



**THE LAW REFORM COMMISSION
OF WESTERN AUSTRALIA**

Project No 22

Innocent Misrepresentation

REPORT

OCTOBER 1973

The Law Reform Commission of Western Australia was established by the *Law Reform Commission Act 1972*.

The Commissioners are –

Mr B. W. Rowland, Chairman

Professor E. J. Edwards

Mr E. G. Freeman

The Executive Officer of the Commission is Mr C W Ogilvie, and the Commission's offices are on the 11th floor, R & I Bank Building 593 Hay Street, Perth, WA 6000 (Tel: 25 9198 and 25 7835)

To: THE HON. T. D. EVANS, M.L.A.
ATTORNEY GENERAL

TERMS OF REFERENCE

1. The Law Reform Committee was asked –

"To consider any alterations desirable in the law relating to innocent misrepresentation and the remedies available for such misrepresentation".

The Commission now submits this report.

2. The Committee assumed that it was intended that it should consider only misrepresentations which induce contracts, and that the question of innocent misrepresentations in other contexts was not within the terms of reference. The Commission as also followed this approach.

THE PRESENT LAW IN WESTERN AUSTRALIA

3. The law in Western Australia on the subject is that of the common law, modified in particular areas by statute (see paragraph 7 below).

4. The general rule is that the only remedy available to a person misled into entering a contract by an innocent (that is, non-fraudulent) misrepresentation which induces, but is not a term of the contract, is rescission of the contract. Generally, the plaintiff has no right to damages for any loss suffered as result of the misrepresentation, although he may obtain a limited form of indemnity (see paragraph 6 below). It is possible that where a "special relationship" exists between the parties, damages on a tortious basis could be recovered if the misrepresentation was made in breach of a duty of care (see *Hedley Byrne & Co. v. Heller & Partners* [1964] A.C. 465; *Mutual Life & Citizens' Assurance Co. v. Evatt* [1971] A.C. 793; *Dillingham Constructions Pty. Ltd v. Downs* [1972] 2 N.S.W.R 49).

5. It seems generally to be accepted that the right of rescission for innocent misrepresentation is lost after the contract has been performed, although outside of contracts for the sale of land the legal basis for this rule is slender. *Seddon v. North Eastern Salt Co. Ltd* [1905] 1 Ch. 326, is usually cited as authority for the proposition that the rule applies to all contracts, but some commentators think that that decision can be explained on other grounds, such as that the representee had impliedly affirmed the contract (see for example, Cheshire & Fifoot, *The Law of Contract*, 2nd. Aus. ed., 395-396).

6. In granting rescission the court can order the defendant to indemnify the plaintiff for loss resulting from obligations created by the contract, but not for any other loss. This distinction is illustrated by the facts in *Whittington v. Seale-Hayne* (1900) 82 L.T. 49. The plaintiff took a lease of the defendant's premises for the purpose of breeding poultry, relying on the defendant's representation that the premises were sanitary. In fact the water supply was poisoned by drains so that the plaintiff's manager became ill and most of the birds died. The defendant submitted to rescission of the lease and agreed to pay the plaintiff compensation for the rent and rates he had paid and repairs he had done under the lease. The plaintiff also claimed for loss of stock, loss of profit on sales, loss of a breeding season, removal expenses and medical expenses, but the court rejected this claim because the lease did not oblige the plaintiff to move in, rear poultry or employ a manager.

7. The common law is qualified in Western Australia in respect of the sale of goods. Section 59(2) of the *Sale of Goods Act* preserves "the rules of the common law", including the effect of misrepresentation, unless they are inconsistent with the Act. It has been held in Victoria (*Watt v. Westhoven* [1933] V.L.R. 458) and in New Zealand (*Riddiford v. Warren* (1901) 20 N.Z.L.R. 572) that the term "common law" in this context is used in a narrow sense so as to exclude the rules of equity, so that a purchaser would have no right to rescind a contract for innocent misrepresentation unless it was such as to constitute a total failure of consideration (see Sutton, *The Law of Sale of Goods in Australia and New Zealand*, 5-6, where the question is discussed) .

THE LAW AND PROPOSALS FOR CHANGE ELSEWHERE.

