



**THE LAW REFORM COMMISSION
OF WESTERN AUSTRALIA**

Project No 22

Innocent Misrepresentation

WORKING PAPER

MAY 1972

INTRODUCTION

The Law Reform Committee has been asked to consider any alterations desirable in the law relating to innocent misrepresentation and the remedies available for such misrepresentation.

The Committee has now completed its first consideration of the matter and issues this working paper. The paper does not necessarily represent the final views of the Committee.

Comments and criticisms are invited. The Committee requests that they be submitted by 7 September 1972.

Copies of the paper are being forwarded to -

The Chief Justice and Judges of the Supreme Court

The Judges of the District Court

The Solicitor General

The Under Secretary for Law

The Law Society

The Law School

The Magistrates' Institute

Other Law Reform Commissions and Committees with which this Committee is in correspondence.

The research material on which this paper is based is at the offices of the Committee and will be made available on request.

TERMS OF REFERENCE

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

THE LAW IN WESTERN AUSTRALIA

2. The common law rule relating to innocent misrepresentation expressed in general terms is that, where a person, mistakenly believing in the existence of a certain fact, represents the existence of that fact to another person, that representation, if it induces the representee to enter into a contract with him, gives the representee the right to rescind the contract, subject to certain conditions regarding execution, restitution and the intervening rights of third parties. If the representee affirms the contract or it is executed, the right to rescind may be lost. An innocent misrepresentation gives him no right to damages. For a fuller account, see Cheshire and Fifoot *Law of Contract* (2nd Aus. ed; Part 4, Ch. 2, p.360).

3. There are a number of Western Australian statutes which qualify the common law.

Section 59 (2) of the *Sale of Goods Act 1895* preserves "the rules of the common law", including the effect of misrepresentation, unless they are inconsistent with that 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 to exclude the rules of equity, so that a purchaser would have no right to rescind the contract for innocent misrepresentation unless the misrepresentation was such as to constitute a failure of consideration. The same view does not appear to have been taken in England (and see Sutton *The Law of Sale of Goods in Australia and New Zealand*, pp. 5-16, where the question is discussed).

Section 6 of the *Hire Purchase Act 1959* (see the note to paragraph 7(6) below), s.6 of the *Sale of Land Act 1970* (restricting the right of rescission of a terms contract) and s.10 of the same Act (providing a remedy for the purchaser in certain cases) also appear to affect the position.

MOVEMENT FOR REFORM

4. It is generally conceded that the law is unsatisfactory. In those cases where the right to rescission is lost the purchaser is left without a remedy. The English Law Reform Committee in its Tenth Report (*Innocent Misrepresentation*) (Cmnd. 1782 para. 25) drew attention to the ingenuity which the courts often display to avoid unjust results, in finding that the representation formed an oral part of a written contract, that it was an implied or collateral warranty, or that it amounted to a collateral or preliminary contract.

5. The problem has been dealt with in England by the enactment of legislation based on the report of the English Law Reform Committee (Cmnd. 1782).

Two Committees have issued reports on the matter in New Zealand but no legislation has yet been passed.

England

6. The English Committee listed the areas of the law complained of. It said (in para. 2 of its report) -

"We have been impressed by the fact that there is extensive criticism of three aspects of the existing law. First, in the majority of the memoranda we have received the restrictions on the right to rescind a contract on account of misrepresentation are attacked as being too stringent, although opinions differ as to the extent to which rescission should be made easier; secondly, there is an almost unanimous demand for a remedy in damages, either in addition to, or in lieu of, rescission; thirdly, it is said by those speaking from practical experience of sales and other commercial transactions that there ought to be some curtailment of the freedom to exclude liability for misrepresentation by a provision in the contract in cases where the parties are not bargaining as equals. To these criticisms must be added others of a more technical character, such as the artificiality of the present distinction between damages which cannot, and an indemnity which can, be granted in the course of rescission; and the fact that some anomalies and much uncertainty result from the distinction between the legal consequences of a misrepresentation and of a breach of a term in the contract."

