agreement to pay the additional 10 per cent . . . I do not think that an intention on the part of the owners not to affirm the agreement for the extra payments not indicated to the Yard can avail them in the view of their overt acts. As was said in *Deacon* v *Transport Regulation Board* [1958] VR 458, 460 in considering whether a payment was made voluntarily or not: 'No secret mental reservation of the doer is material. The question is — what would his conduct indicate to a reasonable man as his mental state.' I think this test is equally applicable to the decision this court has to make whether a voidable contract has been affirmed or not, and I have applied this test in reaching the conclusion I have just expressed.

I think I should add very shortly that having considered the many authorities cited, even if I had come to a different conclusion on the issue about consideration, I would have come to the same decision adverse to the owners on the question whether the payments were made voluntarily in the sense of being made to close the transaction.

Pao On v *Lau Yiu Long*
[1980] AC 614 (PC)

(The full facts of this case appear at page 113.) The plaintiffs threatened not to perform their promise that they would not sell 60 per cent of their shares in the Fu Chip Company for one year unless the defendants, the majority shareholders in the company, agreed to indemnify them against a loss in the value of their shares in that period. The defendants agreed to

this demand and signed a written indemnity to compensate the plaintiffs on 60 per cent of their holding if the market price fell below $2.50 a share. The share price dropped and the plaintiffs sought to rely on the indemnity, but the defendants refused to comply with its terms. One of the questions related to whether the defendants' consent was vitiated by duress. Held: although the defendants had been subjected to commercial pressure, their will had not been coerced because they had taken a commercial decision. They had considered that the risk of a loss of public confidence in the company if the sale of the shares by the plaintiffs to the company did not take place, was greater than the risk that the share price would fall and that they would have to pay under the indemnity.

LORD SCARMAN: Duress, whatever form it takes, is a coercion of the will so as to vitiate consent. Their Lordships agree with the observation of Kerr J in *Occidental Worldwide Investment Corporation* v *Skibs A/S Avanti* [1976] 1 Lloyd's Rep 293, 336 that in a contractual situation commercial pressure is not enough. There must be present some factor 'which could in law be regarded as a coercion of his will so as to vitiate his consent.' This conception is in line with what was said in this Board's decision in *Barton* v *Armstrong* [1976] AC 104, 121 by Lord Wilberforce and Lord Simon of Glaisdale — observations with which the majority judgment appears to be in agreement. In determining whether there was a coercion of will such that there was no true consent, it is material to inquire whether the person alleged to have been coerced did or did not protest; whether, at the time he was allegedly coerced into making the contract, he did or did not have an alternative course open to him such as an adequate legal remedy; whether he was independently advised; and whether after entering the contract he took steps to avoid it. All these matters are, as was recognised in *Maskell* v *Horner* [1915] 3 KB 106, relevant in determining whether he acted voluntarily or not.

In the present case there is unanimity amongst the judges below that there was no coercion of the first defendant's will. In the Court of Appeal the trial judge's finding . . . that the first defendant considered the matter thoroughly, chose to avoid litigation, and formed the opinion that the risk in giving the guarantee was more apparent than real was upheld. In short, there was commercial pressure, but no coercion. Even if this Board was disposed, which it is not, to take a different view, it would not substitute its opinion for that of the judges below on this question of fact.

It is, therefore, unnecessary for the Board to embark upon an inquiry into the question whether English law recognises a category of duress known as 'economic duress.' But, since the question has been fully argued in this appeal, their Lordships will indicate very briefly the view which they have formed. At common law money paid under economic compulsion could be recovered in an action for money had and received: *Astley* v *Reynolds* (1731) 2 Str 915. The compulsion had to be such that the party was deprived of 'his freedom of exercising his will' (see p. 916). It is doubtful, however, whether at common law any duress other than duress to the person sufficed to render a contract voidable: see *Blackstone's Commentaries*, Book 1, 12th ed. pp. 130–131 and *Skeate* v *Beale* (1841) 11 Ad & E 983. American law (*Williston on Contracts*, 3rd ed.) now recognises that a contract may be avoided on the ground of economic duress. The commercial pressure alleged to constitute such duress must, however, be such that the victim must have entered the contract against his will, must have had no alternative course open to him, and must have been confronted with coercive acts by the party exerting the pressure: *Williston on Contracts*, 3rd ed., vol. 13

(1970), section 1603. American judges pay great attention to such evidential matters as the effectiveness of the alternative remedy available, the fact or absence of protest, the availability of independent advice, the benefit received, and the speed with which the victim has sought to avoid the contract. Recently two English judges have recognised that commercial pressure may constitute duress the pressure of which can render a contract voidable: Kerr J in *Occidental Worldwide Investment Corporation* v *Skibs A/S Avanti* [1976] 1 Lloyd's Rep 293 and Mocatta J in *North Ocean Shipping Co. Ltd* v *Hyundai Construction Co. Ltd* [1979] QB 705. Both stressed that the pressure must be such that the victim's consent to the contract was not a voluntary act on his part. In their Lordship's view, there is nothing contrary to principle in recognising economic duress as a factor which may render a contract voidable provided always that the basis of such recognition is that it must amount to a coercion of will, which vitiates consent. It must be shown that the payment made or the contract entered into was not a voluntary act. . . .

Note

Emphasis is placed upon whether there was any realistic alternative choice open to the defendants (see Macdonald [1989] JBL 460). In *Pao On* v *Lau Yiu Long*, Fu Chip could have sued the plaintiffs for specific performance of the original sale contract, but this possibility might have been so damaging that it could not realistically be entertained.

B & S Contracts & Design Ltd v *Victor Green Publications Ltd* [1984] ICR 419 (CA)

The plaintiffs had agreed to erect exhibition stands for the defendants at Olympia for an exhibition which was to begin on 23 April 1979. A week before this date the plaintiffs' workers refused to work until a demand for £9,000 severance pay had been met. They rejected an offer by the plaintiffs of £4,500, and the plaintiffs informed the defendants that the contract would be cancelled unless the defendants paid the other £4,500 to meet this demand. The defendants paid this sum to avoid serious losses and claims from exhibitors to whom they had let stands. However, the defendants then deducted £4,500 from the contract price that they paid to the plaintiffs. Held: that the cancellation of the contract would have caused such serious damage to the defendants' economic interests that they had no choice but to pay. Although they could have refused to pay this figure and sued the plaintiffs for breach of contract, it was felt that this action would be too damaging.

KERR LJ: . . . [T]he plaintiffs were clearly saying in effect, 'This contract will not be performed by us unless you pay an additional sum of £4,500.' This faced the defendants with a disastrous situation in which there was no way out for them, and in the face of this threat — which is what it was — they paid the £4,500. In the light of the authorities it is perhaps important to emphasise that there is no question in this case of the defendants having subsequently approbated this payment or failed to seek to avoid it, which in some cases (such as the *North Ocean Shipping Co. Ltd* v *Hyundai Construction Co. Ltd* [1979] QB 705) . . . would be fatal. In the present case the defendants took immediate action by deducting that £4,500 from the invoice price.

I also bear in mind that a threat to break a contract unless money is paid by the other party can, but by no means always will, constitute duress. It appears from the authorities that it will only constitute duress if the consequences of a refusal would be serious and immediate so that there is no reasonable alternative open, such as by legal redress, obtaining an injunction, etc. . . .

Note

A tight causal link must be established between the pressure and the contract. The test of causation in economic duress must be stricter than that used in *Barton* v *Armstrong* [1975] 2 All ER 465 (page 528), in that the economic duress must be the predominant or the only reason for contracting.

(b) There must be pressure which is illegitimate

(i) *Pressure* In *Alec Lobb (Garages) Ltd* v *Total Oil GB Ltd* [1985] 1 All ER 303 (page 589), the Court of Appeal held that it was not sufficient that on the facts the plaintiffs were in serious financial difficulties and had no realistic alternative but to make the leaseback agreement with the defendant containing a 'tie' covenant. The defendant had exerted no pressure on them and was reluctant to enter into the transaction, and it was the plaintiffs who had sought the defendant's assistance to avert financial collapse.

In *Williams* v *Roffey Brothers & Nicholls (Contractors) Ltd* [1990] 1 All ER 512 (page 125), it was the main contractors who had initiated the new arrangement rather than the subcontractor, so that there was no economic duress. This is likely to lead to fine distinctions between 'advising' a main contractor of an impending breach and applying pressure by threatening breach. Such a distinction will be impossible to operate in practice.

(ii) *Illegitimate*

Universe Tankships Inc. of Monrovia v *International Transport Workers Federation, The Universe Sentinel*
[1983] 1 AC 366 (HL)

A ship had docked at Milford Haven on 17 July 1978, and had discharged its cargo, but, had been 'blacked' by ITF (a trade union) so that it was unable to leave port. The owners agreed to comply with ITF's demands, which included a contribution of $6,480 to a general welfare fund for sailors, because they feared disastrous economic consequences if they refused since the ship was off-hire under a time charter while the blacking continued. The ship was able to sail on 29 July, and on 10 August the owners claimed the return of the $6,480 paid under duress. However, s. 13 of the Trade Union and Labour Relations Act 1974 granted immunity in tort to the trade union in relation to actions, which included blacking vessels, if their actions had been taken in furtherance of a 'trade dispute' within s. 29 of that Act (i.e., this would have technically legitimated their

acts). A majority (Lord Scarman and Lord Brandon of Oakbrook dissenting) thought that the payment to the welfare fund was recoverable, since s. 29(1)(a) required the trade dispute to relate to 'terms and conditions of employment' of the crew members and therefore s. 13 did not protect the trade union in respect of this payment to a general welfare fund so that the action was illegitimate.

LORD DIPLOCK: . . . [I]t is conceded that the financial consequences to the shipowners of the *Universe Sentinel* continuing to be rendered off-hire under her time charter to Texaco, while the blacking continued, were so catastrophic as to amount to a coercion of the shipowners' will which vitiated their consent to those agreements and to the payments made by them to ITF. This concession makes it unnecessary for your Lordships to use the instant appeal as the occasion for a general consideration of the developing law of economic duress as a ground for treating contracts as voidable and obtaining restitution of money paid under economic duress as money had and received to the plaintiffs' use. That economic duress may constitute a ground for such redress was recognised, albeit obiter, by the Privy Council in *Pao On* v *Lau Yiu Long* [1980] AC 614. . . .

It is, however, in my view crucial to the decision of the instant appeal to identify the rationale of this development of the common law. It is not that the party seeking to avoid the contract which he has entered into with another party, or to recover money that he has paid to another party in response to a demand, did not know the nature or the precise terms of the contract at the time when he entered into it or did not understand the purpose for which the payment was demanded. The rationale is that his apparent consent was induced by pressure exercised upon him by that other party which the law does not regard as legitimate, with the consequence that the consent is treated in law as revocable unless approbated either expressly or by implication after the illegitimate pressure has ceased to operate on his mind. It is a rationale similar to that which underlies the avoidability of contracts entered into and the recovery of money exacted under colour of office, or under undue influence or in consequence of threats of physical duress.

Commercial pressure, in some degree, exists wherever one party to a commercial transaction is in a stronger bargaining position than the other party. It is not, however, in my view, necessary, nor would it be appropriate in the instant appeal, to enter into the general question of the kinds of circumstances, if any, in which commercial pressure, even though it amounts to a coercion of the will of a party in the weaker bargaining position, may be treated as legitimate and, accordingly, as not giving rise to any legal right of redress. In the instant appeal the economic duress complained of was exercised in the field of industrial relations to which very special considerations apply. . . .

Lord Scarman disagreed with the majority view of s. 29(1)(a). He considered that this was a legitimate exercise of pressure and did not constitute duress.

LORD SCARMAN: It is, I think, already established law that economic pressure can in law amount to duress; and that duress, if proved, not only renders voidable a transaction into which a person has entered under its compulsion but is actionable as a tort, if it causes damage or loss: *Barton* v *Armstrong* [1976] AC 104 and *Pao On* v *Lau Yiu Long* [1980] AC 614. The authorities upon which these two cases were based

reveal two elements in the wrong of duress: (1) pressure amounting to compulsion of the will of the victim: and (2) the illegitimacy of the pressure exerted. There must be pressure, the practical effect of which is compulsion or the absence of choice. Compulsion is variously described in the authorities as coercion or the vitiation of consent. The classic case of duress is, however, 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. This is the thread of principle which links the early law of duress (threat to life or limb) with later developments when the law came also to recognise as duress first the threat to property and now the threat to a man's business or trade. The development is well traced in *Goff and Jones, The Law of Restitution*, 2nd ed. (1978), chapter 9.

The absence of choice can be proved in various ways, e.g. by protest, by the absence of independent advice, or by a declaration of intention to go to law to recover the money paid or the property transferred: see *Maskell* v *Horner* [1915] 3 KB 106. But none of these evidential matters goes to the essence of duress. The victim's silence will not assist the bully, if the lack of any practicable choice but to submit is proved. The present case is an excellent illustration. There was no protest at the time, but only a determination to do whatever was needed as rapidly as possible to release the ship. Yet nobody challenges the judge's finding that the owner acted under compulsion. He put it thus [1981] ICR 129, 143:

> It was a matter of the most urgent commercial necessity that the plaintiffs should regain the use of their vessel. They were advised that their prospects of obtaining an injunction were minimal, the vessel would not have been released unless the payment was made, and they sought recovery of the money with sufficient speed once the duress had terminated.

The real issue in the appeal is, therefore, as to the second element in the wrong duress: was the pressure applied by the ITF in the circumstances of this case one which the law recognises as legitimate? For, as Lord Wilberforce and Lord Simon of Glaisdale said in *Barton* v *Armstrong* [1976] AC 104, 121D: 'the pressure must be one of a kind which the law does not regard as legitimate.'

As the two noble and learned Lords remarked at p. 121D, in life, including the life of commerce and finance, many acts are done 'under pressure, sometimes overwhelming pressure': but they are not necessarily done under duress. That depends on whether the circumstances are such that the law regards the pressure as legitimate.

In determining what is legitimate two matters may have to be considered. The first is as to the nature of the pressure. In many cases this will be decisive, though not in every case. And so the second question may have to be considered, namely, the nature of the demand which the pressure is applied to support.

The origin of the doctrine of duress in threats to life or limb, or to property, suggests strongly that the law regards the threat of unlawful action as illegitimate, whatever the demand. Duress 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 many cases, therefore, 'What [one] has to justify is not the threat, but the demand . . .': see *per* Lord Atkin in *Thorne* v *Motor Trade Association* [1937] AC 797, 806.

The present is a case in which the nature of the demand determines whether the pressure threatened or applied, i.e. the blacking, was lawful or unlawful. If it was unlawful, it is conceded that the owner acted under duress and can recover. If it

was lawful, it is conceded that there was no duress and the sum sought by the owner is irrecoverable. The lawfulness or otherwise of the demand depends upon whether it was an act done in contemplation or furtherance of a trade dispute. If it was, it would not be actionable in tort: section 13(1) of the Act. Although no question of tortious liability arises in this case and section 13(1) is not, therefore, directly in point, it is not possible, in my view, to say of acts which are protected by statute from suit in tort that they nevertheless can amount to duress. Parliament having enacted that such acts are not actionable in tort, it would be inconsistent with legislative policy to say that, when the remedy sought is not damages for tort but recovery of money paid, they become unlawful.

