Scottish Law Commission

(SCOT. LAW COM. No. 92)

OBLIGATIONS

REPORT ON NEGLIGENT MISREPRESENTATION

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SCOTTISH LAW COMMISSION

Item 2 of the First Programme

OBLIGATIONS

NEGLIGENT MISREPRESENTATION

To: The Right Honourable the Lord Cameron of Lochbroom, Q.C.,
Her Majesty's Advocate

We have the honour to submit our Report on Negligent Misrepresentation.

(*Signed*) PETER MAXWELL, *Chairman*
R. D. D. BERTRAM
E. M. CLIVE
JOHN MURRAY
GORDON NICHOLSON

R. EADIE, *Secretary*
22nd November 1984

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PART I INTRODUCTION

1.1 In Consultative Memorandum No. 42—Defective Consent and Consequential Matters,[1] we considered potential reforms of the law on negligent misrepresentation and of various aspects of the law of contract. With the benefit of the opinions of consultees, for which we are grateful, we have reviewed our provisional proposals applying a general criterion that for reform to be recommended there should first be a clear need and demand for a simplification, clarification or replacement of existing legal rules. This approach is consonant with the views of most consultees and also, we think, would represent the best use of our resources at this stage.

1.2 The result of our review is that we have decided to consider in this Report reform of the law on negligent misrepresentation alone. This is an area of the law where there is, in our view, a clear need for immediate reform.

PART II NEGLIGENT MISREPRESENTATION

2.1 Whatever doubts may have existed in the law on negligent misrepresentation prior to the publication of the Memorandum several cases since then have clearly revealed a serious obstacle to the judicial development of this area of the law. The source of the present difficulty is to be found in a ruling made at the end of the last century by the First Division of the Court of Session in *Manners* v. *Whitehead*.[2] In that case the pursuer had entered a contract of co-partnership with the defender, having been induced to do so, it was alleged, by misrepresentations made in balance sheets and in a prospectus relating to the defender's business. The business did not prove to be as profitable as the pursuer had expected and he sought damages from the defender for fraud and misrepresentation. Fraud was not established, however, and no damages were awarded. In the words of Gloag:[3] "It was held that the action . . . was in substance an action for damages, which could succeed only on proof of actual fraud, not on a statement which, though negligent, was honestly made". Indeed the court did not even discuss any question of negligence. This approach was similar to that of English law under the House of Lords' authority of *Derry* v. *Peek*[4] whereby, as interpreted then and for many years afterwards, no action lay in tort for financial loss caused by the mere negligent use of words.[5] It was considered that there was no duty to be careful when making a statement and in the absence of a breach of a duty of care no question of negligence arose.[6] This position can be contrasted with that of the modern law of delict which since the House of Lords' decision in the English appeal of *Hedley Byrne Ltd* v. *Heller & Partners Ltd.*[7] has, simply stated, recognised that in the absence of a disclaimer of liability a party may be liable for his negligent mis-statements upon which another has relied to

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[1]Hereinafter referred to as "the Memorandum".

[2](1898) 1 F. 171.

[3]*Gloag on Contract*, 2nd ed., pp. 478–9.

[4](1889) 14 App.Cas. 337.

[5]See *Cheshire and Fifoot's Law of Contract*, 10th ed., p. 246; and *Chitty on Contracts*, 25th ed., para. 417.

[6]See *Gloag on Contract*, p. 477.

[7][1964] A.C. 465.

his financial loss.[1] Several Scottish courts of first instance, whilst accepting the general authority of *Hedley Byrne* v. *Heller* as part of Scots law, have recently stated, however, that they remained bound by *Manners* v. *Whitehead,* though, by analogy with the facts of that case, only in so far as one party has been induced to enter a contract through the misrepresentation of another contracting party. Thus an anomaly has arisen. If a negligent misrepresentation has induced a contract with a party other than the misrepresentor, and in circumstances where all relevant criteria for delictual liability are satisfied, the misrepresentor can be sued for his negligence but that remedy is excluded, following *Manners* v. *Whitehead,* if the contract is made with the misrepresentor himself, for in those circumstances only his fraudulent statements will render him liable in delict. Fraud, however, may not only be more difficult to prove than negligence, but also less frequently encountered in practice.