7. After it had examined these criticisms, the English Committee made the following recommendations (para. 27) -

" (1) Contracts for the sale or other disposition of an interest in land should not be capable of being rescinded after execution. An exception should, however, be made for leases to which section 54(2) of the *Law of Property Act, 1925*, applies, viz. those taking effect in possession for a term not exceeding three years, and these should be treated in the same way as contracts not affecting land.

(2) All other contracts should be capable of being rescinded after execution but the other bars to rescission should remain as at present.

(3) Where the court has power to order rescission (whether before or after the execution of the contract) it should have a discretion to award damages instead of rescission if it is satisfied that damages would adequately compensate the plaintiff, having regard to the nature of the representation and the fact that the injury is small compared with what rescission would involve.

(4) Where a misrepresentation is made independently and is later incorporated in the contract the plaintiff should have the same right to rescission (or to damages in lieu of rescission) as he would have had in respect of the original misrepresentation.

(5) Where a person has, either by himself or his agent, induced another to enter into a contract with him (including a contract relating to land) by an untrue representation made for the purpose of inducing the contract he should be liable in damages for any loss suffered in consequence of the representation unless he proves that up to the time the contract was made he (or his agent, if the representation was made by him) believed the representation to be true and had reasonable grounds for his belief.

(6) In the case of any hire-purchase agreement to which a finance company is a party, where negotiations for the agreement are conducted by a dealer he should, notwithstanding any agreement to the contrary, be deemed to be the agent of the

finance company for the purpose of any representations in respect of the goods which are the subject-matter of the agreement. [Note that in Western Australia s.6 of the *Hire Purchase Act 1959* gives the hirer a right of rescission against the owner in respect of misrepresentation by the dealer].

(7) It should not be possible to exclude liability to damages or rescission for any misrepresentation made with the intention of inducing a contract unless the representor can show that up to the time the contract was made he had reasonable grounds for believing the representation to be true.

(8) It is suggested that some of the remedies available under the *Sale of Goods Act, 1893*, are unsatisfactory and will become still more so if the foregoing recommendations are adopted; and it might therefore usefully be considered whether -

- (i) acts amounting to acceptance within the meaning of section 35 of the Act of 1893 should not be held to do so until the buyer has had an opportunity of examining the goods as contemplated by section 34 [Cf. ss.35 & 34 of the W.A. *Sale of Goods Act 1895*];
- (ii) the right to reject specific goods for breach of condition should depend not on the passing of the property in the goods to the buyer but on his acceptance of the goods."

8. The sixth recommendation (see para. 7(6) above) of the English Committee was given effect to by s.16 of the *Hire Purchase Act 1965*. The first (see para. 7(1) above) was not accepted. The rest of the recommendations were given effect to by the *Misrepresentation Act 1967*, although certain of its provisions do not follow precisely the terms of that Committee's suggestions - (see Appendix for the full text of that Act).

New Zealand

9. The New Zealand Contracts and Commercial Law Reform Committee studied the same problem in 1967. See its *Report of the contracts and Commercial Law Reform*

Committee on Misrepresentation and Breach of Contract, - subsequently referred to in this working paper as "The New Zealand Report" or "N.Z.R. "

