

ESSENTIALS OF BUSINESS LAW

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 Pearson

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Essentials of
Business Law

Damages for the tort of deceit are usually much greater than contract damages as a claim can be made for all expenses and losses caused by the deceit, even if these were not reasonably foreseeable.

Negligent misrepresentation

Section 2(1) of the Misrepresentation Act 1967 (MA 1967) defines a negligent misrepresentation as one made by a person who cannot prove that he honestly believed that the facts represented were true and that he had reasonable grounds for this belief.

Example

Daniel sells a printer to Bill and makes a misrepresentation to the effect that it is a colour printer. Daniel believes this to be true. The misrepresentation will be negligent unless Daniel can prove that he had reasonable grounds for believing that the printer was a colour printer. (Notice that the burden of proof is on Daniel.)

Remedies for negligent misrepresentation

A negligent misrepresentation allows the injured party to rescind the contract and to sue for damages for the tort of deceit. If the contract is to be rescinded for negligent misrepresentation, this must be done within a reasonable time of the misrepresentation having been made.

A person to whom a false statement was made might try to recover damages for negligent misstatement at common law (see Chapter 8). However, if an action for negligent misrepresentation is possible, a claim for negligent misstatement is rarely made. There are three disadvantages to such a claim. First, the claimant will need to prove that there was a 'special relationship' between the parties. Second, the burden of proving negligence will be on the claimant. Third, any damages will be for negligence rather than for the tort of deceit. For these reasons a claim under s. 2(1) MA 1967 is almost always preferable.

Wholly innocent misrepresentation

A wholly innocent misrepresentation is one made by a person who can prove that he honestly believed that the facts represented were true and that he had reasonable grounds for this belief.

Example

Minoosh sells a computer to Jill and makes a misrepresentation to the effect that it can operate Apple software. Minoosh believed this to be true. If Minoosh can prove that she had reasonable grounds for believing it was true (perhaps because that is what the shop told her when she bought the computer), then she will have made a wholly innocent misrepresentation. If Minoosh cannot prove this, then she will have made a negligent misrepresentation. (Again, notice that the burden of proof is on Minoosh.)

Remedies for wholly innocent misrepresentation

The injured party can rescind but has no right to claim damages. However, as regards both negligent and innocent misrepresentation, s. 2(2) of the Misrepresentation Act 1967 allows the court to award contract damages instead of rescission where the court considers it 'equitable to do so'. It is rare for the courts to use this section to award damages for an innocent misrepresentation, but they sometimes do so when the misrepresentation was so trivial that rescission would be too drastic a remedy.

William Sindall v Cambridgeshire County Council (1994) provides an example. In 1989 building land was sold for £5 million. The purchasers alleged that there had been a misrepresentation made by the sellers of the land, on account of there being a sewage pipe on the land. By this time the land was worth only £2.5 million because the property market had collapsed. The purchasers claimed that they were rescinding the contract for misrepresentation. The Court of Appeal found that there had been no misrepresentation. However, they said that if there had been a misrepresentation, damages would have been awarded under s. 2(2) instead of rescission. These damages would have compensated for the relatively small cost of removing the sewage pipes. Rescission would have been too drastic a remedy. Until recently there was considerable doubt about whether damages under s. 2(2) would still be available once the right to rescind had been lost. In **Salt v Stratstone Specialist Ltd (2015)** the Court of Appeal considered the conflicting cases and held that damages under s. 2(2) cannot be awarded once the right to rescind has been lost. (The ways in which the right to rescind can be lost are set out below.)

The burden of proof

The person who has the burden of proof must prove what he alleges. In civil cases the claimant must prove what he alleges on a balance of probabilities, meaning that he must prove that it is more likely to be true than untrue. In criminal cases all of the elements of the crime must be proved beyond reasonable doubt. There is no special standard of proof for fraud, although the courts are somewhat reluctant to find it in civil cases because fraud is an unusual matter.

If a party alleges negligent misrepresentation then he must prove, on the civil standard of proof, that there has been a misrepresentation. The burden of proof is then shifted to the other party, using the civil standard of proof, to prove that he had reasonable grounds for believing that his statement was true. If he cannot do this, the misrepresentation will have been negligent. Because the remedies for fraudulent and negligent misrepresentation are virtually identical, many victims of fraudulent misrepresentation allege negligent rather than fraudulent misrepresentation. All they have to do is prove that there has been a misrepresentation, and this will then be negligent unless the misrepresenter can prove that he had reasonable grounds for believing that his statement was true. This is much easier than proving fraudulent misrepresentation.

Figure 4.3 shows the burden of proof in cases of non-fraudulent misrepresentation.