2.2 Ironically, in the first of a series of modern cases on negligent misrepresentation, that of *John Kenway Ltd.* v. *Orcantic Ltd.*,[2] Lord Dunpark did not consider that under Scots law any such problem as outlined above presented itself. He found no difficulty in adopting the ruling of Lord Denning M.R. in the English appeal of *Esso Petroleum Co. Ltd.* v. *Mardon,*[3] to the effect that where a man with special knowledge or skill thereby gives advice, information or his opinion on a matter, with the intention of inducing another party to contract with him, he is under a duty of care to ensure that the statement is accurate and if it is not, and is made negligently, then he will be liable in damages for the loss occasioned by his misrepresentation. Lord Dunpark said he knew of no authority in Scots law to that effect but he was sure that Lord Denning's statement would also fall within the principles of the Scots law of delict.[4] He in addition specifically recognised the principles stated by the House of Lords in *Hedley Byrne* v. *Heller* as applicable to Scotland. At the same time he admitted that the facts in the case before him were somewhat different from those in *Esso Petroleum* v. *Mardon,* in that in *Kenway* v. *Orcantic* the alleged misrepresentations were not made with the intention of inducing a contract with the representors, but he did not regard this distinction as material. Shortly thereafter, however, in *Foster* v. *Craigmillar Laundry Ltd*,[5] where the entering of a contract induced by the alleged misrepresentation of another contracting party was in point, Sheriff Nicholson considered that the distinction *was* material. He was of the opinion that the case of *Manners* v. *Whitehead* remained binding on him with the result that an action for damages in those circumstances would be available only where the misrepresentation was fraudulent. Accordingly, although he agreed with Lord Dunpark that the rules stated in *Hedley Byrne* v. *Heller* did apply in the Scots law of delict, the Sheriff also said that, nonetheless, he could not agree

[1]An additional qualification to this rule is that there must have been a "special relationship" between the parties, a concept which we will discuss further (see para. 3.2 below), for the representor to be under a duty of care to the representee.

[2]1980 S.L.T. 46.

[3][1976] Q.B. 801.

[4]At page 48 of the report he made particular reference to the concept of duty of care in the law of delict and referred to the definition given by Lord Macmillan in *Muir* v. *Glasgow Corporation,* 1944 S.L.T. at p. 62, as being ". . . the duty to avoid an act or omission which may have as its reasonable and probable consequence injury to others, and the duty is owed to those to whom injury may reasonably and probably be anticipated if the duty is not observed".

[5]1980 S.L.T. (Sh.Ct.) 100.

with him in acceptance of the principle put forward by Lord Denning in *Esso Petroleum* v. *Mardon*. He added, however:[1]

> "I have little doubt that the principle *should* form part of the law of Scotland, but it will require a more authoritative court than mine to make it so."

2.3 The above approach has also been taken by two judges in the Outer House of the Court of Session. In the case of *Twomax Ltd* v. *Dickson, McFarlane & Robinson*[2] Lord Stewart referred to the judgment of Lord Grieve in the then unreported case of *Eastern Marine Services (and Supplies) Ltd.* v. *Dickson Motors Ltd. and Others*[3] where it was held that the First Division's decision in *Manners* v. *Whitehead* was still binding on the Outer House. In this connection Lord Stewart said:[4]

> "His Lordship refers to a case decided by Lord Dunpark (*Kenway* v. *Orcantic*) and says this—'If, as I think he is, Lord Dunpark is correct in saying that in certain circumstances representations made negligently amount to *culpa,* and are therefore actionable as a delict it is very difficult to see why such a delict should not form the basis of an action of damages on the ground that that delict induced a contract which resulted in a loss, but I cannot find any binding authority to say that it does and I can find one in *Manners* to say that it does not.' I respectfully agree with Lord Grieve. I would also refer to the decision of Sheriff Nicholson in *Foster* v. *Craigmillar Laundry Limited.* Accepting that the case of *Manners* v. *Whitehead* is out of line with modern developments in the law concerning negligent statements but is, nevertheless, still binding upon me, I am inclined to regard it as authoritative only in respect of representations made with the intention of inducing another party to enter into a contract with the maker of the representations or his principal. . . . I am not, in any event, prepared to hold that the decision in *Manners,* except to the very limited extent I have mentioned, stops the flow of the tide of judicial opinion in cases of delict as exemplified by such important cases as *Donoghue* v. *Stevenson* and *Hedley Byrne & Co. Limited* v. *Heller & Partners Limited.*"

It is clear from the above judgments that it was with reluctance that their Lordships found *Manners* v. *Whitehead* to be binding. Indeed the legal outcome of that finding in most cases effectively denies the important remedy of damages in delict in circumstances where its availability would seem fully justified. If a duty of care is owed by the provider of information to the recipient when it is reasonably foreseeable that he may rely on that information when entering a contract with a third party, it seems neither logical nor just that the duty of care should not also be owed when the party the recipient intends to contract with happens also to be the provider of the information in question.[5] In those circumstances the proximity of relationship between the parties and the knowledge of the representor of the reliance that might be placed on his statements are particularly apparent and, we think, subject to such qualifications as the general law has already established, justify the imposition of a legal duty of care which if breached should result in delictual liability for negligence. Accordingly, we consider that the rule in *Manners* v.

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[1] at p. 103.
[2] 1983 S.L.T. 98.
[3] see now 1981 S.C. 355.
[4] at pp. 102–3.
[5] It is here assumed that there is a "special relationship" between the parties (see para. 3.2 below) for a duty of care to be owed.