10. The New Zealand Committee summarised its criticisms of the present law as follows (para. 7.1) -

- "(a) The rules are too complex and correspondingly difficult to apply in practice. Especially is this so in relation to the representation-term distinction, and the condition-warranty distinction. Some writers assert that they are useless for commercial purposes. No two lawyers can begin to agree upon the classification of any given statement. Cynics remark that Judges themselves must choose the remedy they consider just then find an appropriate legal basis for it.
- (b) Because of the confused state of the law, it is difficult for an innocent party to decide whether he has an option to rescind or affirm, and he tends to and is often advised to, equivocate (e.g. *Szwarcz v. Ede*, plaint No. 7893/64 in the Magistrate's Court, Wellington; M.15/65 Supreme Court Wellington).
- (c) Rescission for innocent misrepresentation is not always available. Where it is available the party misled is constrained either to sacrifice the bargain or to go without a remedy. This is a hard choice for him and in many cases some financial adjustment would bring about a more proper settlement. In other cases rescission will impose a liability upon the misleading party which is altogether disproportionate to the importance of his assertion. This would be avoided by the payment of suitable compensation. Where rescission is not available the situation is even less satisfactory.
- (d) Especially in cases of sale of goods, but in other cases too, the principles upon which a party is entitled to cancel for breach of a term of the contract are vague and unreal.
- (e) The unrestricted liberty to "contract out" preserved by the *Suisse* case [*Suisse Atlantique etc. v. N.V. Rotterdamsche etc.* [1967] 1 A.C. 361] has been abused

and is open to abuse by standard printed clauses, notably in hire purchase contracts (e.g. *Lowe v. Lombank Ltd.* [1960] 1 W.L.R. 196, [1960] 1 All E.R. 611).

The restrictions on the right to rescind for innocent misrepresentation are said to be too severe, especially in the loss of the right after completion."

11. The New Zealand Committee (see N.Z.R., para.9.41) has four major objections to the recommendations of the English Committee

- (1) **As to recommendation (3)** (see above, para.7(3)), now embodied in s.2(2) of the *Misrepresentation Act 1967*: this will "compound complexity by adding to the problems of classification the difficulties inherent in any discretionary remedy" (see N.Z.R., paras. 9.41 and 9.42).
- (2) **As to recommendation (5)** (see above, para. 7(5)), now embodied in s.2(1) of the *Misrepresentation Act 1967*: this introduces the concept of negligence and the New Zealand Committee feels that negligence has no place in the law of contract (see N.Z.R., paras 9.41 and 9.43).
- (3) **As to recommendation (4)** (see above, para. 7(4)), now embodied in s.1 of the *Misrepresentation Act 1967*: no support should be given to this recommendation which is to the effect that a plaintiff should have the right to rescission for a misrepresentation which was first independently made and later incorporated into the contract. As most terms of a contract begin life as representations, the recommendation opens up a third method of obtaining rescission: by proving that a warranty which started as a representation is in fact incorrect. As a result the whole course of negotiations would be in issue regarding these terms of a contract, as they are in a misrepresentation case (see N.Z.R., paras. 9.41 and 9.45).
- (4) **As to the recommendations as a whole**: they do not deal with the anomaly whereby rescission is available for a minor misrepresentation which, if it was a term of the contract, would carry an award of damages only (see N.Z.R., paras. 9.41 and 9.44).

12. But more generally, the New Zealand Committee was of the view that the English approach was too restricted, with the result that the changes brought about by the 1967 Act do not go far enough (N.Z.R., para. 1.2).

13. When studying this matter, the New Zealand Committee considered the unanimous conclusions of a sub-committee consisting of Professor D.E. Allan, then Professor of Commercial Law at the Victoria University of Wellington, Mr. B.J. Cameron, Chief Advisory Officer of the Department of Justice, Mr. W. Iles, Assistant Law Draftsman, Mr. C.W. Ogilvie, Advisory Officer of the Department of Justice, Mr. C.I. Patterson, Barrister and Solicitor and Mr. W.S. Shires, Barrister and Solicitor, all of Wellington, to which the problem had been referred earlier. Those conclusions found favour with a minority group of the New Zealand Committee.