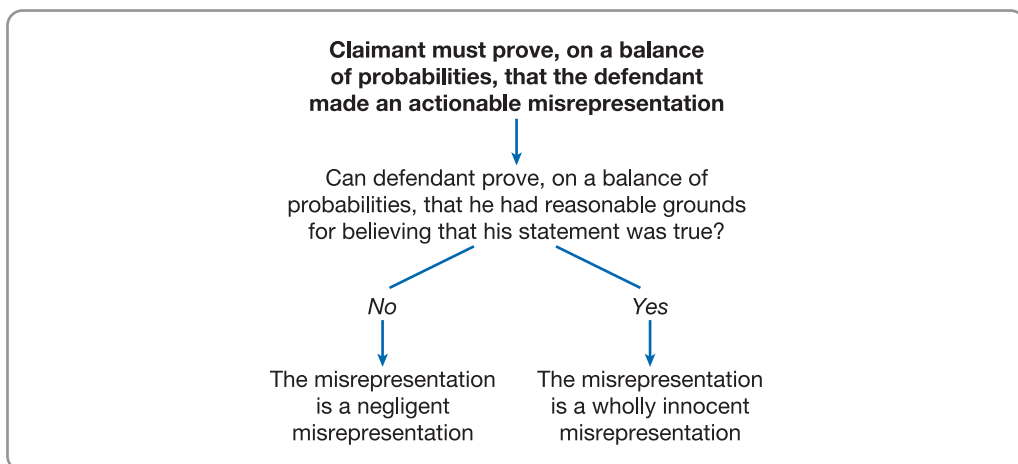


Figure 4.3 The burden of proof in non-fraudulent misrepresentation

Losing the right to rescind

All three types of misrepresentation give the injured party the right to rescind.

Rescission of a contract means that the parties are returned to the position they were in before the contract was made. So the whole of the purchase price will be returned to a purchaser who rescinds. A party can rescind merely by letting the other party know that the contract is no longer regarded as binding. Rescission can also be used as a defence to a person who is sued for refusing to perform the contract, as we saw in **Redgrave v Hurd**.

The right to rescind can be lost in the following three ways:

- (1) if the contract is affirmed;
- (2) if a third party acquires rights or
- (3) if the subject matter of the contract no longer exists.

The contract is affirmed

The contract will be affirmed if the claimant decides to carry on with the contract after discovering the misrepresentation. The claimant might indicate affirmation expressly or impliedly. If the claimant does nothing for a considerable period of time, the court might well take the view that the contract has been impliedly affirmed.



Leaf v International Galleries (1950) (Court of Appeal)

The claimant bought a painting from International Galleries because of a non-fraudulent misrepresentation that the painting was by Constable. Five years later the claimant discovered that the painting was not by Constable and he immediately applied to the court for rescission of the contract.

Held The claimant was too late to rescind. He had affirmed the contract by doing nothing for five years.

Comment If the misrepresentation by the gallery had been fraudulent, time would only have started to run against the claimant from the moment when the misrepresentation was discovered. He would therefore have been able to rescind the contract. This is the main difference between the remedies for fraudulent and negligent misrepresentation.

If a third party has acquired rights

A contract which can be rescinded is said to be a voidable contract, because one of the parties has the option to avoid the contract (call it off). Although a misrepresentation makes a contract voidable, it does not prevent ownership of goods sold under the contract from passing to a person who made the misrepresentation. In such a case the person making the misrepresentation will own the goods unless and until the innocent party avoids the contract. The innocent party has no obligation to avoid and may choose to affirm the contract, despite the misrepresentation, and keep what was gained under the contract.

If the misrepresenter sells goods he received under the contract to a third party *before* the contract is avoided, then the third party can keep the goods forever. This is because, at the time when the goods were sold on, the misrepresenter still owned the goods, and therefore still had ownership to pass on. This rule is confirmed by s. 23 of the Sale of Goods Act 1979, which provides that:

Where the seller of goods has a voidable title to them, but his title has not been avoided at the time of the sale, the buyer acquires a good title to the goods, provided he buys them in good faith and without notice of the seller's defect of title.

If, however, the goods are sold to the innocent third party *after* the contract has been avoided, then the innocent third party will get no ownership of the goods. This is because, when the goods were sold on, the misrepresentor no longer had any ownership to pass on, the contract having been avoided.

Cases on this matter amount to a dispute about who did what first.



Lewis v Averay (1972) (Court of Appeal)

A rogue bought the claimant's car. The rogue paid with a bad cheque, pretending to be a famous actor called Richard Greene. (The rogue therefore made a fraudulent misrepresentation.) At first, the claimant was unwilling to take the rogue's cheque. However, the claimant did take the cheque when the rogue produced a Pinewood Studios pass in the name of Richard Greene, which showed the rogue's photograph. Having got possession of the car, the rogue sold it to the defendant. The defendant paid a reasonable price for the car and believed that the rogue owned it. The claimant later tried to avoid the contract.