Notes

1. Lord Diplock avoids defining what is acceptable commercial pressure and what is illegitimate. Lord Scarman does provide some assistance by stating that pressure *may* be illegitimate if what is threatened is in itself unlawful, e.g., to injure the victim or to breach a contract. Pressure may also be illegitimate even though what is threatened is lawful if the way in which that pressure is exerted is illegitimate, e.g., if the advantage which the party is seeking to obtain is illegitimate. Lord Scarman used blackmail to illustrate this. A threat to disclose a particular fact about a person may be perfectly lawful and yet the demand of money is unlawful.

2. In *Vantage Navigation Corporation* v *Suhail and Saud Bahwan Building Materials LLC, The Alev* [1989] 1 Lloyd's Rep 138, the plaintiffs had time-chartered the vessel to the charterers who had loaded a cargo. The charterers defaulted in the payment of hire but the plaintiffs were contractually obliged to carry the cargo to its destination. They advised the defendants, cargo owners, that unless the defendants agreed to pay what the plaintiffs demanded they would not get their cargo. The defendants agreed to pay port expenses and discharging costs, and the plaintiffs agreed to refrain from arresting or detaining the vessel. The defendants pleaded duress. Hobhouse J held that the defendants' promise had clearly been made under duress. The pressure exerted by the plaintiffs was illegitimate since the plaintiffs had no rights over the goods and could not refuse to deliver the cargo.

CTN Cash and Carry Ltd v *Gallaher Ltd*
[1994] 4 All ER 714 (CA)

The plaintiffs purchased consignments of cigarettes from the defendants under individual contracts on the defendants' standard terms. The defendants had also arranged credit facilities for the plaintiffs which they could withdraw for any reason at any time. One consignment had been incorrectly delivered to the wrong warehouse, but before the defendants could deliver it to the correct warehouse it had been stolen from the plaintiffs' premises. The defendants genuinely believed that the goods were at the plaintiffs' risk at the time of the theft and accordingly invoiced them for the goods. The plaintiffs refused to pay and only did so after the defendants

threatened to withdraw their credit facilities. They then claimed the return of the money paid on the basis that it had been obtained as a result of economic duress and that the pressure was illegitimate because the defendants had demanded money to which they were not entitled. Held: the defendants' conduct did not constitute duress.

STEYN LJ: . . . The present dispute does not concern a protected relationship. It also does not arise in the context of dealings between a supplier and a consumer. The dispute arises out of arm's length commercial dealings between two trading companies. It is true that the defendants were the sole distributors of the popular brands of cigarettes. In a sense the defendants were in a monopoly position. The control of monopolies is, however, a matter for Parliament. Moreover, the common law does not recognise the doctrine of inequality of bargaining power in commercial dealings (see *National Westminster Bank plc* v *Morgan* [1985] 1 All ER 821, [1985] AC 686). The fact that the defendants were in a monopoly position cannot therefore by itself convert what is not otherwise duress into duress.

A second characteristic of the case is that the defendants were in law entitled to refuse to enter into any future contracts with the plaintiffs for any reason whatever or for no reason at all. Such a decision not to deal with the plaintiffs would have been financially damaging to the defendants, but it would have been lawful. A fortiori, it was lawful for the defendants, for any reason or for no reason, to insist that they would no longer grant credit to the plaintiffs. The defendants' demand for payment of the invoice, coupled with the threat to withdraw credit, was neither a breach of contract nor a tort.

A third, and critically important, characteristic of the case is the fact that the defendants bona fide thought that the goods were at the risk of the plaintiffs and that the plaintiffs owed the defendants the sum in question. The defendants exerted commercial pressure on the plaintiffs in order to obtain payment of a sum which they bona fide considered due to them. The defendants' motive in threatening withdrawal of credit facilities was commercial self-interest in obtaining a sum that they considered due to them. . . .

I . . . readily accept that the fact that the defendants have used lawful means does not by itself remove the case from the scope of the doctrine of economic duress. Professor Birks, in *An Introduction to the Law of Restitution* (1989) p. 177, lucidly explains:

> Can lawful pressures also count? This is a difficult question, because, if the answer is that they can, the only viable basis for discriminating between acceptable and unacceptable pressures is not positive law but social morality. In other words, the judges must say what pressures (though lawful outside the restitutionary context) are improper as contrary to prevailing standards. That makes the judges, not the law or the legislature, the arbiters of social evaluation. On the other hand, if the answer is that lawful pressures are always exempt, those who devise outrageous but technically lawful means of compulsion must always escape restitution until the legislature declares the abuse unlawful. It is tolerably clear that, at least where they can be confident of a general consensus in favour of their evaluation, the courts are willing to apply a standard of impropriety rather than technical unlawfulness.

And there are a number of cases where English courts have accepted that a threat may be illegitimate when coupled with a demand for payment even if the threat is one of lawful action (see *Thorne* v *Motor Trade Association* [1937] 3 All ER 157 at 160–161,

[1937] AC 797 at 806-807, *Mutual Finance Ltd* v *John Wetton & Sons Ltd* [1937] 2 All ER 657, [1937] 2 KB 389 and *Universe Tankships Inc of Monrovia* v *International Transport Workers' Federation* [1982] 2 All ER 67 at 76, 89, [1983] 1 AC 366 at 384, 401). On the other hand, Goff and Jones *Law of Restitution* (3rd edn, 1986) p. 240 observed that English courts have wisely not accepted any general principle that a threat not to contract with another, except on certain terms, may amount to duress.

We are being asked to extend the categories of duress of which the law will take cognisance. That is not necessarily objectionable, but it seems to me that an extension capable of covering the present case, involving 'lawful act duress' in a commercial context in pursuit of a bona fide claim, would be a radical one with far-reaching implications. It would introduce a substantial and undesirable element of uncertainty in the commercial bargaining process. Moreover, it will often enable bona fide settled accounts to be reopened when parties to commercial dealings fall out. The aim of our commercial law ought to be to encourage fair dealing between parties. But it is a mistake for the law to set its sights too highly when the critical inquiry is not whether the conduct is lawful but whether it is morally or socially unacceptable. That is the inquiry in which we are engaged. In my view there are policy considerations which militate against ruling that the defendants obtained payment of the disputed invoice by duress.

Outside the field of protected relationships, and in a purely commercial context, it might be a relatively rare case in which 'lawful act duress' can be established. And it might be particularly difficult to establish duress if the defendant bona fide considered that his demand was valid. In this complex and changing branch of the law I deliberately refrain from saying 'never'. But as the law stands, I am satisfied that the defendants' conduct in this case did not amount to duress.

Notes

1. This demonstrates that in future cases the nature of the pressure may be the significant factor.

2. The Court of Appeal rejected any general category of 'lawful act duress'. In so doing it is clear that the Court was not comfortable with the fact that the defendants were permitted to keep money to which they were not entitled. However, Sir Donald Nicholls considered that in such circumstances the money might be reclaimed in restitution on the basis that the defendant had been unjustly enriched.

3. There is a clear willingness to grant greater protection to consumers than to commercial concerns 'dealing at arm's length'. Do you consider that the plaintiffs were dealing at arm's length?

SECTION 2: UNDUE INFLUENCE

The doctrine of undue influence is an equitable doctrine allowing a contract to be set aside where there has been a wrongful exercise of influence by one party over the other. What sort of influence will the courts view as being wrongful?

In *Bank of Credit and Commerce International SA* v *Aboody* [1990] 1 QB 923, at p. 953, Slade LJ referred to two classes of undue influence; actual and presumed:

Ever since the judgments of this court in *Allcard* v *Skinner* (1887) 36 ChD 145 a clear distinction has been drawn between (1) those cases in which the court will uphold a plea of undue influence only if it is satisfied that such influence has been affirmatively proved on the evidence (commonly referred to as cases of 'actual undue influence' and, in argument before us, as 'class 1' cases); (2) those cases (commonly referred to as cases of 'presumed undue influence,' and, in argument before us, as 'class 2' cases) in which the relationship between the parties will lead the court to presume that undue influence has been exerted unless evidence is adduced proving the contrary, e.g. by showing that the complaining party has had independent advice.

A: ACTUAL UNDUE INFLUENCE

Slade LJ in *BCCI* v *Aboody* stated:

. . . [W]e think that a person relying on a plea of actual undue influence must show that (a) the other party to the transaction (or someone who induced the transaction for his own benefit) had the capacity to influence the complainant; (b) the influence was exercised; (c) its exercise was undue; (d) its exercise brought about the transaction. . . .

Notes

1. For examples for actual undue influence see *BCCI* v *Aboody*, page 553, and *CIBC Mortgages plc* v *Pitt* [1993] 4 All ER 433, page 561.

2. Although the Court of Appeal in *BCCI* v *Aboody* held that a transaction could not be set aside for actual undue influence unless the transaction in question was manifestly disadvantageous to the party affected, the House of Lords in *CIBC* v *Pitt* has emphatically rejected this requirement in the context of actual undue influence.

Lord Browne-Wilkinson in *CIBC* v *Pitt* said:

My Lords, I am unable to agree with the Court of Appeal decision in *BCCI* v *Aboody*. I have no doubt that the decision in *Morgan* does not extend to cases of actual undue influence. Despite two references in Lord Scarman's speech to cases of actual undue influence, as I read his speech he was primarily concerned to establish that disadvantage had to be shown, not as a constituent element of the cause of action for undue influence, but in order to raise a presumption of undue influence within class 2. That was the only subject matter before the House of Lords in *Morgan* and the passage I have already cited was directed solely to that point. With the exception of a passing reference to *Ormes* v *Beadel* (1860) 2 Giff 166, 66 ER 70 all the cases referred to by Lord Scarman were cases of presumed undue influence. In the circumstances, I do not think that this House can have been intending to lay down any general principle applicable to all claims of undue influence, whether actual or presumed.

Whatever the merits of requiring a complainant to show manifest disadvantage in order to raise a class 2 presumption of undue influence, in my judgment there is no logic in imposing such a requirement where actual undue influence has been exercised and proved. Actual undue influence is a species of fraud. Like any other victim of fraud, a person who has been induced by undue influence to carry out a transaction which he did not freely and knowingly enter into is entitled to have that transaction set aside as of right. No case decided before *Morgan* was cited (nor am I aware of any) in which a transaction proved to have been obtained by actual undue influence has

been upheld nor is there any case in which a court has even considered whether the transaction was, or was not, advantageous. A man guilty of fraud is no more entitled to argue that the transaction was beneficial to the person defrauded than is a man who has procured a transaction by misrepresentation. The effect of the wrongdoer's conduct is to prevent the wronged party from bringing a free will and properly informed mind to bear on the proposed transaction which accordingly must be set aside in equity as a matter of justice.

I therefore hold that a claimant who proves actual undue influence is not under the further burden of proving that the transaction induced by undue influence was manifestly disadvantageous: he is entitled as of right to have it set aside.

B: PRESUMED UNDUE INFLUENCE

From the nature of the relationship between the parties, can it be presumed that one party influenced the other? If so, it is then for the other to rebut that presumption by showing that no undue influence in fact occurred.

There are two categories of presumed undue influence. Slade LJ defined them in *Bank of Credit and Commerce* v *Aboody*:

> There are well established categories of relationship, such as a religious superior and inferior and doctor and patient where the relationship as such will give rise to the presumption (frequently referred to in argument before us as 'class 2A' cases). The relationship of husband and wife does not as such give rise to the presumption: see *National Westminster Bank Plc* v *Morgan* [1985] AC 686, 703B, and *Bank of Montreal* v *Stuart* [1911] AC 120. Nor does the normal relationship of banker and customer as such give rise to it. Nevertheless, on particular facts (frequently referred to in argument as 'class 2B' cases) relationships not falling within the class 2A category may be shown to have become such as to justify the court in applying the same presumption.

In 'class 2B' cases, the particular relationship between the parties concerned must be such as to justify the presumption applying.

Lloyds Bank Ltd v *Bundy*
[1975] QB 326 (CA)

The defendant, an elderly farmer, and his son had been customers of the plaintiff bank for many years. The son's company account was held at the same branch. Previously, the defendant had given a guarantee and a charge for £7,500 over his farmhouse (his only asset) to secure this company's overdraft. On that occasion he had been advised by a solicitor that this was the most that he could afford to put into his son's business. In December 1969, the son and the assistant bank manager visited the defendant, and the assistant manager told the defendant that the bank could only allow the company's overdraft to increase if the defendant guaranteed the account up to £11,000 and gave a further charge on the farmhouse to bring the total charge up to that amount. The defendant signed that charge documentation. The evidence was that the assistant manager knew that the

defendant relied on him as his bank manager for advice in the transaction and that he knew that the house was the defendant's only asset. Subsequently the bank enforced the charge and sought possession of the house. Held: the charge should be set aside for undue influence. The bank had a conflict of interest and the defendant had received no independent advice as to the wisdom of the transaction.

SIR ERIC SACHS (with whose judgment Cairns LJ concurred): The first and most troublesome issue which here falls for consideration is as to whether on the particular and somewhat unusual facts of the case, the bank was, when obtaining his signatures on December 17, 1969, in a relationship with Mr Bundy that entailed a duty on their part of what can for convenience be called fiduciary care.

. . . As was pointed out in *Tufton* v *Sperni* [1952] 2 TLR 516, the relationships which result in such a duty must not be circumscribed by reference to defined limits; it is necessary to

> refute the suggestion that, to create the relationship of confidence, the person owing the duty must be found clothed in the recognisable garb of a guardian, trustee, solicitor, priest, doctor, manager, or the like. (Sir Raymond Evershed MR, at p. 522.)

Everything depends on the particular facts, and such a relationship has been held to exist in unusual circumstances as between purchaser and vendor, as between great uncle and adult nephew, and in other widely differing sets of circumstances. Moreover, it is neither feasible nor desirable to attempt closely to define the relationship, or its characteristics, or the demarcation line showing the exact transition point where a relationship that does not entail that duty passes into one that does.

On the other hand, whilst disclaiming any intention of seeking to catalogue the elements of such a special relationship, it is perhaps of a little assistance to note some of those which have in the past frequently been found to exist where the court has been led to decide that this relationship existed as between adults of sound mind. Such cases tend to arise where someone relies on the guidance or advice of another, where the other is aware of that reliance and where the person upon whom reliance is placed obtains, or may well obtain, a benefit from the transaction or has some other interest in it being concluded. In addition, there must, of course, be shown to exist a vital element which in this judgment will for convenience be referred to as confidentiality. It is this element which is so impossible to define and which is a matter for the judgment of the court on the facts of any particular case.

Confidentiality, a relatively little used word, is being here adopted, albeit with some hesitation, to avoid the possible confusion that can arise through referring to 'confidence.' Reliance on advice can in many circumstances be said to import that type of confidence which only results in a common law duty to take care — a duty which may co-exist with but is not coterminous with that of fiduciary care. 'Confidentiality' is intended to convey that extra quality in the relevant confidence that is implicit in the phrase 'confidential relationship', and may perhaps have something in common with 'confiding' and also 'confidant' when, for instance, referring to someone's 'man of affairs.' It imports some quality beyond that inherent in the confidence that can well exist between trustworthy persons who in business affairs deal with each other at arm's length. It is one of the features of this element that once it exists, influence naturally grows out of it (cf. Sir Raymond Evershed MR, *Tufton's* case [1952] 2 TLR 516, 523. . . .)