14. The unanimous recommendations of that sub-committee are as under (see N.Z.R., para. 11.1) -

- "(a) That it should be affirmed without circumlocution that in ascertaining the existence and terms of a contract the Court will have regard not merely to the culminating expression of agreement between the parties but will take into account all relevant prior communications between them with a view to finding whether they were in agreement, and if so, the terms of their bargain;
- (b) That [that] recommendation should apply to signed written agreements as well as oral agreements, provided that writings signed by the party to be charged should be received as prima facie evidence of his agreement to the terms contained therein;
- (c) That it should also apply notwithstanding that the writing may contain a declaration that the writing records the entirety of the bargain or to the like effect. In such a case, the Court should receive relevant extrinsic evidence to ascertain whether, notwithstanding the declaration, there were in fact extrinsic points of agreement comprised in the bargain. If there were, the writing and such points of agreement should comprise the contract;

- (d) That all legal requirements of writing (e.g. the *Contracts Enforcement Act 1956* and the *Moneylenders Act 1908*) should be reviewed to ensure that extrinsic evidence will be admissible where writing is required merely to prove the existence of the transaction;
- (e) That at this stage the rule in *North Eastern Rail Co. v. Hastings* [1900] A.C. 260 should not be disturbed, but it may call for review if these proposals are adopted;
- (f) That the parol evidence rule should be abolished;
- (g) That express rules should be enacted regarding assignees to the following effect -
 - (i) That the terms of a contract ascertained in accordance with recommendation (a) should be enforceable by or against any assignee of the contract or any assignee of the benefit or burden thereof, unless otherwise provided by the contract;

Provided that the assignee should not be liable in damages, whether by way of set-off, counterclaim or otherwise in a sum exceeding the value of the performance of the assigned contract to which he is entitled by virtue of the assignment, unless otherwise agreed by the assignee or provided in the assigned contract.
 - (ii) An assignee should have, by statute, an indemnity from the assignor against losses incurred by the assignee arising out of any term of the assigned contract which was not disclosed to the assignee at the time of assignment, unless otherwise agreed.
 - (iii) Nothing in this recommendation should affect the law as to negotiable instruments."

15. In support of the recommendations set out in paragraph 14 above, the minority group in the New Zealand Committee pointed out (see N.Z.R., para. 11.2) -

- " (a) That in fact our Courts proceed in the way recommended if the case is pleaded in a manner adequate to exhaust the heads of classification mentioned in paragraph 5 [of the New Zealand Report].
- (b) That the recommendations accord with the reality of the bargaining process.
- (c) That adoption of the recommendations will open the way to a direct approach to the problems of mistake, selection of remedies and exemption clauses.
- (d) That the parol evidence rule is tautological; extrinsic evidence will not be admitted in derogation from the writing if the writing records the bargain, a condition which can only be tested by the examination of extrinsic evidence.
- (e) That no greater uncertainty will arise under these recommendations than already exists. The probe for reality will be unimpeded by subtle distinctions of law and accidents of pleading."

16. However, some members of the New Zealand Contracts and Commercial Law Reform Committee considered that the subcommittee's recommendations, by merging representations and terms, made too radical a departure from the existing principles of the law of contract (N.Z.R., para. 12.1): they considered that the argument for the assimilation of misrepresentations and terms is based on invalid premises, and that the distinction between them is real, the reality residing on the position that a representation is, *ex hypothesi*, not an agreed term (N.Z.R., para. 10.2).

17. These members also considered that the abolition of the parol evidence rule is neither desirable nor feasible. They doubted whether the abolition would achieve the desired aim of the minority opinion, i.e. the removal of the representation - term distinction with its uncertainties and contrasting remedies. Although agreeing that it was desirable to assimilate the remedies for misrepresentation and breach of contract, they believed this could be achieved without recourse to abolition of the parol evidence rule (N.Z.R., paras. 12.31 and 12.32).

18. In addition; these members considered that abolition would have a most unfortunate effect in the field of commerce. It would shake the confidence the business man and the man in the street have in what is written down. Furthermore, in the case of the bulky, well-thought out businessman's type of contract, which usually is the end product of a long process of bargaining in which each party has received legal and technical advice, it appeared to the majority that it would be both unreasonable and impracticable to allow the whole course of negotiations to be traversed in order to ascertain the terms of such a contract. Before litigation, there would be no certainty as to the terms of a contract and, if litigation was resorted to, its length and expense would be great (N.Z.R., paras. 12.4. to 12.42).