8. In England the *Misrepresentation Act 1967*, based largely on the recommendations of the English Law Reform Committee (Tenth Report, 1962, Cmnd. 1782), made substantial changes in the law relating to innocent misrepresentation as follows -

- (a) The fact that a contract has been performed is no longer a bar to its rescission for innocent misrepresentation (s.1(b)).
- (b) However the court is empowered, instead of rescinding the contract for an innocent misrepresentation, to declare it subsisting and to award damages instead, if it thinks it equitable to do so, having regard to the nature of the representation, the loss that would be caused by it if the contract were upheld and the loss that rescission would cause to the other party (s.2(2)).
- (c) The representee is also given the right to claim damages unless the representor can prove that he believed, on reasonable grounds, in the truth of his representation and continued so to believe up to the time the contract was made (s.2(1)). Any damages awarded in lieu of rescission under (b) above must be taken into account in assessing damages under s.2(1) (s.2(3)).
- (d) The right to rescind the contract for an innocent misrepresentation notwithstanding that it became incorporated in the contract is expressly preserved (s.1(a)). (The position was thought to have been unclear under the common law).
- (e) Any provision in a contract excluding liability for misrepresentation is made void (s.3).
- (f) The *Sale of Goods Act* is amended to provide that the right to rescind a contract for a breach of a condition is not lost until the buyer has had a reasonable opportunity of examining the goods (s.4). (This was done to ensure that the remedies for breach of condition are kept broadly in line with the remedies for a misrepresentation which induces a contract).

9. South Australia has recently enacted legislation in similar terms to the English *Misrepresentation Act* (see Parts III and IV of the South Australian *Misrepresentation Act 1971-1972*).

10. In New Zealand the remedies for misrepresentation and for breach of contract were considered by the Contracts and Commercial Law Reform Committee. In its *Report on Misrepresentation and Breach of Contract*, 1967, the Committee recommended that, where there has been a misrepresentation, the right to rescission of the contract and to damages should be the same as for a breach of a term of the contract (Report, paragraphs 13.3 and 14).

11. The New Zealand Committee also recommended changes in the circumstances under which an aggrieved party could rescind the contract as follows. He should be able to rescind if the other party has not commenced performance of his obligations or if the effect of the breach or misrepresentation is to deprive the aggrieved party substantially of the benefit of the contract, but in no other case (Report, paragraph 18.5(b)).

12. As yet, no legislation has been enacted to give effect to the New Zealand Committee's recommendations.

WORKING PAPER AND COMMENTS THEREON

13. The Committee issued a working paper in May 1972, a copy of which is attached.

14. The Committee's provisional view as expressed in paragraphs 20 to 22 of the working paper, can be summarised as follows. It favoured the enactment of legislation whereby -

- (a) the fact that a contract has been performed would not of itself bar rescission;
- (b) the court would be empowered to award damages in lieu of rescission;
- (c) rescission would be available for a misrepresentation which had become a term of the contract;

- (d) the equitable remedy of rescission would be available in cases of contracts for the sale of goods;
- (e) a buyer of goods would not be barred from rejecting goods for a mis-statement which is a term of the contract until he had had reasonable opportunity of examining them.

15. The Committee said that it was not inclined to favour legislative action beyond its suggestions in paragraph 14 above. The common law as to liability for negligent mis-statements was in the process of evolution in the courts and the Australian Attorneys General were studying the special problems of consumer credit laws. In these circumstances the Committee thought it would be advisable to await developments.

16. Comments on the working paper were received from -

the Honourable John Hale (then Mr. Justice Hale)

the Hon. Mr. Justice Wallace

the Council of the Law Society of W.A.

17. Mr. Justice Hale said that the essential problem was to decide which of two innocent persons should bear the loss, and in his view this should be the representor, since he gave occasion for the loss and could have refrained from making the statement at all, or made it clear that he was merely expressing an opinion or a hope. The only need was to remedy the present inability to give relief where a contract had been performed, and this could be done by empowering the court in the normal case to award damages and in the exceptional case to order rescission of the contract. The measure of damages should be the difference between the consideration given by the representee and the consideration received. If the representation had become a term of the contract, the remedy for breach of that term should be the same as for any other term and the fact that the term began as a misrepresentation should be irrelevant. The legislation should say nothing on that subject.