It was inevitably conceded on behalf of the bank that the relevant relationship can arise as between banker and customer. Equally, it was inevitably conceded on behalf of Mr Bundy that in the normal course of transactions by which a customer guarantees a third party's obligations, the relationship does not arise. The onus of proof lies on the customer who alleges that in any individual case the line has been crossed and the relationship has arisen.

Before proceeding to examine the position further, it is as well to dispose of some points on which confusion is apt to arise. Undue influence is a phrase which is commonly regarded — even in the eyes of a number of lawyers — as relating solely to occasions when the will of one person has become so dominated by that of another that, to use the county court judge's words, 'the person acts as the mere puppet of the dominator.' Such occasions, of course, fall within what Cotton LJ in *Allcard* v *Skinner*, 36 ChD 145, 171 described as the first class of cases to which the doctrine on undue influence applies. There is, however, a second class of such cases. This is referred to by Cotton LJ as follows:

> In the second class of cases the court interferes, not on the ground that any wrongful act has in fact been committed by the donee, but on the ground of public policy, and to prevent the relations which existed between the parties and the influence arising therefrom being abused.

It is thus to be emphasised that as regards the second class the exercise of the court's jurisdiction to set aside the relevant transaction does *not* depend on proof of one party being 'able to dominate the other as though a puppet' nor any wrongful intention on the part of the person who gains a benefit from it; but on the concept that once the special relationship has been shown to exist, no benefit can be retained from the transaction unless it has been positively established that the duty of fiduciary care has been entirely fulfilled. To this second class, however, the judge never adverted and plainly never directed his mind.

It is also to be noted that what constitutes fulfilment of that duty (the second issue in the case now under consideration) depends again on the facts before the court. It may in the particular circumstances entail that the person in whom confidence has been reposed should insist on independent advice being obtained or ensuring in one way or another that the person being asked to execute a document is not insufficiently informed of some factor which could affect his judgment. The duty has been well stated as being one to ensure that the person liable to be influenced has formed 'an independent *and informed* judgment', or, to use the phraseology of Lord Evershed MR in *Zamet* v *Hyman* [1961] 1 WLR 1442, 1446, 'after full, free *and informed* thought.'

. . .

Having discussed the nature of the issues to which the county court judge should have directed his mind, it is now convenient to turn to the evidence relating to the first of them — whether the special relationship has here been shown to exist at the material time.

. . . what happened on December 17, 1969, has to be assessed in the light of the general background of the existence of the long-standing relations between the Bundy family and the bank. It not infrequently occurs in provincial and country branches of great banks that a relationship is built up over the years, and in due course the senior officials may become trusted counsellors of customers of whose affairs they have an intimate knowledge. Confidential trust is placed in them because of a combination of status, goodwill and knowledge. . . .

It is, of course, plain that when Mr Head was asking Mr Bundy to sign the documents, the bank would derive benefit from the signature, that there was a conflict

of interest as between the bank and Mr Bundy, that the bank gave him advice, that he relied on that advice, and that the bank knew of the reliance. The further question is whether on the evidence concerning the matters already recited there was also established that element of confidentiality which has been discussed. In my judgment it is thus established. . . .

What was required to be done on the bank's behalf once the existence of that duty is shown to have been established?. . . .

The documents Mr Bundy was being asked to sign could result, if the company's troubles continued, in Mr Bundy's sole asset being sold, the proceeds all going to the bank, and his being left penniless in his old age. That he could thus be rendered penniless was known to the bank — and in particular to Mr Head. That the company might come to a bad end quite soon with these results was not exactly difficult to deduce (less than four months later, on April 3, 1970, the bank were insisting that Yew Tree Farm be sold).

The situation was thus one which, to any reasonably sensible person, who gave it but a moment's thought, cried aloud Mr. Bundy's need for careful independent advice. Over and above the need any man has for counsel when asked to risk his last penny on even an apparently reasonable project, was the need here for informed advice as to whether there was any real chance of the company's affairs becoming viable if the documents were signed. . . . without which Mr Bundy could not come to an informed judgment as to the wisdom of what he was doing.

No such advice to get an independant opinion was given; on the contrary, Mr Head chose to give his own views on the company's affairs and to take this course, though he had at trial to admit: 'I did not explain the company's affairs very fully as I had only just taken over.' . . .

There remains to mention that [counsel for the Bank], whilst conceding that the relevant special relationship could arise as between banker and customer, urged in somewhat doom-laden terms that a decision taken against the bank on the facts of this particular case would seriously affect banking practice. With all respect to that submission, it seems necessary to point out that nothing in this judgment affects the duties of a bank in the normal case where it is obtaining a guarantee, and in accordance with standard practice explains to the person about to sign its legal effect and the sums involved. When, however, a bank, as in the present case, goes further and advises on more general matters germane to the wisdom of the transaction, that indicates that it may — not necessarily must — be crossing the line into the area of confidentiality so that the court may then have to examine all the facts including, of course, the history leading up to the transaction, to ascertain whether or not that line has, as here, been crossed. It would indeed be rather odd if a bank which vis-à-vis a customer attained a special relationship in some ways akin to that of a 'man of affairs' — something which can be a matter of pride and enhance its local reputation — should not, where a conflict of interest has arisen as between itself and the person advised, be under the resulting duty now under discussion. Once, as was inevitably conceded, it is possible for a bank to be under that duty, it is, as in the present case, simply a question for 'meticulous examination' of the particular facts to see whether that duty has arisen. On the special facts here it did arise and it has been broken.

Notes

1. The judgment of Lord Denning MR rested on there being a general principle of inequality of bargaining power and is discussed at page 571.

2. The presumption in this case arose from the particular facts. The defendant clearly relied solely on the bank manager for advice, and the bank

manager was aware that the defendant had done so. The bank obtained a benefit in the form of security for an overdrawn account.

National Westminster Bank plc v *Morgan*
[1985] AC 686 (HL)

A husband and wife had a building society mortgage, but in 1977 the building society had begun proceedings for repossession. The husband's business was also in difficulty. The plaintiff bank agreed to refinance the building society loan on the normal condition that they obtained a charge over the property. The husband signed the charge instrument and the bank manager visited the wife to obtain her signature. The wife was concerned about the effect of the charge. She did not possess much confidence in her husband's business and did not want any security to extend to borrowing by the business. The bank manager innocently misled her into thinking that the charge was only to cover the home debt when in fact it also covered lending to the husband's business. Later the bank brought proceedings for possession. The wife claimed undue influence by the bank in obtaining her signature to the charge. Held: the relationship between the wife and the bank had never gone beyond the normal business relationship of banker and customer, and therefore no presumption of undue influence arose on the facts. The transaction had to be to the manifest disadvantage of the person seeking to avoid it, whereas the wife had benefited from the transaction because, if the bank not given the mortgage, her home would have been repossessed by the building society. Therefore, the bank was not under any duty to ensure that she received independent advice.

LORD SCARMAN: As to the facts, I am far from being persuaded that the trial judge fell into error when he concluded that the relationship between the bank and Mrs Morgan never went beyond the normal business relationship of banker and customer. Both Lords Justices saw the relationship between the bank and Mrs Morgan as one of confidence in which she was relying on the bank manager's advice. Each took the view that the confidentiality of the relationship was such as to impose upon him a 'fiduciary duty of care.' It was his duty, in their view, to ensure that Mrs Morgan had the opportunity to make an independent and informed decision: but he failed to give her any such opportunity. They, therefore, concluded that it was a case for the presumption of undue influence.

My Lords, I believe that the Lords Justices were led into a misinterpretation of the facts by their use, as is all too frequent in this branch of the law, of words and phrases such as 'confidence,' 'confidentiality,' 'fiduciary duty.' There are plenty of confidential relationships which do not give rise to the presumption of undue influence (a notable example is that of husband and wife, *Bank of Montreal* v *Stuart* [1911] AC 120); and there are plenty of non-confidential relationships in which one person relies upon the advice of another, e.g. many contracts for the sale of goods. Nor am I persuaded that the charge, limited as it was by [the bank manager's] declaration to securing the loan to pay off the Abbey National debt and interest during the bridging period, was disadvantageous to Mrs Morgan. It meant for her the rescue of her home upon the terms sought by her — a short-term loan at a commercial rate of interest. The Court

of Appeal has not, therefore, persuaded me that the judge's understanding of the facts was incorrect.

But, further, the view of the law expressed by the Court of Appeal was, as I shall endeavour to show, mistaken. Dunn LJ, . . . while accepting that in all the reported cases to which the court was referred the transactions were disadvantageous to the person influenced, took the view that in cases where public policy requires the court to apply the presumption of undue influence there is no need to prove a disadvantageous transaction. Slade LJ also clearly held that it was not necessary to prove a disadvantageous transaction where the relationship of influence was proved to exist. . . . [However] the authorities show that [the transaction] must constitute a disadvantage sufficiently serious to require evidence to rebut the presumption that in the circumstances of the relationship between the parties it was procured by the exercise of undue influence. In my judgment, therefore, the Court of Appeal erred in law in holding that the presumption of undue influence can arise from the evidence of the relationship of the parties without also evidence that the transaction itself was wrongful in that it constituted an advantage taken of the person subjected to the influence which, failing proof to the contrary, was explicable only on the basis that undue influence has been exercised to procure it. . . .

The principle justifying the court in setting aside a transaction for undue influence can now be seen to have been established by Lindley LJ in *Allcard* v *Skinner*, 36 ChD 145. It is not vague 'public policy' but specifically the victimisation of one party by the other. It was stated by Lindley LJ in a famous passage, at pp. 182–183:

> The principle must be examined. What then is the principle? Is it that it is right and expedient to save persons from the consequences of their own folly? or is it that it is right and expedient to save them from being victimised by other people? In my opinion the doctrine of undue influence is founded upon the second of these two principles. Courts of equity have never set aside gifts on the ground of the folly, imprudence, or want of foresight on the part of donors. The courts have always repudiated any such jurisdiction. It would obviously be to encourage folly, recklessness, extravagance and vice if persons could get back property which they foolishly made away with, whether by giving it to charitable institutions or by bestowing it on less worthy objects. On the other hand, to protect people from being forced, tricked or misled in any way by others into parting with their property is one of the most legitimate objects of all laws; and the equitable doctrine of undue influence has grown out of and been developed by the necessity of grappling with insidious forms of spiritual tyranny and with the infinite varieties of fraud.

The wrongfulness of the transaction must, therefore, be shown: it must be one in which an unfair advantage has been taken of another. [A] relationship of banker and customer may become one in which the banker acquires a dominating influence. If he does and a manifestly disadvantageous transaction is proved, there would then be room for the court to presume that it resulted from the exercise of undue influence.

This brings me to *Lloyds Bank Ltd* v *Bundy* [1975] QB 326. It was, as one would expect, conceded by counsel for the respondent that the relationship between banker and customer is not one which ordinarily gives rise to a presumption of undue influence: and that in the ordinary course of banking business a banker can explain the nature of the proposed transaction without laying himself open to a charge of undue influence. This proposition has never been in doubt, though some, it would appear, have thought that the Court of Appeal held otherwise in *Lloyds Bank Ltd* v *Bundy*. If any such view has gained currency, let it be destroyed now once and for all

time . . . I would prefer to avoid the term 'confidentiality' as a description of the relationship which has to be proved. In truth, as Sir Eric recognised, the relationships which may develop a dominating influence of one over another are infinitely various. There is no substitute in this branch of the law for a 'meticulous examination of the facts.'

A meticulous examination of the facts of the present case reveals that Mr Barrow never 'crossed the line.' Nor was the transaction unfair to Mrs Morgan. The bank was, therefore, under no duty to ensure that she had independent advice. It was an ordinary banking transaction whereby Mrs Morgan sought to save her home.

I would allow the appeal. In doing so, I would wish to give a warning. There is no precisely defined law setting limits to the equitable jurisdiction of a court to relieve against undue influence. This is the world of doctrine, not of neat and tidy rules. The courts of equity have developed a body of learning enabling relief to be granted where the law has to treat the transaction as unimpeachable unless it can be held to have been procured by undue influence. It is the unimpeachability at law of a disadvantageous transaction which is the starting-point from which the court advances to consider whether the transaction is the product merely of one's own folly or of the undue influence exercised by another. A court in the exercise of this equitable jurisdiction is a court of conscience. Definition is a poor instrument when used to determine whether a transaction is or is not unconscionable: this is a question which depends upon the particular facts of the case.

Notes

1. Note that both *Lloyds Bank* v *Bundy* and *National Westminster Bank* v *Morgan* are cases involving alleged undue influence by the other contracting party, i.e. the bank.

2. Although there was no express mention of the requirement that the transaction be to the manifest disadvantage of the victim in *Lloyds Bank* v *Bundy*, it is clear that the transaction was manifestly disadvantageous and unfair to Mr Bundy. The transaction in *National Westminster Bank* v *Morgan* was not manifestly disadvantageous to Mrs Morgan. Lord Browne-Wilkinson in *CIBC Mortgages plc* v *Pitt* [1993] 4 All ER 433, page 561, has questioned the manifest disadvantage requirement in *Morgan*:

I should add that the exact limits of the decision in *Morgan* may have to be considered in the future. The difficulty is to establish the relationship between the law as laid down in *Morgan* and the long standing principle laid down in the abuse of confidence cases, viz the law requires those in a fiduciary position who enter into transactions with those to whom they own fiduciary duties to establish affirmatively that the transaction was a fair one: see for example *Demarara Bauxite Co. Ltd* v *Hubbard* [1923] AC 673, *Moodie* v *Cox* [1917] 2 Ch 71, [1916–17] All ER Rep 548 and the discussion in *BCCI* v *Aboody* [1992] 4 All ER 955 at 971–973, [1990] 1 QB 923 at 962. The abuse of confidence principle is founded on considerations of general public policy, viz that in order to protect those to whom fiduciaries owe duties *as a class* from exploitation by fiduciaries *as a class*, the law imposes a heavy duty on fiduciaries to show the righteousness of the transactions they enter into with those to whom they owe such duties. This principle is in sharp contrast with the view of this House in *Morgan* that in cases of presumed undue influence (a) the law is not based on considerations of public policy and (b) that it is for the claimant to prove that the transaction was

disadvantageous rather than for the fiduciary to prove that it was not disadvantageous. Unfortunately, the attention of this House in *Morgan* was not drawn to the abuse of confidence cases and therefore the interaction between the two principles (if indeed they are two separate principles) remains obscure: see also 48 MLR 579 and *Wright* v *Carter* [1903] 1 Ch 27, [1900–3] All ER Rep 706.

3. Lord Scarman rejected the 'confidentiality' factor which had been used by Sir Eric Sachs in *Lloyds Bank* v *Bundy* as determining whether the relationship had 'crossed the line'. Instead he favoured the test of whether the banker has acquired a 'dominating influence' over the customer. However, 'dominating influence' was rejected by the Court of Appeal in *Goldsworthy* v *Brickell* [1987] 1 All ER 853, where Nourse LJ stated that all that was required was a relationship of trust and confidence which had been ceded by the making of an improvident gift or transaction.