19. In conclusion, the majority group made the following recommendations -

- (1) It should be affirmed that the question whether a given statement is or is not a term of the contract is to be decided without regard to the supposed state of mind of any party undisclosed to the other at the time of contracting, but is to be decided according to the conduct of the parties, on their words and behaviour (N.Z.R., para. 4.8).
- (2) It should be enacted that a party to a contract who is induced to enter into it by misrepresentation (whether innocent or fraudulent) of another party shall be entitled to damages from such other party as if the representation had been a term of the contract. In this context the terms "representation" and "misrepresentation" are intended to have their common law meanings (N.Z.R., para. 13.3).
- (3) The remedies of rescission for misrepresentation and acceptance of repudiation should be replaced by a single remedy known as "cancellation", as described in recommendation 6 below (N.Z.R., para. 16.1).
- (4) The existing right of a party aggrieved by breach of contract or misrepresentation to choose between the available remedies should be retained (N.Z.R., para. 16.3).

- (5) It should be affirmed that the parties to a contract may expressly designate the remedies for misrepresentation or breach (N.Z.R., para. 17.2).
- (6) It should be enacted that where there is no express designation of the kind in (5) above, the remedy of cancellation should be available according to the following rules -
 - (a) Whenever a party to a contract manifests his intention to another party that he will no longer be bound by the contract, the other party may either affirm or cancel the contract.
 - (b) Subject to any express provision of the contract, whenever there is a breach of contract or a misrepresentation whether innocent or fraudulent, the party aggrieved thereby may (unless with knowledge of the breach or misrepresentation he has affirmed the contract) cancel the contract if -
 - (i) the party in breach, or the representor, has not commenced performance of his obligations, or
 - (ii) the effect on the party aggrieved of the breach or misrepresentation is substantially to deprive him of the benefit of the contract, but not in any other case.
 - (c) Whenever a contract is cancelled under rule (a) or (b) -
 - (i) any obligations under the contract which are still executory need not be performed; and
 - (ii) all rights based on prior breach or performance survive; and
 - (iii) the cancelling party retains any right to damages available to him for breach of the contract or for misrepresentation.
 - (d) Where a contract has been cancelled, the court may on the application of either party make an order for restoration of property to the extent

that restoration is just and practicable and upon such terms as the court thinks just.

- (e) No order for restoration shall be made under rule (d) -
 - (i) of any property in which a third party has in good faith and for value acquired an interest, or
 - (ii) of any property if any party has so altered his position in relation to that property (whether before or after cancellation) that having regard to all the relevant circumstances it would be inequitable to any party to order restoration thereof.
 - (f) Neither cancellation nor an order for restoration will disentitle the party who cancels to such further or other relief by way of damages or otherwise as may be appropriate in the circumstances.
 - (g) In order to cancel in accordance with these rules it is not necessary to employ any particular form of words provided that the party having the right to cancel communicates his election so to do. Communication may be dispensed with if it is not reasonably practicable (N.Z.R., para. 18.5).
- (7) It should be enacted that -
- (a) the remedies recommended in paragraph 19, subparas. (2) and (6) above, should be enforceable by or against any assignee of the contract or any assignee of the benefit or burden thereof, unless otherwise provided by the contract: provided that the assignee should not be liable in damages, whether by way of set-off, counterclaim or otherwise in a sum exceeding the value of the performance of the assigned contract to which he is entitled by virtue of the assignment, unless otherwise agreed by the assignee or provided in the assigned contract;

- (b) an assignee should have, by statute, an indemnity from the assignor against losses incurred by the assignee arising out of any term of the assigned contract or any misrepresentation which was not disclosed to the assignee at the time of assignment, unless otherwise agreed;
- (c) nothing in this recommendation should affect the law as to negotiable instruments.