18. Mr. Justice Wallace said he agreed with the views of the Committee expressed in the working paper.

19. The Law Society said that in the case of an innocent misrepresentation which induced a contract, the court should be empowered, in its discretion, to award rescission of the contract or damages in lieu of rescission, or both rescission and damages for any actual loss suffered by the representee. These remedies should be available notwithstanding that the contract has been performed, and whether or not the representation had been incorporated into the contract as a term.

DISCUSSION AND RECOMMENDATIONS

20. The Commission has considered the matter having regard to the comments on the working paper. The Commission is of the view that the present remedies for an innocent misrepresentation which induces, but is not a term of a contract, are too limited (see paragraphs 4, 5 and 6 above) and should be extended.

21. Put broadly, there are three possible approaches to reform of the law relating to innocent misrepresentation -

- (a) The remedies for an innocent misrepresentation which induces a contract could be made the same as for a breach of a term of a contract.

This was the recommendation of the New Zealand Contracts and Commercial Law Reform Committee (see paragraph 10 above). Adoption of this approach would enable a representee to rescind the contract (whether or not it had been performed) if the misrepresentation was of major consequence, and to obtain damages. If the misrepresentation was of lesser consequence, he would be able to obtain damages but would have no right of rescission. The measure of damages would be as in contract, that is, the amount which would put the representee in the position he would have been in if the representation had been true.

Those who support this approach would argue that there is no valid distinction between a representation which induces the representee to enter into a contract and a warranty or promise, and that attempts to make such a distinction have been a source of complexity and confusion.

- (b) The courts could be given a wide discretion to award rescission or damages or both, and to choose between the contractual measure of damages (see comment on (a) above) or the tortious measure (that is, the amount which would put the plaintiff in the position he would have been in if the representation had not been made).

This approach has points of similarity with the proposal suggested by Mr. Justice Hale (see paragraph 17 above) and with that put forward by the Law Society (see paragraph 19 above).

It could be argued in support of this approach that approach (a) above is too inflexible, and that it would be preferable to give the courts power to do justice in the light of the circumstances of each case. It could be said that the courts already exercise a wide discretion under the present law, but do so by means of fictions, such as treating the representation as a collateral undertaking. Lord Denning has said -

"In practice when I get a representation prior to a contract which is broken and the man ought to pay damages I treat it as a collateral contract. I have never known any of my colleagues to do otherwise" ((1967) 41 A.L.J. 293).

It could be argued that this proposal would overcome the need for artificial distinctions and devices, and enable the courts to do justice in a straightforward way.

- (c) The courts could be empowered to award damages (as in tort) or rescission, or both, in the case of a misrepresentation made negligently.

In support of this limited approach, it could be argued that the Legislature should be reluctant to vary well-established concepts and rules beyond what is strictly necessary and that it is only in cases where the representation has been made without reasonable care that the present law has been found wanting. It would be undesirable to go further and give the courts this discretion in the case of a misrepresentation which is quite innocent and not negligent, and which the parties have not made a term of the contract. In some cases the representor may himself be the one who suffered loss as a result of his innocent misrepresentation, and there can of course be no question of granting him relief.

22. While each member of the Commission favours the adoption of a different one of the approaches outlined above, two would support approach (b). The remaining member advocates approach (c).

23. If the Government adopts any of the three approaches above, the Commission thinks the law should not restrict the right of the parties to contract out of any statutory provision. Restrictions on freedom of contract should be made only in legislation specially designed to protect particular classes of persons, such as consumers.

24. The Commission agrees with the tentative view in paragraph 21 of the working paper that equitable remedies should be available in the case of contracts for the sale of goods (see paragraph 7 above). Any changes in the law of innocent misrepresentation should of course also be made to apply to the sale of goods. But the Commission does not consider that any amendment should be made to the provisions of the *Sale of Goods Act* which prescribe the circumstances under which a buyer can rescind a contract for breach of condition (see paragraph 8(f) above). It believes that such an amendment should be made only in the course of revision of that Act.

Professor E J Edwards
ACTING CHAIRMAN:

Mr E G Freeman
MEMBER:

9th October 1973.

The Chairman of the Commission, Mr. Rowland, was present during the discussion and agreed with the conclusion reached, but was absent when this report was signed.