4. In *Avon Finance Co. Ltd* v *Bridger* [1985] 2 All ER 281 (page 104), the majority of the Court of Appeal (Brandon and Brightman LJJ) stressed the important factor was being in a position to influence. They held that the presumption of undue influence had arisen because the relationship between the son and his elderly parents was such that he could be expected to have had some influence over them and the finance company should have known this. The transaction was set aside for undue influence since no independent advice had been given to the parents.

Lord Denning based his decision on the grounds of inequality of bargaining power and undue pressure. The son had exercised undue pressure as he had misled his parents concerning the nature of the document they were signing. As a result, the parents' bargaining power was impaired by their ignorance of the true situation.

Questions

1. Could *Lloyds Bank* v *Bundy* ('old Mr Bundy'), *Goldsworthy* v *Brickell* (where the plaintiff was 85) and *Avon Finance Co. Ltd* v *Bridger* have been based on the age of the victims in these cases? (See the discussion on inequality of bargaining power, at page 570.)

2. Could *Avon Finance* v *Bridger* have been decided on the basis of a misrepresentation? Would it have helped Mrs Morgan in *National Westminster Bank* v *Morgan* if the transaction had been set aside for misrepresentation?

It appears that in this context of undue influence by a contracting party, the fact that independent legal advice has been received will not necessarily rebut the presumption of undue influence. It will depend on the circumstances. See Millett LJ in *Credit Lyonnais Bank Nederland NV* v *Burch* [1997] 1 All ER 144, page 563.

C: UNDUE INFLUENCE EXERCISED BY A THIRD PARTY

Can a transaction be set aside on the ground that undue influence was exercised by a third party? For example, a wife gives a guarantee and charge

over the matrimonial home to a bank and wishes to have that contract with the bank set aside on the basis that she entered into the contract only because of her husband's undue influence.

The courts traditionally laid down very limited circumstances when such a transaction could be set aside. It first needed to be established that there was either actual undue influence by the husband, or that the presumption could be shown to arise on the facts (class 2B). (Husband and wife is not a class 2A case: *Bank of Montreal* v *Stuart* [1911] AC 120.)

Bank of Credit and Commerce International SA v *Aboody* [1990] 1 QB 923 (CA)

A husband and wife were the directors and shareholders of a family company which had exceeded its overdraft limit at the plaintiff bank. The company's liabilities to the bank were secured by guarantees given by the husband and wife and charges on the wife's house signed by her. In May 1983, the company collapsed owing the bank nearly £890,000. The wife challenged the guarantees and one of the charges on the ground, *inter alia*, that they were obtained by actual undue influence by her husband. Held: although there was evidence of actual undue influence by the husband, the transaction would not in any circumstances be set aside because it had not been shown to be manifestly disadvantageous to the wife. (The House of Lords in *CIBC Mortgages plc* v *Pitt* [1993] 4 All ER 433, page 561, has since held that this aspect of the decision in *BCCI* v *Aboody* is incorrect and that there is no requirement to establish manifest disadvantage in cases of actual undue influence.)

SLADE LJ: . . . [W]e do not see how it could be disputed that unfair advantage had been taken of [the wife] by her husband. In this context we cite a brief passage from the judge's judgment:

> There was more than a situation of trust; there was actual influence founded on that trust and [Mr Aboody] used it intentionally. He intended and knew that without any discussion or consideration of risk [Mrs Aboody] would sign security documents for a series of increasingly large overdrafts of the company. He never offered her any choice of her own. She was deprived altogether of the free use of any independent and informed judgment in the transaction. He never mentioned risk at all even if he thought it was a slight one. The only judgment that she could be said to have exercised was her mistaken judgment of Mr Aboody and his business capacity and probity.

When one couples with these findings the fact that it was Mr Aboody who suggested to his wife that she should enter into the first five transactions, the unfair advantage taken of her by him became apparent. If he had positively misrepresented to her the extent of the risks involved, a plea based on misrepresentation might well have been available to her. The mere fact that in order to get his own way he chose deliberately to say nothing as to the risks, rather than to misrepresent them, would not, in our judgment, save his conduct from being unconscionable or absolve him from a charge of actual undue influence, bearing in mind that it was he who invited her to enter into

them. On the particular facts of this case we think it could fairly be said that Mrs Aboody's mind was in effect 'a mere channel through which the will of [Mr Aboody] operated'. . . .

Note

Obiter Slade LJ explained the additional requirements before the bank could be affected by Mr Aboody's undue influence over his wife and the transaction set aside as against the bank:

> There are two distinct grounds on which the bank could be affected by Mr Aboody's action: (i) agency; and (ii) notice; although in some of the authorities cited to us these two grounds appear to have become mixed.
>
> *(i) Agency*
>
> Some confusion may have been caused by the use of the word 'agent'. We are not concerned here with the question as to whether or not the bank is vicariously responsible for the acts of Mr Aboody. The issue is whether the bank can be in any better position than Mr Aboody if, when Mr Aboody was acting on its behalf, Mr Aboody exerted (or, if this had been a class 2 case, was presumed to have exerted) undue influence. As we have made clear . . ., the undue influence is required to have brought about the transaction, and it would be inconsistent with the equitable nature of the relief for the bank not to be affected by the undue influence exerted by its agent when the transaction would not exist but for the wrongful acts of its agent. As a matter of principle, the bank in such circumstances should not be entitled to rely on the transaction and this is the view which has been taken by a series of authorities going back to the beginning of this century. The clearest statement of the principle, which we would adopt, is to be found in the judgment of Dillon LJ in *Kings North Trust Ltd* v *Bell* [1986] 1 WLR 119, 123:
>
> > if a creditor, or potential creditor, of a husband desires to obtain, by way of security for the husband's indebtedness, a guarantee from his wife or a charge on property of his wife and if the creditor entrusts to the husband himself the task of obtaining the execution of the relevant document by the wife, then the creditor can be in no better position than the husband himself, and the creditor cannot enforce the guarantee or the security against the wife if it is established that the execution of the document by the wife was procured by undue influence by the husband and the wife had no independent advice.
>
> As Dillon LJ made clear, this approach is in accord with the approach of the general law of principal and agent in relation to fraudulent misrepresentations made by an agent in carrying out the specific instructions of his principal.
>
> Examples of liability on the basis of agency in similar circumstances are to be found in *Turnbull & Co* v *Duval* [1902] AC 429 and *Chaplin & Co. Ltd* v *Brammall* [1908] 1 KB 233. Whether in any particular case the person who exerts the undue influence is the agent (in this sense) of the principal creditor must be a question of fact. For an example of a recent case where agency was not established, see *Coldunell Ltd* v *Gallon* [1986] QB 1184.
>
> *(ii) Notice*
>
> If a creditor has actual or constructive notice, at the time of the execution of the charge or guarantee in question, that the guarantee or charge on which it relies has been procured by the exercise of undue influence, it cannot enforce the transaction; an equity is raised against the creditor irrespective of any question of agency.

Examples of the application of this principle are to be found in *Kempson* v *Ashbee* (1874) LR 10 Ch App 15 and *Bainbrigge* v *Browne* (1881) 18 ChD 188. In the former case James LJ said, at p. 21:

> The first question, therefore, is, whether the bond of 1859 was obtained by the undue exercise of influence of the stepfather, and was it obtained under such exercise as that the knowledge of it can be imputed to [the creditor]?

What notice will be requisite will depend on the nature of the undue influence alleged. Thus, in a class 1 case (actual undue influence), the creditor must have notice of the circumstances alleged to constitute the actual exercise of the undue influence; in a class 2 case it must have notice of the circumstances from which the presumption of undue influence is alleged to arise.

In *Avon Finance Co. Ltd* v *Bridger* [1985] 2 All ER 281 the majority of the court (Brandon and Brightman LJJ) decided the case on a combination of the two grounds of agency and constructive notice.

On the facts there was no evidence that the bank had entrusted Mr Aboody with obtaining his wife's signature so as to have appointed him agent for the bank. However, the solicitor appointed and paid by the bank to give Mrs Aboody advice had witnessed the actual undue influence by the husband and the Court of Appeal therefore considered that the solicitor's knowledge was to be imputed to his client, the bank.

Barclays Bank plc v *O'Brien*
[1993] 4 All ER 417 (HL)

Mr O'Brien was a shareholder in a company and arranged an overdraft for the company with the company's bank on the basis that Mr O'Brien would guarantee the company's indebtedness and that it would be secured by a second charge over the matrimonial home which was jointly owned by husband and wife. Although the manager gave instructions that both husband and wife should be made aware of the nature and effect of the documents they were signing and should be advised to take independent advice, the bank staff had not followed those instructions. Mrs O'Brien had signed the charge document at the bank without reading it. When the company's indebtedness exceeded the agreed overdraft the bank brought proceedings to enforce the guarantee. Mrs O'Brien claimed that she had signed because of her husband's undue influence and that he had misrepresented the nature of the document so that she thought she was signing a charge up to only £60,000 to last only three weeks, when in fact the charge covered £135,000. The Court of Appeal ([1992] 4 All ER 983) held the husband had not exercised undue influence, but that as a matter of policy married women providing security for their husband's debts were to be treated as a specially protected class of surety so that the transaction could be set aside as against the bank even if it had no knowledge of any undue influence or misrepresentation and had not appointed the husband as its agent. Since the relationship giving rise to a likelihood of influence was known to the bank, the bank had a duty to take reasonable steps to ensure

that the married woman understood the nature and effect of the transaction and that the consent given was true and informed. The bank had failed in that duty so that the charge was not enforceable beyond £60,000. Held: on appeal their Lordships affirmed the decision of the Court of Appeal but on other grounds.

LORD BROWNE-WILKINSON: *Undue influence*

A person who has been induced to enter into a transaction by the undue influence of another (the wrongdoer) is entitled to set that transaction aside as against the wrongdoer. Such undue influence is either actual or presumed. In *Bank of Credit and Commerce International SA* v *Aboody* (1988) [1992] 4 All ER 955 at 964, [1990] 1 QB 923 at 953 the Court of Appeal helpfully adopted the following classification.

Class 1: actual undue influence. In these cases it is necessary for the claimant to prove affirmatively that the wrongdoer exerted undue influence on the complainant to enter into the particular transaction which is impugned.

Class 2: presumed undue influence. In these cases the complainant only has to show, in the first instance, that there was a relationship of trust and confidence between the complainant and the wrongdoer of such a nature that it is fair to presume that the wrongdoer abused that relationship in procuring the complainant to enter into the impugned transaction. In class 2 cases therefore there is no need to produce evidence that actual undue influence was exerted in relation to the particular transaction impugned: once a confidential relationship has been proved, the burden then shifts to the wrongdoer to prove that the complainant entered into the impugned transaction freely, for example by showing that the complainant had independent advice. Such a confidential relationship can be established in two ways, viz:

Class 2A. Certain relationships (for example solicitor and client, medical advisor and patient) as a matter of law raise the presumption that undue influence has been exercised.

Class 2B. Even if there is no relationship falling within class 2A, if the complainant proves the de facto existence of a relationship under which the complainant generally reposed trust and confidence in the wrongdoer, the existence of such relationship raises the presumption of undue influence. In a class 2B case therefore, in the absence of evidence disproving undue influence, the complainant will succeed in setting aside the impugned transaction merely by proof that the complainant reposed trust and confidence in the wrongdoer without having to prove that the wrongdoer exerted actual undue influence or otherwise abused such trust and confidence in relation to the particular transaction impugned. . . .

Although there is no class 2A presumption of undue influence as between husband and wife, it should be emphasised that in any particular case a wife may well be able to demonstrate that de facto she did leave decisions on financial affairs to her husband thereby bringing herself within class 2B, i.e. that the relationship between husband and wife in the particular case was such that the wife reposed confidence and trust in her husband in relation to their financial affairs and therefore undue influence is to be presumed. Thus, in those cases which still occur where the wife relies in all financial matters on her husband and simply does what he suggests, a presumption of undue influence within class 2B can be established solely from the proof of such trust and confidence without proof of actual undue influence. . . .

Undue influence, misrepresentation and third parties

Up to this point I have been considering the right of a claimant wife to set aside a transaction as against the wrongdoing husband when the transaction has been

procured by his undue influence. But in surety cases the decisive question is whether the claimant wife can set aside the transaction, not against the wrongdoing husband, but against the creditor bank. Of course, if the wrongdoing husband is acting as agent for the creditor bank in obtaining the surety from the wife, the creditor will be fixed with the wrongdoing of its own agent and the surety contract can be set aside as against the creditor. Apart from this, if the creditor bank has notice, actual or constructive, of the undue influence exercised by the husband (and consequentially of the wife's equity to set aside the transaction) the creditor will take subject to that equity and the wife can set aside the transaction against the creditor (albeit a purchaser for value) as well as against the husband: see *Bainbrigge* v *Browne* (1881) 18 Ch D 188 and *BCCI* v *Aboody* [1992] 4 All ER 955 at 980, [1990] 1 QB 923 at 973. Similarly, in cases such as the present where the wife has been induced to enter into the transaction by the husband's misrepresentation, her equity to set aside the transaction will be enforceable against the creditor if either the husband was acting as the creditor's agent or the creditor had actual or constructive notice.

. . . In my judgment your Lordships should seek to restate the law in a form which is principled, reflects the current requirements of society and provides as much certainty as possible.

Conclusions

(a) *Wives*

My starting point is to clarify the basis of the law. Should wives (and perhaps others) be accorded special rights in relation to surety transactions by the recognition of a special equity applicable only to such persons engaged in such transactions? Or should they enjoy only the same protection as they would enjoy in relation to their other dealings? In my judgment, the special equity theory should be rejected. First, I can find no basis in principle for affording special protection to a limited class in relation to one type of transaction only. Second, to require the creditor to prove knowledge and understanding by the wife in all cases is to reintroduce by the back door either a presumption of undue influence of class 2A (which has been decisively rejected) or the Romilly heresy (which has long been treated as bad law). Third, although Scott LJ found that there were two lines of cases one of which supported the special equity theory, on analysis although many decisions are not inconsistent with that theory the only two cases which support it are *Yerkey* v *Jones* (1940) 63 CLR 649 and the decision of the Court of Appeal in the present case. Finally, it is not necessary to have recourse to a special equity theory for the proper protection of the legitimate interests of wives as I will seek to show.

In my judgment, if the doctrine of notice is properly applied, there is no need for the introduction of a special equity in these types of cases. A wife who has been induced to stand as a surety for her husband's debts by his undue influence, misrepresentation or some other legal wrong has an equity as against him to set aside that transaction. Under the ordinary principles of equity, her right to set aside that transaction will be enforceable against third parties (e.g. against a creditor) if either the husband was acting as the third party's agent or the third party had actual or constructive notice of the facts giving rise to her equity. Although there may be cases where, without artificiality, it can properly be held that the husband was acting as the agent of the creditor in procuring the wife to stand as surety, such cases will be of very rare occurrence. The key to the problem is to identify the circumstances in which the creditor will be taken to have had notice of the wife's equity to set aside the transaction.