(N.Z.R., para. 19.8)

COMMITTEE'S PROVISIONAL VIEWS

20. Our immediate concern is for those who suffer as the result of an innocent misrepresentation but are left without a remedy at all. Relief in such cases could be given by the enactment of a provision whereby the fact that a contract was executed would not of itself bar rescission. In addition, it seems desirable to widen the court's powers by giving it a discretion to award damages in lieu of rescission if it is of opinion that it is equitable to do so, and to ensure that rescission is available for a misrepresentation which has become a term of the contract. In brief, we think that the problem can be sufficiently alleviated by adopting ss. 1 and 2(2) of the English *Misrepresentation Act 1967*.

21. There does not seem to be any good reason why equitable remedies should not be available in cases of contracts for the sale of goods induced by innocent misrepresentation, and the Committee suggests that an amendment to the *Sale of Goods Act* be introduced to ensure that this is so (see para. 3 above). As a corollary, it would seem logical to further amend the Act along the lines of s.4 of the English *Misrepresentation Act* so as not to bar rejection of goods for a mis-statement which is a term of the contract until the buyer has had a reasonable opportunity of examining them.

22. At this stage the Committee is not inclined to favour any further legislative action. The question of liability based on negligent mis-statements has been under judicial consideration in several recent cases (see in particular *Hedley Byrne & Co. v. Heller & Partners* [1964] A.C. 465, and *The Mutual Life & Citizens' Assurance Co. Ltd. v. Evatt* [1971] A.C. 793). Further, consumer credit laws are currently under review by the Standing Committee of the Australian Attorneys General and a committee of the Law Council of Australia has recently

reported to the Victorian Attorney General on the matter. In the circumstances we think it may be advisable for the time being to await developments before making any further statutory modifications to the law relating to innocent misrepresentation.

APPENDIX

The Misrepresentation Act 1967

1. **Removal of certain bars to rescission for innocent misrepresentation** - Where a person has entered into a contract after a misrepresentation has been made to him, and -

- (a) the misrepresentation has become a term of the contract; or
- (b) the contract has been performed;

or both, then, if otherwise he would be entitled to rescind the contract without alleging fraud, he shall be so entitled, subject to the provisions of this Act, notwithstanding the matters mentioned in paragraphs (a) and (b) of this section.

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 had 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.

(2) Where a person has entered into a contract after a mis-representation 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.

(3) Damages may be awarded against a person 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 the said subsection (2) shall be taken into account in assessing his liability under the said subsection (1).

3. **Avoidance of certain provisions excluding liability for misrepresentation** - If any agreement (whether made before or after the commencement of this Act) contains a provision 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 provision shall be of no effect except to the extent (if any) that, in any proceedings arising out of the contract the court or arbitrator may allow reliance on it as being fair and reasonable in the circumstances of the case.

4. **Amendments of Sale of Goods Act 1893** – (1) In paragraph (c) of section 11(1) of the *Sale of Goods Act 1893* (condition to be treated as warranty where the buyer has accepted the goods or where the property in specific goods has passed) the words "or where the contract is for specific goods, the property in which has passed to the buyer" shall be omitted.

(2) In section 35 of that Act (acceptance) before the words "when the goods have been delivered to him, and he does any act in relation to them which is inconsistent with the ownership of the seller" there shall be inserted the words " (except where section 34 of this Act otherwise provides)".

5. **Saving for past transactions** - Nothing in this Act shall apply in relation to any misrepresentation or contract of sale which is made before the commencement of this Act.

6. **Short title, commencement and extent** – (1) This Act may be cited as the *Misrepresentation Act 1967*.

(2) This Act shall come into operation at the expiration of the period of one month beginning with the date on which it is passed. (It came into force on 22 April 1967).

(3) This Act, except section 4(2), does not extend to Scotland.

(4) This Act does not extend to Northern Ireland.