Held Although the contract was voidable for fraudulent misrepresentation, the defendant gained complete ownership of it by virtue of s. 23 SGA 1979. Once the car had been resold by the rogue, the claimant was too late to avoid the contract and had lost ownership of the car.



Car and Universal Finance Co v Caldwell (1965) (Court of Appeal)

A rogue bought a car with a bad cheque, knowing that the cheque would not be honoured. The car was later sold to a third party who bought it in good faith. Before this sale the original seller found out about the rogue's fraudulent misrepresentation. He could not find the rogue to tell him that he was avoiding the contract, so he told the police and the AA.

Held Telling the police and the AA was enough to avoid the contract because it was an action which showed a definite intention to avoid the contract. The original seller therefore got the car back from the third party. If the original seller had not told the police and the AA until *after* the rogue had resold the car, s. 23 of the Sale of Goods Act 1979 would have applied and he would never have got the car back.

Comment The misrepresentation in this case was fraudulent. The Court of Appeal raised the question as to whether or not the contract would have been avoided by telling the authorities if the misrepresentation had been either negligent or innocent. Unfortunately, having raised the question, the court said that it did not know the answer. So the case is only an authority where the misrepresentation was fraudulent.

In all of these cases where a rogue buys goods with a stolen cheque, one of two innocent parties is bound to suffer a loss. Either the original owner will get the goods back, in which case the purchaser from the rogue will have paid money to the rogue in return for nothing at all, or the original owner will not get the goods back, and will therefore have been deprived of ownership of the goods in return for a worthless cheque. (It should be noticed that s. 23 SGA 1979 will never operate in favour of a third party who did not act in good faith when buying from the misrepresentor.)

Whichever of the two parties suffers the loss will be left with the right to sue the rogue for damages. However, it should be pointed out that this right is likely to be worth very little.

First, the rogue might never be identified. Second, rogues who buy goods with bad cheques rarely have enough money to pay damages.

If it is impossible to put the parties back into their pre-contract positions

When a contract is treated as terminated for breach of a term, future performance of the contract is not required. This is the case whether or not the contract has been partly performed. However, when a contract is avoided, the parties must be put back into the positions they were in before the contract was made. If this cannot be done, then the contract cannot be avoided. In **Clarke v Dickson (1858)** Crompton J gave the example of a butcher who bought live cattle because a farmer had made a fraudulent misrepresentation about them. He said that once the cattle had been slaughtered and butchered rescission would not be possible. (Damages for the tort of deceit could have been claimed.) However, because rescission is an equitable remedy a court may order rescission even if the subject matter of the contract cannot be returned in exactly the same condition as it was before the contract was made. A monetary payment can be ordered to take account of any reduction in value. An example can be seen in **Salt v Stratstone Specialist Ltd (2015)** where the Court of Appeal allowed rescission of a contract to buy a specialist sports car, wrongly but not fraudulently described as new, despite the car having been intermittently used by the buyer over a two-year period and despite the inevitable depreciation in the car's value. Rescission for misrepresentation was ordered, along with a payment by the buyer to compensate for reduction in the car's value. In such cases it is up to the misrepresenter to prove that there should be compensation for the reduction in value. Nor did affirmation prevent rescission, despite the two-year delay, because the buyer did not know of the misrepresentation until after he had claimed to rescind the contract.

Mistake

When the parties make their contract, one or both of them might be mistaken as to some fundamental matter. Here we examine the types of mistake which might be made and the effect of these mistakes upon the validity of the contract. First, we consider the position where both parties make the same mistake. (This is known as common mistake.) Then we consider the position where only one of the parties makes a mistake. (This is known as unilateral mistake.) Figure 4.4 shows an outline of the different types of mistake.

Common mistake

There is said to be a common mistake when both of the parties freely reach agreement, but do so while making the same mistake.

Common mistake as to existence of goods

A common mistake might be made about the existence of the subject matter of the contract. For example, let us assume that X Ltd agrees to buy a second-hand machine from Y Ltd. Let us also assume that at the time of the contract, unknown to both parties, the machine does not exist because it has been destroyed in a fire. Section 6 of the Sale of Goods Act provides that, where there is a contract for the sale of specific goods, and the goods, without the knowledge of the seller, have perished at the time the contract is made, the contract is void. Y Ltd will not therefore be in breach of contract for failure to deliver the machine and X Ltd will not have to pay the contract price. If the contract had been for the sale of unascertained goods, such as 100 tons of wheat, then Y Ltd would have to find another 100 tons of wheat from elsewhere or be in breach of contract. (The difference between specific and unascertained goods is explained in Chapter 7.)