The doctrine of notice lies at the heart of equity. Given that there are two innocent parties, each enjoying rights, the earlier right prevails against the later right if the

acquirer of the later right knows of the earlier right (actual notice) or would have discovered it had he taken proper steps (constructive notice). In particular, if the party asserting that he takes free of the earlier rights of another knows of certain facts which put him on inquiry as to the possible existence of the rights of that other and he fails to make such inquiry or take such other steps as are reasonable to verify whether such earlier right does or does not exist, he will have constructive notice of the earlier right and take subject to it. Therefore where a wife has agreed to stand surety for her husband's debts as a result of undue influence or misrepresentation, the creditor will take subject to the wife's equity to set aside the transaction if the circumstances are such as to put the creditor on inquiry as to the circumstances in which she agreed to stand surety.

It is at this stage that, in my view, the 'invalidating tendency' or the law's 'tender treatment' of married women, becomes relevant. As I have said above in dealing with undue influence, this tenderness of the law towards married women is due to the fact that, even today, many wives repose confidence and trust in their husbands in relation to their financial affairs. This tenderness of the law is reflected by the fact that voluntary dispositions by the wife in favour of her husband are more likely to be set aside than other dispositions by her: a wife is more likely to establish presumed undue influence of class 2B by her husband than by others because, in practice, many wives do repose in their husbands trust and confidence in relation to their financial affairs. Moreover the informality of business dealings between spouses raises a substantial risk that the husband has not accurately stated to the wife the nature of the liability she is undertaking, i.e. he has misrepresented the position, albeit negligently.

Therefore, in my judgment a creditor is put on inquiry when a wife offers to stand surety for her husband's debts by the combination of two factors: (a) the transaction is on its face not to the financial advantage of the wife; and (b) there is a substantial risk in transactions of that kind that, in procuring the wife to act as surety, the husband has committed a legal or equitable wrong that entitles the wife to set aside the transaction.

It follows that, unless the creditor who is put on inquiry takes reasonable steps to satisfy himself that the wife's agreement to stand surety has been properly obtained, the creditor will have constructive notice of the wife's rights.

What, then are the reasonable steps which the creditor should take to ensure that it does not have constructive notice of the wife's rights, if any? Normally the reasonable steps necessary to avoid being fixed with constructive notice consist of making inquiry of the person who may have the earlier right (i.e. the wife) to see whether such right is asserted. It is plainly impossible to require of banks and other financial institutions that they should inquire of one spouse whether he or she has been unduly influenced or misled by the other. But in my judgment the creditor, in order to avoid being fixed with constructive notice, can reasonably be expected to take steps to bring home to the wife the risk she is running by standing as surety and to advise her to take independent advice. As to past transactions, it will depend on the facts of each case whether the steps taken by the creditor satisfy this test. However for the future in my judgment a creditor will have satisfied these requirements if it insists that the wife attend a private meeting (in the absence of the husband) with a representative of the creditor at which she is told of the extent of her liability as surety, warned of the risk she is running and urged to take independent legal advice. If these steps are taken in my judgment the creditor will have taken such reasonable steps as are necessary to preclude a subsequent claim that it had constructive notice of the wife's rights. I should make it clear that I have been considering the ordinary case where the creditor knows only that the wife is to stand surety for her husband's debts. I would not exclude exceptional cases where a creditor has knowledge of further facts

which render the presence of undue influence not only possible but probable. In such cases, the creditor to be safe will have to insist that the wife is separately advised.

I am conscious that in treating the creditor as having constructive notice because of the risk of class 2B undue influence or misrepresentation by the husband I may be extending the law as stated by Fry J in *Bainbrigge* v *Browne* (1881) 18 Ch D 188 at 197 and the Court of Appeal in *BCCI* v *Aboody* [1992] 4 All ER 955 at 980, [1990] 1 QB 923 at 973. Those cases suggest that for a third party to be affected by constructive notice of presumed undue influence the third party must actually know of the circumstances which give rise to a presumption of undue influence. In contrast, my view is that the risk of class 2B undue influence or misrepresentation is sufficient to put the creditor on inquiry. But my statement accords with the principles of notice: if the known facts are such as to indicate the possibility of an adverse claim that is sufficient to put a third party on inquiry.

If the law is established as I have suggested, it will hold the balance fairly between on the one hand the vulnerability of the wife who relies implicitly on her husband and, on the other hand, the practical problems of financial institutions asked to accept a secured or unsecured surety obligation from the wife for her husband's debts. In the context of suretyship, the wife will not have any right to disown her obligations just because subsequently she proves that she did not fully understand the transaction: she will, as in all other areas of her affairs, be bound by her obligations unless her husband has, by misrepresentation, undue influence or other wrong, committed an actionable wrong against her. In the normal case, a financial institution will be able to lend with confidence in reliance on the wife's surety obligation provided that it warns her (in the absence of the husband) of the amount of her potential liability and of the risk of standing surety and advises her to take independent advice. . . .

(b) *Other persons*

I have hitherto dealt only with the position where a wife stands surety for her husband's debts. But in my judgment the same principles are applicable to all other cases where there is an emotional relationship between cohabitees. The 'tenderness' shown by the law to married women is not based on the marriage ceremony but reflects the underlying risk of one cohabitee exploiting the emotional involvement and trust of the other. Now that unmarried cohabitation, whether heterosexual or homosexual, is widespread in our society, the law should recognise this. Legal wives are not the only group which are now exposed to the emotional pressure of cohabitation. Therefore if, but only if, the creditor is aware that the surety is cohabiting with the principal debtor, in my judgment the same principles should apply to them as apply to husband and wife.

In addition to the cases of cohabitees, the decision of the Court of Appeal in *Avon Finance Co. Ltd* v *Bridger* [1985] 2 All ER 281 shows (rightly in my view) that other relationships can give rise to a similar result. In that case a son, by means of misrepresentation, persuaded his elderly parents to stand surety for his debts. The surety obligation was held to be unenforceable by the creditor inter alia because to the bank's knowledge the parents trusted the son in their financial dealings. In my judgment that case was rightly decided: in a case where the creditor is aware that the surety reposes trust and confidence in the principal debtor in relation to his financial affairs, the creditor is put on inquiry in just the same way as it is in relation to husband and wife.

Summary

I can therefore summarise my views as follows. Where one cohabitee has entered into an obligation to stand as surety for the debts of the other cohabitee and the creditor

is aware that they are cohabitees: (1) the surety obligation will be valid and enforceable by the creditor unless the suretyship was procured by the undue influence, misrepresentation or other legal wrong of the principal debtor; (2) if there has been undue influence, misrepresentation or other legal wrong by the principal debtor, unless the creditor has taken reasonable steps to satisfy himself that the surety entered into the obligation freely and in knowledge of the true facts, the creditor will be unable to enforce the surety obligation because he will be fixed with constructive notice of the surety's right to set aside the transaction; (3) unless there are special exceptional circumstances, a creditor will have taken such reasonable steps to avoid being fixed with constructive notice if the creditor warns the surety (at a meeting not attended by the principal debtor) of the amount of her potential liability and of the risks involved and advises the surety to take independent legal advice.

I should make it clear that in referring to the husband's debts I include the debts of a company in which the husband (but not the wife) has a direct financial interest.

The decision of this case

Applying those principles to this case, to the knowledge of the bank Mr and Mrs O'Brien were man and wife. The bank took a surety obligation from Mrs O'Brien, secured on the matrimonial home, to secure the debts of a company in which Mr O'Brien was interested but in which Mrs O'Brien had no direct pecuniary interest. The bank should therefore have been put on inquiry as to the circumstances in which Mrs O'Brien had agreed to stand as surety for the debt of her husband. If the Burnham branch had properly carried out the instructions from Mr Tucker of the Woolwich branch, Mrs O'Brien would have been informed that she and the matrimonial home were potentially liable for the debts of a company which had an existing liability of £107,000 and which was to be afforded an overdraft facility of £135,000. If she had been told this, it would have counteracted Mr O'Brien's misrepresentation that the liability was limited to £60,000 and would last for only three weeks. In addition according to the side letter she would have been recommended to take independent legal advice.

Unfortunately Mr Tucker's instructions were not followed and to the knowledge of the bank (through the clerk at the Burnham branch) Mrs O'Brien signed the documents without any warning of the risks or any recommendation to take legal advice. In the circumstances the bank (having failed to take reasonable steps) is fixed with constructive notice of the wrongful misrepresentation made by Mr O'Brien to Mrs O'Brien. Mrs O'Brien is therefore entitled as against the bank to set aside the legal charge on the matrimonial home securing her husband's liability to the bank.

Notes

1. The decision of the Court of Appeal had been interpreted as suggesting that a married woman could avoid such a contract as against the bank simply by stating that she did not understand the nature and effect of what she had signed and that the bank had failed in its duty to advise her.

2. Lord Browne-Wilkinson stressed the policy considerations and the need to balance the desire to protect married women against losing their homes with the need to ensure that banks would be prepared to lend money on the security of a jointly owned home. The banks needed some guidance on the steps they needed to take in order to protect themselves against the risk of losing their security because of the undue influence of a third party. It appears that the House of Lords has provided this guidance.

3. The House of Lords has made it clear that there must first be a legal wrong, i.e. undue influence (actual or presumed) or misrepresentation by the third party. (*Banco Exterior Internacional SA* v *Thomas* [1997] 1 All ER 46, is an example of a case where the presumption of undue influence was rebutted so that there was no legal wrong and *O'Brien* did not apply.) The question of whether the bank would be affected by that wrong would in practice turn on the question of the bank's notice of that influence, actual or constructive. The bank dealing with a wife or other cohabitee would be put on inquiry because of the likelihood of undue influence resulting from the relationship of trust and confidence, where the transaction was not of obvious financial advantage to that party. The bank would then come under a duty to take the reasonable steps specified, and if it failed to do so would be affected by constructive notice of the third party's undue influence.

4. In *CIBC Mortgages plc* v *Pitt* [1993] 4 All ER 433, the House of Lords applied these principles but concluded that the lender was not affected by constructive notice of the third party's undue influence.

The husband had influenced his wife into agreeing to let him borrow money on the security of the matrimonial home in order to buy shares on the stock market. However, on the joint application form for a loan they had both expressed the loan to be for the purpose of paying off the outstanding mortgage and using the balance to purchase a holiday home. The wife did not read the relevant documents, did not know the amount being borrowed and did not receive any advice about the transaction. The husband used the money to speculate but when he became unable to repay the mortgage payments the lender sought possession of the matrimonial home. Held:

> . . . Applying the decision of this House in *O'Brien*, Mrs Pitt has established actual undue influence by Mr Pitt. The plaintiff will not however be affected by such undue influence unless Mr Pitt was, in a real sense, acting as agent of the plaintiff in procuring Mrs Pitt's agreement or the plaintiff had actual or constructive notice of the undue influence. The judge has correctly held that Mr Pitt was not acting as agent for the plaintiff. The plaintiff had no actual notice of the undue influence. What, then, was known to the plaintiff that could put it on inquiry so as to fix it with constructive notice?
>
> So far as the plaintiff was aware, the transaction consisted of a joint loan to the husband and wife to finance the discharge of an existing mortgage on 26 Alexander Avenue and, as to the balance, to be applied in buying a holiday home. The loan was advanced to both husband and wife jointly. There was nothing to indicate to the plaintiff that this was anything other than a normal advance to a husband and wife for their joint benefit.
>
> [Counsel] for Mrs Pitt argued that the invalidating tendency which reflects the risk of there being class 2B undue influence was, in itself, sufficient to put the plaintiff on inquiry. I reject this submission without hesitation. It accords neither with justice nor with practical common sense. If third parties were to be fixed with constructive notice of undue influence in relation to every transaction between husband and wife, such transactions would become almost impossible. On every purchase of a home in joint names, the building society or bank financing the purchase would have to insist on meeting the wife separately from her husband,

advise her as to the nature of the transaction and recommend her to take legal advice separate from that of her husband. If that were not done, the financial institution would have to run the risk of a subsequent attempt by the wife to avoid her liabilities under the mortgage on the grounds of undue influence or misrepresentation. To establish the law in that sense would not benefit the average married couple and would discourage financial institutions from making the advance.

What distinguishes the case of the joint advance from the surety case is that, in the latter, there is not only the possibility of undue influence having been exercised but also the increased risk of it having in fact been exercised because, at least on its face, the guarantee by a wife of her husband's debts is not for her financial benefit. It is the combination of these two factors that puts the creditor on inquiry.

The husband had clearly exercised undue influence over the wife in relation to completion of the mortgage application form, but the decision in *O'Brien* makes it clear that, where the bank has no actual knowledge, it need not specifically inquire of the wife whether she was the victim of undue influence and can rely on what is stated in an application form.

This case can be contrasted with *Dunbar Bank plc* v *Nadeem* [1997] 2 All ER 253 where the wife became liable for both joint debts and her husband's personal debts to the bank.

5. As Lord Browne-Wilkinson made clear, it is important that the wife is advised separately from her husband, and a failure to achieve this will result in the bank failing in its duty (*TSB Bank plc* v *Camfield* [1995] 1 All ER 951).

6. See Lehane (1994) 110 LQR 167, Arora [1994] JBL 242 and Fehlberg (1994) 57 MLR 467, and see especially Fehlberg (1996) 59 MLR 675.

7. It is important to note that the reasonable steps necessary to avoid being fixed with constructive notice include only a duty to advise the surety to take independent advice. If the bank does this, it appears from subsequent case law that it will fulfil the duty. Banks are not concerned to stipulate the advice that a solicitor must give. (See *Massey* v *Midland Bank plc* [1995] 1 All ER 929 and see also *Banco Exterior Internacional* v *Mann* [1995] 1 All ER 936, where a majority of the Court of Appeal held that the bank was entitled to assume that the solicitor had given the proper professional advice as he had signed a certificate stating that he had done so. On the facts it made no difference that the solicitor in question was the solicitor of the company which would benefit from the secured loan.) It is a matter for the solicitor to decide if there is any conflict of interest. See *Bank of Baroda* v *Rayarel* [1995] 2 FLR 376, where although the surety was advised by the solicitor acting for the third party, the bank was entitled to assume that the surety had been properly advised. See also *Halifax Mortgage Services Ltd* v *Stepsky* [1996] 2 All ER 277 (solicitor acting for husband, wife and the building society). The Court of Appeal held that the knowledge gained by the solicitor from the husband relating to the true purpose of the loan could not be imputed to the building society because it had been gained prior to the building society appointing the solicitor.

The trend of this case law is to shift the burden to solicitors, who in theory can be sued if the advice is negligently given.

In *Barclays Bank* v *O'Brien*, Lord Browne-Wilkinson made it clear that in an exceptional case where the creditor is aware of facts so that undue influence is not only possible but probable, in order to be protected from the risk of losing its security the bank will need to insist that the surety is independently advised. This appears to have been applied in the following case:

Credit Lyonnais Bank Nederland NV* v *Burch
[1997] 1 All ER 144 (CA)

The defendant was a junior employee of a tour operating company. The company wanted to increase its bank overdraft from £250,000 to £270,000. The defendant had done baby-sitting for and was a family friend of the plaintiff, the main shareholder in the company. The plaintiff asked the defendant to provide security to the bank for the increased overdraft although she had no financial interest in the company. The defendant was to give a second charge over her flat (with equity of £70,000) and an unlimited all moneys guarantee. At no time was she informed by the bank or the plaintiff of the company's indebtedness or the extent of the overdraft being granted. Although she was advised by the bank to seek independent advice she did not do so, but claimed that she understood the nature and extent of the obligations she was undertaking. She signed the relevant documents, but the company later went into liquidation and the bank demanded the outstanding debt of £60,000 from the defendant. When she failed to pay, the bank sought possession of her flat. The trial judge considered that the relationship between the plaintiff and the defendant was based on trust and confidence giving rise to the presumption of undue influence which had not been rebutted. He concluded that the charge should be set aside. The bank appealed arguing that it had discharged its duty by urging the defendant to seek legal advice and could not be responsible if she failed to do so. Held: the bank knew of the relationship of employer and employee and should have been aware that there was a real possibility of undue influence. Nevertheless the bank had not explained the potential extent of her liability to the defendant. The amount of the indebtedness and extent of the overdraft covered by the guarantee were vital facts necessary to make an assessment regarding a guarantee which was unlimited in time and amount. In the circumstances the bank needed to *ensure* that she obtained independent legal advice. Therefore the bank had constructive notice of the undue influence and the transaction should be set aside.

MILLETT LJ: . . . Mr Pelosi provided the bank with an unlimited all moneys guarantee given by Miss Burch at his request. She was a junior employee of the company employed at a modest wage. She was not a director of the company or shareholder in it. Her guarantee was supported by a second charge on her home, a small flat of suitably modest value, which was valued at £100,000 and was subject to a mortgage of £30,000. She understood that the guarantee and charge were unlimited in time and amount, but she had not taken independent legal advice.

No court of equity could allow such a transaction to stand. The facts which I have recited are sufficient to entitle Miss Burch to have the transaction set aside as against Mr Pelosi and the company. Every one of those facts was known to the bank when it accepted the security. The bank must accordingly be taken to have had notice of Miss Burch's equity, and must submit to the transaction being set aside against it also.

An eighteenth century Lord Chancellor would have contented himself with saying as much. It is an extreme case. The transaction was not merely to the manifest disadvantage of Miss Burch; it was one which, in the traditional phrase, 'shocks the conscience of the court'. Miss Burch committed herself to a personal liability far beyond her slender means, risking the loss of her home and personal bankruptcy, and obtained nothing in return beyond a relatively small and possibly temporary increase in the overdraft facility available to her employer, a company in which she had no financial interest. The transaction gives rise to grave suspicion. It cries aloud for an explanation. . . .

In the present case, the only relationship between Mr Pelosi (and his company) on the one hand and Miss Burch on the other which has been proved (and of which the bank had any knowledge) was that of employer and junior employee. That is not a relationship within class 2a. At the same time, it is clearly one which is capable of developing into a relationship of trust and confidence with the attendant risk of abuse, particularly in the case of a small business where the parties are accustomed to work closely together.

Accordingly, it was for Miss Burch to prove that the relationship between her and Mr Pelosi had developed into a relationship of trust and confidence. Whether it had done so or not was a question of fact. While she had to prove this affirmatively, she did not have to prove it as a primary fact by direct evidence. It was sufficient for her to prove facts from which the existence of a relationship of trust and confidence could be inferred. In the present case, the excessively onerous nature of the transaction into which she was persuaded to enter, coupled with the fact that she did so at the request of, and after discussion with Mr Pelosi, is in my judgment, quite enough to justify the inference, which is really irresistible, that the relationship of employer and employee had ripened into something more and that there had come into existence between them a relationship of trust and confidence which he improperly exploited for his own benefit.

I do not accept the bank's submission that this conclusion is inconsistent with the authorities. I repeat that the mere fact that a transaction is improvident or manifestly disadvantageous to one party is not sufficient by itself to give rise to a presumption that it has been obtained by the exercise of undue influence; but where it is obtained by a party between whom and the complainant there is a relationship like that of employer and junior employee which is easily capable of developing into a relationship of trust and confidence, the nature of the transaction may be sufficient to justify the inference that such a development has taken place; and where the transaction is so extravagantly improvident that it is virtually inexplicable on any other basis, the inference will be readily drawn.

The bank submitted that in the absence of evidence that there was a sexual or emotional tie between Mr Pelosi and Miss Burch the facts were insufficient to justify the recorder's finding that there was a relationship of confidence between them; and that, in the absence of evidence that the bank was aware of such a tie between Mr Pelosi and Miss Burch, the facts known to the bank were insufficient to fix it with notice of the existence of a relationship of trust and confidence between them. I do not accept this. The presence of a sexual or emotional tie would at least make the transaction explicable. A wife might well consider (and be properly advised) that it

was in her interest to provide a (suitably limited) guarantee of her husband's business borrowings and to charge it on her interest in the matrimonial home, even if she had no legal interest in the company which owned the business. Her livelihood and that of her family would no doubt depend on the success of the business; and a refusal to entertain her husband's importunity might put at risk the marital relationship as well as the continued prosperity of herself and her family. Similar considerations would no doubt influence a cohabitee and her adviser.

But Miss Burch had no such incentive to induce her to enter into the transaction. No competent solicitor could possibly have advised her to enter into it. He would be bound to warn her against it in the strongest possible terms, and to have refrained from acting for her further if she had persisted in it against his advice (see *Powell* v *Powell* [1900] 1 Ch 243 at 247).

The bank had actual notice of the facts from which the existence of a relationship of trust and confidence between Mr Pelosi and Miss Burch could be inferred. It knew that they were respectively employer and junior employee working in a small business, and should have 'appreciated that the possibility of influence exist[ed]' (see *Avon Finance Co. Ltd* v *Bridger* (1979) [1985] 2 All ER 281 at 288 per Brandon LJ). It also knew that Miss Burch was neither a shareholder nor a director of the company and, so far as it knew, had no incentive to enter into the transaction, which was entirely for his benefit and to her detriment. This was sufficient to put the bank on inquiry. It probably appreciated this, or it would not have encouraged Miss Burch to take legal advice.

The bank submitted that it had discharged its duty to Miss Burch by urging her to obtain independent legal advice. This does not accurately reflect the legal position. The bank owed no duty to Miss Burch. If it urged Miss Burch to take independent legal advice, this was for its own protection. If it had not had cause to suspect that Miss Burch's agreement to enter into the transaction might have been improperly obtained, it would have had no need to encourage her to take legal advice. Since it did have cause to suspect it, it could not avoid the consequences unless two conditions were satisfied: (i) it must have taken reasonable steps to allay any such suspicion; and (ii) the result of the steps which it took must be such as would reasonably allay any such suspicion.

The bank urged Miss Burch to obtain independent legal advice. In a letter obviously written at the instance of Mr Pelosi and after consultation with him, she declined to do so. The bank had taken all reasonable steps open to it to allay any suspicion it might have had that Miss Burch's agreement to the transaction had been procured by the exercise of undue influence on the part of Mr Pelosi. But what followed could not reasonably have allayed any such suspicion; on the contrary, it should have confirmed it.

That is sufficient to dispose of this appeal, but I should not be taken to accept that it would necessarily have made any difference even if Miss Burch had entered into the transaction after taking independent legal advice. Such advice is neither always necessary nor always sufficient. It is not a panacea. The result does not depend mechanically on the presence or absence of legal advice. I think that there has been some misunderstanding of the role which the obtaining of independent legal advice plays in these cases.

It is first necessary to consider the position as between the complainant and the alleged wrongdoer. The alleged wrongdoer may seek to rebut the presumption that the transaction was obtained by undue influence by showing that the complainant had the benefit of independent legal advice before entering into it. It is well established that in such a case the court will examine the advice which was actually given. It is

not sufficient that the solicitor has satisfied himself that the complainant understands the legal effect of the transaction and intends to enter into it. That may be a protection against mistake or misrepresentation . . . is no protection against undue influence. As Lord Eldon LC said in *Huguenin* v *Baseley* (1807) 14 Ves 273 at 300, [1803–13] All ER Rep 1 at 13: 'The question is, not, whether she knew what she was doing, had done, or proposed to do, but how the intention was produced . . .'

Accordingly, the presumption cannot be rebutted by evidence that the complainant understood what she was doing and intended to do it. The alleged wrongdoer can rebut the presumption only by showing that the complainant was either free from any undue influence on his part or had been placed, by the receipt of independent advice, in an equivalent position. That involves showing that she was advised as to the propriety of the transaction by an adviser fully informed of all the material facts (see *Powell* v *Powell*, *Brusewitz* v *Brown*, *Permanent Trustee Co. of New South Wales Ltd* v *Bridgewater* [1936] 3 All ER 501 at 507 and *Bester* v *Perpetual Trustee Co. Ltd* [1970] 3 NSWLR 30 at 35–36).

Some of those cases were concerned with the equity to set aside a harsh and unconscionable bargain rather than one obtained by the exercise of undue influence, but the role of the independent adviser, while not identical, is not dissimilar. The solicitor may not be concerned to protect the complainant against herself, but he is concerned to protect her from the influence of the wrongdoer. The cases show that it is not sufficient that she should have received independent advice unless she has acted on that advice. If this were not so, the same influence that produced her desire to enter into the transaction would cause her to disregard any advice not to do so. They also show that the solicitor must not be content to satisfy himself that his client understands the transaction and wishes to carry it out. His duty is to satisfy himself that the transaction is one which his client could sensibly enter into if free from improper influence; and if he is not so satisfied to advise her not to enter into it, and to refuse to act further for her if she persists. He must advise his client that she is under no obligation to enter into the transaction at all and, if she still wishes to do so, that she is not necessarily bound to accept the terms of any document which has been put before her but (where this is appropriate) that he should ascertain on her behalf whether less onerous terms might be obtained.

It is next necessary to consider the position of the third party who has been put on enquiry of the possible existence of some impropriety and who wishes to avoid being fixed with constructive notice. One means of doing so is to ensure that the complainant obtains competent and independent legal advice before entering into the transaction. If she does so, and enters into the transaction nonetheless, the third party will usually escape the consequences of notice. This is because he is normally entitled to assume that the solicitor has discharged his duty and that the complainant has followed his advice. But he cannot make any such assumption if he knows or ought to know that it is false.

In the present case, the bank did not have actual notice of the exercise of undue influence, or even of the existence of a relationship of trust and confidence between Miss Burch and Mr Pelosi. It did not know for a fact that Miss Burch had no incentive to enter into the transaction. For all the bank knew, for example, the parties might be intending to set up home together and live off the profits of the company's business. It did not, therefore, know (as was the case) that no competent solicitor could possibly advise Miss Burch to guarantee the company's overdraft.

But it must have known that no competent solicitor could advise her to enter into a guarantee in the terms she did. He would be bound to inquire, of the bank if necessary, of the reason why it required additional security. Having discovered that it

was to enable the limit of the company's overdraft to be increased from £250,000 to £270,000, he would be bound to advise Miss Burch that an unlimited guarantee was unnecessary and inappropriate for this purpose, and that, if she felt that she must accommodate Mr Pelosi's wishes, she should offer a limited guarantee with a limit of £20,000 or (better still) a guarantee of the company's liability in excess of £250,000 with a maximum of £270,000. The terms of Miss Burch's letters indicate that if she had been given appropriate advice of the alternatives which were legally available, she would have chosen one which was less onerous to her while still meeting the bank's ostensible requirements.

I do not, therefore, accept that a bank, in circumstances where it ought to appreciate the possibility that undue influence has been exercised, can escape the consequences by putting forward an unnecessarily onerous form of guarantee and relying on the failure of the guarantor's solicitor to advise her of the possibility of offering a guarantee on less onerous terms and more appropriate to the situation.

In the present case, the bank accepted an unlimited guarantee of her employer's indebtedness obtained by the employer from a junior employee with no incentive to give it; and who had, at the instance of her employer, declined to obtain legal advice, was known to be concerned at the unlimited nature of the obligation which she was undertaking, and was almost certainly unaware of the alternatives open to her. In my opinion, the transaction must be set aside and the appeal must be dismissed.

Notes

1. This decision confirms that advising the surety to take independent legal advice may not be sufficient in some cases. It will all depend on the facts. The facts and the merits in this case were considered strongly to favour the defendant.

2. The balance appears to have shifted to requiring the bank in some circumstances to ensure that advice is actually received. This is explicable on the basis of the extreme factual context in this case, namely an unlimited personal guarantee by an employee. However, banks may consider it necessary to be on the safe side and ensure that independent advice is received in all cases. Millett LJ appears to consider that it is vital that the surety should actually receive independent advice, as opposed to merely being advised to take it, and he appears to consider that this should happen in all cases, whereas the judgments of Nourse LJ and Swinton Thomas LJ restrict this duty to facts such as those in this case where it was inevitable that a solicitor would have queried the onerous terms and advised her against the transaction in its present form.

The bank considered itself to be protected by the fact that it had advised the defendant to obtain independent legal advice but she had refused and confirmed that she knew what she was doing. In such circumstances what more could the bank do?

3. The judgment of Millett LJ contains some helpful clarification of the responsibilities of solicitors in the giving of advice. In particular, if the charge is unlimited it is likely to be onerous, and the solicitor must inquire as to whether there are any onerous clauses in the agreement. However, the burdens on solicitors are also heavy as a result of Millett LJ's paternalistic approach which requires that a solicitor should 'refuse to act further' if the

surety persists in going ahead when the solicitor has advised the surety that it would not be sensible to do so.

D: THE EFFECT OF UNDUE INFLUENCE

The contract is voidable so that both parties are to be restored to their original positions. However, in *TSB Bank plc* v *Camfield* [1995] 1 All ER 951, the Court of Appeal rejected a claim for partial rescission, i.e., for the charge to be set aside on terms that it was a valid security for £15,000 (the amount that the wife thought was her maximum liability as a result of her husband's misrepresentation). The Court of Appeal held that the charge had to be set aside in its entirety.

If the charge and loan agreement are set aside for undue influence, the surety must be able to make restitution and will have to account to the bank for the benefit she has received from the use of the money. In *Dunbar Bank plc* v *Nadeem* [1997] 2 All ER 253, this was interpreted to mean that the surety had to make restitution of a half of the £210,000 lent to her and her husband in order to purchase a leasehold, plus simple interest on that amount.

What is the position if restoration to the original positions cannot be achieved?

Cheese v *Thomas*
[1994] 1 All ER 35 (CA)

In 1990 the 86-year-old plaintiff and the defendant, his great nephew, had agreed to purchase a house. The purchase price was £83,000. The house was purchased in the sole name of the defendant, with the plaintiff contributing £43,000 and the defendant £40,000 by means of a building society mortgage on the property. It was agreed that the plaintiff would live in the property until his death and then the defendant would be solely entitled. The defendant failed to keep up the mortgage payments. The plaintiff claimed that the transaction should be set aside for undue influence and wanted the return of his £43,000. The house was sold for only £55,000. Held: where it was not possible to restore the parties to their exact original positions the court would look at the circumstances and do what was fair and just in practical terms. Since the purpose of the transaction had been to benefit both parties, it would not be just for the defendant to suffer the entire loss of market value. Each party should receive a proportionate share of the net proceeds (i.e. 43:40).

Notes

1. This case involved an automatic presumption of undue influence (class 2A — fiduciary relationship) which had not been rebutted since the nephew had not advised his uncle to obtain independent advice. However, the Court of Appeal clearly considered that it was relevant that the nephew had not behaved improperly or tricked his uncle.

2. Since this was a presumed undue influence case, the transaction had to be shown to be manifestly disadvantageous to the uncle, which the Court of Appeal held it to be because he could not compel a sale if he wished to move and because he was placed at considerable risk if the nephew failed to pay the mortgage instalments.
3. See Chen-Wishart (1994) 100 LQR 173 and Dixon [1994] CLJ 232.

Mahoney v *Purnell*
[1996] 3 All ER 61

Mahoney had been persuaded to sell his 50 per cent shareholding in a business to his son-in-law, who owned the other 50 per cent, for £200,000. Payment was to be made over a ten-year period. Although the company's solicitor had explained the proposed terms, he had stated that he could not advise Mahoney on the commercial reasonableness of the proposal because he was acting for the company. However, Mahoney was not explicitly advised to obtain independent legal advice. One year after this agreement was made the son-in-law sold the business for over £3 million. Mahoney sought rescission of the agreement and equitable relief of a money judgment on the basis of undue influence. However, the company went into liquidation at a time when Mahoney was still owed £80,000. The issue in the case, the presumption of undue influence not having been rebutted, related to the remedy since the parties could not be restored to their former positions. Held: the court had power to award compensation in equity where, as here, there was a relationship based on trust which was fiduciary in nature and this fiduciary relationship had been abused. Accordingly, May J made an award whereby the son-in-law was to compensate Mahoney in an amount equal to the value at the date of the agreement of what he had surrendered with credit being given for what he had received. This was calculated at approximately £202,000.

MAY J: . . . where an agreement is made as a result of undue influence in circumstances where the court will in equity intervene, the normal remedy is for the agreement to be set aside and for the defendant to account for profits obtained from the improper agreements. The court is not deflected from this course because the parties cannot be restored to their former positions. The remedy is not to leave the agreement as it is and simply compensate the plaintiff for loss upon the principle in *Nocton* v *Lord Ashburton* [1914] AC 932, [1914–15] All ER Rep 45. Allowance must be made to the defendant for improvements or benefits which he has made and which accrue to the plaintiff upon the setting aside of the agreement. Where the facts do not fit neatly into this scheme, the court has to achieve practical justice between the parties. The question is what does the justice of the case require.

In this case, the commonsense and, if I may say so, fair remedy for Mr Mahoney is for him to receive in compensation the March 1988 value of what he surrendered under the agreements, appropriate credit being given for what he received under the agreements. The question is whether the law permits that result. . . . [T]aking an account in this case would not, in my view, do practical justice since, on the evidence, the value of what Mr Mahoney surrendered has been lost through no fault or action

of his. The company is in liquidation and there is no presently quantifiable profit in the hands of Mr Purnell personally. The fact that at times between 1988 and now profits might have been calculated does not help, since there is no reason in principle for choosing any moment in time other than the present for the taking of an account. Practical justice in this case requires an award which is akin to damages. It might be said that the court cannot do that . . . But I am loath to reach that conclusion if the result would be, as I think it would be, that Mr Mahoney was denied commonsense and fair compensation.

In my view, the law is not so constrained. *O'Sullivan* [*O'Sullivan* v *Management Agency and Music Ltd* [1985] 3 All ER 351, [1985] QB 428] recognises that transactions may be set aside provided that the court can achieve practical justice by obliging the defendant to give up advantages while at the same time compensating him for value which he has contributed. No doubt that balance will usually be achieved by taking an account. But where that precise route will not achieve practical justice, an analogous permissible route to that end may be to balance the value which the plaintiff surrendered against any value which he has received and to award him the difference. That is not, I think to award him damages, but fair compensation in equity as an adjunct to setting aside the agreement.

I consider that *Nocton* v *Lord Ashburton* may be seen as authority supporting — or at least strongly encouraging — the conclusion that the court does have power to award fair compensation in equity where a plaintiff who has trusted a defendant succeeds in persuading the court to set aside an unfair agreement induced by reliance on that trust. . . . [A] plaintiff who suffers loss as a result of breach of a fiduciary duty by a defendant may claim relief in equity which need not be limited to the taking of an account of profit, and can take the form of compensation if the defendant has lost the property acquired from the plaintiff by a transaction which arose out of his confidential relationship with the man who had trusted him. . . .

The relationship which existed in this case between Mr Mahoney and Mr Purnell from which undue influence is presumed is based upon trust and may be described as fiduciary. Although Mr Mahoney's claim is not conventionally framed in the language of breach of duty, his ground for equitable relief is founded on abuse of trust. For present purposes the difference may be seen as semantic only. In *Nocton* v *Lord Ashburton* the breach of duty was that which lost the property. In this case, the abuse of the fiduciary relationship induced the agreements and the property was lost later. I do not consider that this is a distinction material to the search for a remedy, since in each case the plaintiff seeks equitable relief for an abuse of (or breach of) trust. . . .

Note

This case is only authority for the existence of jurisdiction to award monetary compensation where the undue influence involves a breach of fiduciary duty. It does not make this remedy available in instances of undue influence which do not involve a breach of fiduciary duty.

SECTION 3: INEQUALITY OF BARGAINING POWER

A: A GENERAL DOCTRINE

See Waddams, 'Unconscionability in Contracts' (1976) 39 MLR 369.

Lord Denning MR in *Lloyds Bank Ltd* v *Bundy* considered that there was a general doctrine of inequality of bargaining power in English law.

Lloyds Bank* v *Bundy
[1975] QB 326 (CA)

The facts of this case appear at page 545.

LORD DENNING MR:

The general rule

Now let me say at once that in the vast majority of cases a customer who signs a bank guarantee or a charge cannot get out of it. No bargain will be upset which is the result of the ordinary interplay of forces. There are many hard cases which are caught by this rule. Take the case of a poor man who is homeless. He agrees to pay a high rent to a landlord just to get a roof over his head. The common law will not interfere. It is left to Parliament. Next take the case of a borrower in urgent need of money. He borrows it from the bank at high interest and it is guaranteed by a friend. The guarantor gives his bond and gets nothing in return. The common law will not interfere. Parliament has intervened to prevent moneylenders charging excessive interest. But it has never interfered with banks.

Yet there are exceptions to this general rule. There are cases in our books in which the courts will set aside a contract, or a transfer of property, when 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. Hitherto those exceptional cases have been treated each as a separate category in itself. But I think the time has come when we should seek to find a principle to unite them. I put on one side contracts or transactions which are voidable for fraud or misrepresentation or mistake. All those are governed by settled principles. I go only to those where there has been inequality of bargaining power, such as to merit the intervention of the court.

The categories

The first category is that of 'duress of goods.' A typical case is when a man is in a strong bargaining position by being in possession of the goods of another by virtue of a legal right, such as by way of pawn or pledge or taken in distress. The owner is in a weak position because he is in urgent need of the goods. The stronger demands of the weaker more than is justly due: and he pays it in order to get the goods. Such a transaction is voidable. He can recover the excess: see *Astley* v *Reynolds* (1731) 2 Stra 915. To which may be added the cases of 'colore officii,' where a man is in a strong bargaining position by virtue of his official position or public profession. He relies upon it so as to gain from the weaker — who is urgently in need — more than is justly due. In such cases the stronger may make his claim in good faith honestly believing that he is entitled to make his demand. He may not be guilty of any fraud or misrepresentation. The inequality of bargaining power — the strength of the one versus the urgent need of the other — renders the transaction voidable and the money paid to be recovered back: see *Maskell* v *Horner* [1915] 3 KB 106.

The second category is that of the 'unconscionable transaction.' A man is so placed as to be in need of special care and protection and yet his weakness is exploited by another far stronger than himself so as to get his property at a gross undervalue. The typical case is that of the 'expectant heir.' But it applies to all cases where a man comes into property, or is expected to come into it — and then being in urgent need —

another gives him ready cash for it, greatly below its true worth, and so gets the property transferred to him. Even though there be no evidence of fraud or misrepresentation, nevertheless the transaction will be set aside: see *Fry* v *Lane* (1888) 40 ChD 312, 322 where Kay J said:

> The result of the decisions is that where a purchase is made from a poor and ignorant man at a considerable undervalue, *the vendor having no independent advice*, a court of equity will set aside the transaction.

This second category is said to extend to all cases where an unfair advantage has been gained by an unconscientious use of power by a stronger party against a weaker: see the cases cited in *Halsbury's Laws of England*, 3rd ed., vol. 17 (1956), p. 682. The third category is that of 'undue influence' usually so called. These are divided into two classes as stated by Cotton LJ in *Allcard* v *Skinner* (1887) 36 ChD 145, 171.

The fourth category is that of 'undue pressure.' The most apposite of that is *Williams* v *Bayley* (1866) LR 1 HL 200. Other instances of undue pressure are where one party stipulates for an unfair advantage to which the other has no option but to submit. As where an employer — the stronger party — has employed a builder — the weaker party — to do work for him. When the builder asked for payment of sums properly due (so as to pay his workmen) the employer refused to pay unless he was given some added advantage. Stuart V-C said: 'Where an agreement, hard and inequitable in itself, has been exacted under circumstances of pressure on the part of the person who exacts it, this court will set it aside': see *Ormes* v *Beadel* (1860) 2 Giff 166, 174 and *D & C Builders Ltd* v *Rees* [1966] 2 QB 617, 625.

The fifth category is that of salvage agreements. When a vessel is in danger of sinking and seeks help, the rescuer is in a strong bargaining position. The vessel in distress is in urgent need. The parties cannot be truly said to be on equal terms. The Court of Admiralty have always recognised that fact. The 'fundamental rule' is

> if the parties have made an agreement, the court will enforce it, unless it be manifestly unfair and unjust; but if it be manifestly unfair and unjust, the court will disregard it and decree what is fair and just. . . .

The general principles

Gathering all together, I would suggest that through all these instances there runs a single thread. They rest on 'inequality of bargaining power.' By virtue of it, the English law gives relief to one who, without independent advice, enters into a contract upon terms which are very unfair or transfers property for a consideration which is grossly inadequate, when his bargaining power is grievously impaired by reason of his own needs or desires, or by his own ignorance or infirmity, coupled with undue influences or pressures brought to bear on him by or for the benefit of the other. When I use the word 'undue' I do not mean to suggest that the principle depends on proof of any wrongdoing. The one who stipulates for an unfair advantage may be moved solely by his own self-interest, unconscious of the distress he is bringing to the other. I have also avoided any reference to the will of the one being 'dominated' or 'overcome' by the other. One who is in extreme need may knowingly consent to a most improvident bargain, solely to relieve the straits in which he finds himself. Again, I do not mean to suggest that every transaction is saved by independent advice. But the absence of it may be fatal. With these explanations, I hope this principle will be found to reconcile the cases. Applying it to the present case, I would notice these points:

(1) The consideration moving from the bank was grossly inadequate. The son's company was in serious difficulty. The overdraft was at its limit of £10,000. The bank considered that its existing security was insufficient. In order to get further security,

it asked the father to charge the house — his sole asset — to the uttermost. It was worth £10,000. The charge was for £11,000. That was for the benefit of the bank. But not at all for the benefit of the father, or indeed for the company. The bank did not promise to continue the overdraft or to increase it. On the contrary, it required the overdraft to be reduced. All that the company gained was a short respite from impending doom.

(2) The relationship between the bank and the father was one of trust and confidence. The bank knew that the father relied on it implicitly to advise him about the transaction. The father trusted the bank. This gave the bank much influence on the father. Yet the bank failed in that trust. It allowed the father to charge the house to his ruin.

(3) The relationship between the father and the son was one where the father's natural affection had much influence on him. He would naturally desire to accede to his son's request. He trusted his son.

(4) There was a conflict of interest between the bank and the father. Yet the bank did not realise it. Nor did it suggest that the father should get independent advice. If the father had gone to his solicitor — or to any man of business — there is no doubt that any one of them would say: 'You must not enter into this transaction. You are giving up your house, your sole remaining asset, for no benefit to you. The company is in such a parlous state that you must not do it.'

These considerations seem to me to bring this case within the principles I have stated. But, in case that principle is wrong, I would also say that the case falls within the category of undue influence of the second class stated by Cotton LJ in *Allcard* v *Skinner*, 36 ChD 145, 171. I have no doubt that the assistant bank manager acted in the utmost good faith and was straightforward and genuine. Indeed the father said so. But beyond doubt he was acting in the interests of the bank — to get further security for a bad debt. There was such a relationship of trust and confidence between them that the bank ought not to have swept up his sole remaining asset into its hands — for nothing — without his having independent advice.

Note

Sir Eric Sachs expressed some sympathy with this view but did not commit himself to it.

Questions

1. If there is such a general doctrine, how will abuse of an unequal bargaining position be determined? Would it give rise to too much uncertainty when in general the sanctity of contract is paramount?

See Thal, 'The Inequality of Bargaining Power Doctrine: The Problem of Defining Contractual Unfairness' (1988) OJLS 17.

2. Has the emergence of a doctrine of economic duress reduced the need for a separate principle of inequality of bargaining power?

Notes

1. There is at least some recognition by the courts of the issue of contractual fairness (e.g., in the incorporation and interpretation of exemption clauses and in the penalty rule).

See P. S. Atiyah, 'Contract and fair exchange' in *Essays in Contract*, pp. 329–54; Tiplady, 'The judicial control of contractual unfairness' (1983) 46 MLR 601.

In *Alec Lobb (Garages) Ltd* v *Total Oil GB Ltd* [1985] 1 All ER 303 (for full facts see page 589), Dillon LJ appeared to recognise that there might be limited circumstances when the court would step in to prevent 'the weak being pushed to the wall', but on these facts the conduct of the defendants was not unconscionable. Mr Lobb's bargaining position was weak because of his financial difficulties, but he did have clear legal advice throughout and rejected it in favour of entering into an unfavourable leaseback arrangement, which included a tie to purchase the defendants' petrol for 21 years. The price and rent charged were either at or below market price, the defendants had been reluctant and the initiative for financial assistance from them had come from Mr Lobb. The Court of Appeal held that a transaction would not be rendered harsh or unconscionable merely because the parties were of unequal bargaining power and the stronger party had not shown that it was fair, just and reasonable in its terms. Dillon LJ said (at p. 313):

> . . . [T]he conduct of Total was not unconscionable, coercive or oppressive. There is ample evidence to support those findings and they are not challenged by the appellants. Their case is that the judge applied the wrong test; where there is unequal bargaining power, the test is, they say, whether its terms are fair, just and reasonable and it is unnecessary to consider whether the conduct of the stronger party was oppressive or unconscionable. I do not accept the appellants' proposition of law. In my judgment the findings of the judge conclude this ground of appeal against the appellants.
>
> Inequality of bargaining power must anyhow be a relative concept. It is seldom in any negotiation that the bargaining powers of the parties are absolutely equal. Any individual wanting to borrow money from a bank, building society or other financial institution in order to pay his liabilities or buy some property he urgently wants to acquire will have virtually no bargaining power; he will have to take or leave the terms offered to him. So, with house property in a seller's market, the purchaser will not have equal bargaining power with the vendor. But Lord Denning MR did not envisage that any contract entered into in such circumstances would, without more, be reviewed by the courts by the objective criterion of what was reasonable: see *Lloyds Bank Ltd* v *Bundy* [1974] 3 All ER 757 at 763, [1975] QB 326 at 336. The courts would only interfere in exceptional cases where as a matter of common fairness it was not right that the strong should be allowed to push the weak to the wall. The concepts of unconscionable conduct and of the exercise by the stronger of coercive power are thus brought in, and in the present case they are negatived by the deputy judge's findings.

2. Lord Denning's views in *Lloyds Bank* v *Bundy* were firmly rejected by Lord Scarman in two cases. First, in *Pao On* v *Lau Yiu Long* [1980] AC 614 (page 113), Lord Scarman held that there could be no relief based solely on an unfair use of a dominant bargaining position. He said (at pp. 634–5):

> . . . [The] question, their Lordships repeat is whether, in a case where duress is not established, public policy may nevertheless invalidate the consideration if there has been a threat to repudiate a pre-existing contractual obligation or an unfair use of a dominating bargaining position. Their Lordships' conclusion is that where business-

men are negotiating at arm's length it is unnecessary for the achievement of justice, and unhelpful in the development of the law, to invoke such a rule of public policy. It would also create unacceptable anomaly. It is unnecessary because justice requires that men, who have negotiated at arm's length, be held to their bargains unless it can be shown that their consent was vitiated by fraud, mistake or duress. If a promise is induced by coercion of a man's will, the doctrine of duress suffices to do justice. The party coerced, if he chooses and acts in time can avoid the contract. If there is no coercion, there can be no reason for avoiding the contract where there is shown to be a real consideration which is otherwise legal.

Such a rule of public policy as is now being considered would be unhelpful because it would render the law uncertain. It would become a question of fact and degree to determine in each case whether there had been, short of duress, an unfair use of a strong bargaining position. It would create anomaly because, if public policy invalidates the consideration, the effect is to make the contract void. But unless the facts are such as to support a plea of 'non est factum,' which is not suggested in this case, duress does no more than confer upon the victim the opportunity, if taken in time, to avoid the contract. It would be strange if conduct less than duress could render a contract void, whereas duress does no more than render a contract voidable. Indeed, it is the defendants' case in this appeal that such an anomaly is the correct result. Their case is that the plaintiffs, having lost by cancellation the safeguard of the subsidiary agreement, are without the safeguard of the guarantee because its consideration is contrary to public policy, and that they are debarred from restoration to their position under the subsidiary agreement because the guarantee is void, not voidable. The logical consequence of [this] submission is that the safeguard which all were at all times agreed the plaintiffs should have — the safeguard against fall in value of the shares — has been lost by the application of a rule of public policy. The law is not, in their Lordship' judgment, reduced to countenancing such stark injustice: nor is it necessary, when one bears in mind the protection offered otherwise by the law to one who contracts in ignorance of what he is doing or under duress. Accordingly, the submission that the additional consideration established by the extrinisic evidence is invalid on the ground of public policy is rejected.

Secondly, in *National Westminster Bank* v *Morgan* [1985] AC 686 (page 549), Lord Scarman said (at pp. 707–8):

Lord Denning MR [in *Lloyds Bank Ltd* v *Bundy*] believed that the doctrine of undue influence could be subsumed under a general principle that English courts will grant relief where there has been 'inequality of bargaining power'. He deliberately avoided reference to the will of one party being dominated or overcome by another. The majority of the court did not follow him; they based their decision on the orthodox view of the doctrine as expounded in *Allcard* v *Skinner*, 36 ChD 145. The opinion of the Master of the Rolls, therefore, was not the ground of the court's decision, which was to be found in the view of the majority, for whom Sir Eric Sachs delivered the leading judgment.

. . . The doctrine of undue influence has been sufficiently developed not to need the support of a principle which by its formulation in the language of the law of contract is not appropriate to cover transactions of gift where there is no bargain. The fact of an unequal bargain will, of course, be a relevant feature in some cases of undue influence. But it can never become an appropriate basis of principle of an equitable doctrine which is concerned with transactions 'not to be reasonably accounted for on

the ground of friendship, relationship, charity, or other ordinary motives on which ordinary men act' (Lindley LJ in *Allcard* v *Skinner*, at p. 185). And even in the field of contract I question whether there is any need in the modern law to erect a general principle of relief against inequality of bargaining power. Parliament has undertaken the task — and it is essentially a legislative task — of enacting such restrictions upon freedom of contract as are in its judgment necessary to relieve against the mischief: for example, the hire-purchase and consumer protection legislation, of which the Supply of Goods (Implied Terms) Act 1973, Consumer Credit Act 1974, Consumer Safety Act 1978, Supply of Goods and Services Act 1982 and Insurance Companies Act 1982 are examples. I doubt whether the courts should assume the burden of formulating further restrictions . . .

Note

See also the Unfair Contract Terms Act 1977, page 318, and the Unfair Terms in Consumer Contracts Regulations 1994, page 344, as further legislative examples, and in particular the requirement of good faith in reg. 3 and sch. 2 of the Regulations.

Question

The statutory provision is necessarily piecemeal. Should the courts therefore do more to recognise abuse of a dominant position?

B: PROTECTION FOR THE 'POOR AND IGNORANT'

There is an ever-widening category where transactions can be set aside on the ground of characteristics possessed by a victim which necessarily mean that he requires protection.

Earl of Aylesford v *Morris*
(1873) 8 Ch App 484

As soon as he reached majority, Aylesford borrowed from Morris at a rate of over 60 per cent interest in order to pay off the large debts he had incurred in his minority. He had an allowance of less than £500 a year at that time but would have been entitled on his father's death to a large inheritance. Lord Selborne LC referred to a presumption of fraud arising from the circumstances or conditions of the parties, with weakness on one side and extortion or advantage taken of that weakness on the other side.

LORD SELBORNE LC: . . . 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.

Notes

1. Fry v *Lane* (1888) 40 ChD 312, involved sales by 'poor and ignorant' persons at considerable undervalues without independent advice. Kay J held

that in those circumstances a court of equity could set aside the sales. He said (at p. 322):

> The result of the decisions is that where a purchase is made from a poor and ignorant man at a considerable undervalue, the vendor having no independent advice, a Court of Equity will set aside the transaction. . . .
>
> The circumstances of poverty and ignorance of the vendor, and absence of independent advice, throw upon the purchaser, when the transaction is impeached, the onus of proving, in Lord Selborne's words, that the purchase was 'fair, just, and reasonable.'

2. In *Cresswell* v *Potter* [1978] 1 WLR 255, Megarry J extended the scope of the principle in *Fry* v *Lane* by holding that a lady who was a Post Office telephonist and who sought to avoid a conveyance of her rights in the matrimonial home to her husband, was 'poor and ignorant'. He said (at pp. 257–9):

> The judge [Kay J in *Fry* v *Lane*] thus laid down three requirements. What has to be considered is, first, whether the plaintiff is poor and ignorant; second, whether the sale was at a considerable undervalue; and third, whether the vendor had independent advice. I am not, of course, suggesting that these are the only circumstances which will suffice; thus there may be circumstances of oppression or abuse of confidence which will invoke the aid of equity. But in the present case only these three requirements are in point. Abuse of confidence, though pleaded, is no longer relied on; and no circumstances of oppression or other matters are alleged. I must therefore consider whether the three requirements laid down in *Fry* v *Lane* are satisfied.
>
> I think that the plaintiff may fairly be described as falling within whatever is the modern equivalent of 'poor and ignorant.' Eighty years ago, when *Fry* v *Lane* was decided, social conditions were very different from those which exist today. I do not, however, think that the principle has changed, even though the euphemisms of the 20th century may require the word 'poor' to be replaced by 'a member of the lower income group' or the like, and the word 'ignorant' by 'less highly educated.' The plaintiff has been a van driver for a tobacconist, and is a Post Office telephonist. The evidence of her means is slender. The defendant told me that the plaintiff probably had a little saved, but not much; and there was evidence that her earnings were about the same as the defendant's, and that these were those of a carpenter. The plaintiff also has a legal aid certificate.
>
> In those circumstances I think the plaintiff may properly be described as 'poor' in the sense used in *Fry* v *Lane*, where it was applied to a laundryman who, in 1888, was earning £1 a week. In this context, as in others, I do not think that 'poverty' is confined to destitution. Further, although no doubt it requires considerable alertness and skill to be a good telephonist. I think that a telephonist can properly be described as 'ignorant' in the context of property transactions in general and the execution of conveyancing documents in particular. I have seen and heard the plaintiff giving evidence, and I have reached the conclusion that she satisfies the requirements of the first head. . . . [The second question was whether the sale was at a 'considerable undervalue'. Megarry J found that it was.]
>
> As for independent advice, from first to last there is no suggestion that the plaintiff had any. The defendant, his solicitor and the inquiry agent stood on one side: on the

other the plaintiff stood alone. This was, of course, a conveyancing transaction, and English land law is notoriously complex. I am certainly not saying that other transactions, such as hire-purchase agreements, are free from all difficulty. But the authorities put before me on setting aside dealings at an undervalue all seem to relate to conveyancing transactions, and one may wonder whether the principle is confined to such transactions, and, if so, why. I doubt whether the principle is restricted in this way; and it may be that the explanation is that it is in conveyancing matters that, by long usage, it is regarded as usual, and, indeed, virtually essential, for the parties to have the services of a solicitor. The absence of the aid of a solicitor is thus, as it seems to me, of especial significance if a conveyancing matter is involved. The more usual it is to have a solicitor, the more striking will be his absence, and the more closely will the courts scrutinise what was done.

. . . [Counsel for the defendant] points out that the plaintiff was not bereft of possible legal assistance; for on or before July 28, 1959, when she was having difficulty in getting some furniture and effects from Slate Hall, she consulted a Colchester firm of solicitors . . . If she wanted legal advice, he said, this shows that she knew how to get it. However, what matters, I think, is not whether she could have obtained proper advice but whether in fact she had it; and she did not. Nobody, of course, can be compelled to obtain independent advice: but I do not think that someone who seeks to uphold what is, to him, an advantageous conveyancing transaction can do so merely by saying that the other party could have obtained independent advice, unless something has been done to bring to the notice of that other party the true nature of the transaction and the need for advice. . . .

At the end of the day, my conclusion is that this transaction cannot stand. In my judgment the plaintiff has made out her case, and so it is for the defendant to prove that the transaction was 'fair, just, and reasonable.' This he has not done. . . .

Question

Is the crucial factor 'ignorance' rather than poverty, since considerable emphasis was placed on the fact that a conveyancing document is not easy for the layman to understand without legal advice?

Notes

1. As in *Lloyds Bank* v *Bundy*, there was a positive duty imposed to advise the plaintiff of the need to seek legal advice. However, since there is no actual definition of 'poor and ignorant', situations covered by this principle are unclear.

2. In *Watkin* v *Watson-Smith* (1986) *The Times*, 3 July, Hirst J held *obiter* (because the contract was vitiated for mistake) that an old man of 80 who signed a contract to sell his bungalow for £2,950 instead of £29,500 could have relied on the principle in *Fry* v *Lane* even though he was not 'poor and ignorant'. He held that the desire for a quick sale and the old man's age, together with the accompanying diminution of his mental capacity and judgment, could suffice in place of 'poor and ignorant'.

Thus *Fry* v *Lane* appears not to be restricted to the traditional three requirements, and it may be that, if this were desired, it could be extended to cover a general concept of 'unconscionable bargains'. However, the test of whether the terms of the transaction are fair, just and reasonable in cases of

inequality in bargaining power was rejected by Dillon LJ in *Alec Lobb* v *Total Oil GB Ltd* [1985] 1 All ER 303. He held that it had to be shown that the conduct of the stronger party was oppressive or unconscionable. (This was confirmed in *Hart* v *O'Connor* [1985] AC 1000, where it was stressed that there must be victimisation, i.e., the stronger party must take advantage of the weaker party.) On unconscionability see the decision of the High Court of Australia in *Commercial Bank of Australia Ltd* v *Amadio* (1983) 151 CLR 447.

3. In *Boustany* v *Pigot* (1993) 69 P & CR 298 (noted Cartwright (1993) 109 LQR 530), the Privy Council set aside a transaction entered into by an ageing lady whose affairs were normally conducted by her cousin, and stressed that it is not sufficient that the transaction is unreasonable or unfair. What is required is unconscionable conduct in the sense of an 'abuse' of position. This suggests that in addition to the *Fry* v *Lane* requirements it is also necessary to prove unconscionability. Unconscionability cannot, it seems, simply be inferred from the existence of the *Fry* v *Lane* requirements.

4. In *Barclays Bank* v *Schwartz* (1995) *The Times*, 2 August, the Court of Appeal held that illiteracy or unfamiliarity with the English language might found a claim in equity to set aside a transaction as a harsh and unconscionable bargain, but it would be necessary to establish more than weaker bargaining power. It would also need to be established that unfair advantage had been gained by the use of this bargaining power against the weaker party. This appears to be in line with the approach advocated in *Boustany* v *Pigot*.

5. In *Credit Lyonnais* v *Burch* [1997] 1 All ER 144, page 563, Nourse LJ considered that the principle in *Fry* v *Lane* was capable of being adapted 'to different transactions entered into in changing circumstances' and that he considered it to be arguable that, applying this principle, Miss Burch could have had the legal charge set aside as an unconscionable bargain. However he did not decide the case on this basis because there had been no argument on this ground in the court below.

It is interesting, however, that Nourse LJ considered that unconscionability was directly material to the undue influence issue. But see Birks and Chin, 'On the Nature of Undue Influence' in *Good Faith and Fault in Contract Law*, Beatson and Friedmann (eds) (OUP, 1995). Millett LJ also appeared to consider that in both cases the impropriety by one party, e.g., taking advantage of the situation, could be inferred from the harshness of the terms of the transaction. He stated that:

> Miss Burch did not seek to have the transaction set aside as a harsh and unconscionable bargain. To do so she would have had to show not only that the terms of the transaction were harsh or oppressive, but that 'one of the parties to it has imposed the objectionable terms in a morally reprehensible manner, that is to say, in a way which affects his conscience' (see *Multiservice Bookbinding Ltd* v *Marden* [1978] 2 All ER 489 at 502, [1979] Ch 84 at 110 per Browne-Wilkinson J and *Alec Lobb (Garages) Ltd* v *Total Oil GB Ltd* [1983] 1 All ER 944 at 961, [1983] 1 WLR 87 at 95, where I pointed out that there must be some impropriety, both in the conduct of the stronger party and in the terms of the transaction itself, but added that 'the former may often be inferred from the latter in the absence of an innocent explanation').

In the present case, the bank did not obtain the guarantee directly from Miss Burch. It was provided to the bank by Mr Pelosi, who obtained it from Miss Burch by the exercise of undue influence. In such a context, the two equitable jurisdictions to set aside harsh and unconscionable bargains and to set aside transactions obtained by undue influence have many similarities. In either case it is necessary to show that the conscience of the party who seeks to uphold the transaction was affected by notice, actual or constructive, of the impropriety by which it was obtained by the intermediary, and in either case the court may in a proper case infer the presence of the impropriety from the terms of the transaction itself.