Whitehead should be abolished. Before reaching our final recommendation for reform, however, we must re-examine certain options for the law on negligent misrepresentation which we canvassed in the Memorandum. Our discussion will be restricted to the law of delict as we consider contractual remedies to be adequate.[1]

PART III REFORM OPTIONS

A Misrepresentation Act?

3.1 In the Memorandum we discussed at some length the English Misrepresentation Act of 1967.[2] That Statute includes a provision rendering liable in damages a party who has made a misrepresentation to another who has contracted with him to his loss.[3] The misrepresentor is liable unless, under a reversed onus, he can prove ". . . that he had reasonable ground to believe and did believe up to the time the contract was made that the facts represented were true". Thus the normal requirement for delictual liability of establishing a duty of care which has been breached need not be satisfied and, moreover, the onus lies on the representor not merely to disprove negligence but positively to establish his reasonable grounds of belief.[4] This bodes well for representees but is a marked divergence from the common law. Indeed the editor of *Cheshire and Fifoot's Law of Contract* has noted:[5]

> ". . . the Act was based on the view of the common law taken by the Law Reform Committee in 1962, which was overtaken by the decision in *Hedley Byrne & Co. Ltd.* v. *Heller & Partners*. This has meant the creation of two different kinds of negligent misrepresentation with different rules and an uncertain relationship".

In the Memorandum we considered other criticisms of the policy and complex drafting of the 1967 Act, including the extent to which it relied on uncertain English common law concepts for its meaning.[6] Those consulted were unanimous in their opinion that the Misrepresentation Act should not be extended to Scotland and we fully endorse this view.

3.2 The question of whether to adopt the 1967 Act can be seen as separate, however, from that of whether there should be alternative legislation on the law of misrepresentation which could deal solely with the problem created by *Manners* v. *Whitehead* or go further. In the Memorandum, which of course was published before the recent series of cases discussed above, we suggested in our provisional proposal No. 45 that, for the avoidance of doubt:

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[1]A contract induced by misrepresentation is voidable even if the misrepresentation was made without fault on the part of the representor. For rescission or reduction of the contract, however, *restitutio in integrum* must still be possible. If the misrepresentation has been incorporated in a contract as a term, and this has not been implemented, the remedies for breach of contract of specific implement, retention or damages will be available. If the breach is material the contract may be rescinded by the aggrieved party. See *Gloag on Contract,* (2nd ed.) pp. 471–3 and Consultative Memorandum No. 42 at paras. 5.26–5.27.

[2]See paras. 5.12–5.31.

[3]Section 2(1).

[4]See *Cheshire and Fifoot's Law of Contract,* 10th ed., p. 252.

[5]*Ibid.*, p. 265.

[6]e.g. Section 2(1) includes the test that: ". . . if the person making the representation 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".

"It should be confirmed by legislation that a contracting party can be liable in delict for loss caused by a negligent statement inducing the other party to contract."

This proposal was aimed purely at the situation of a misrepresentation inducing a contract with the misrepresentor himself and was not, therefore, directed at any general scheme for liability for negligent misrepresentation. A positive statement of that nature if in legislative form would have to be fairly complex, however, if it were intended to encapsulate the common law criteria for delictual liability in such circumstances. In particular the common law, as it has developed since *Hedley Byrne* v. *Heller,* has required the breach of a duty of care arising through a "special relationship" between the parties in order for there to be liability for negligent misrepresentation. One of the factors relevant for determining the existence of a "special relationship" is the circumstances in which advice has been sought, as is explained by Lord Denning M.R. in *Howard Marine and Dredging Company Ltd.* v. *A Ogden & Son (Excavations) Ltd.,* where he states:[1]

"To my mind one of the most helpful passages is to be found in the speech of Lord Pearce in *Hedley Byrne & Co Ltd.* v. *Heller & Partners Limited* [1964] A.C. 465, 539:

'. . . to import such a duty of care the representation must normally, I think, concern a business or professional transaction whose nature makes clear the gravity of the inquiry and the importance and influence attached to the answer. . . . A most important circumstance is the form of the inquiry and of the answer.'

To this I would add the principle stated by Lord Reid and Lord Morris of Borth-y-Gest in the Privy Council case, *Mutual Life and Citizens' Assurance Company Limited* v. *Evatt* [1971] A.C. 793, 812, which I would adopt in preference to that stated by the majority:

'. . . when an inquirer consults a businessman in the course of his business and makes it plain to him that he is seeking considered advice and intends to act on it in a particular way . . . his action in giving such advice . . . (gives rise to) . . . a legal obligation to take such care as is reasonable in the whole circumstances.'

These principles speak of the 'gravity of the inquiry' and the seeking of 'considered advice'. Those words are used so as to exclude representations made during a casual conversation in the street; or in a railway carriage; or an impromptu opinion given offhand; or 'off the cuff' on the telephone. To put it more generally, the duty is one of honesty and no more whenever the opinion, information or advice is given in circumstances in which it appears that it is unconsidered and it would not be reasonable for the recipient to act on it without taking further steps to check it."

To these statements has to be added the requirement of "special knowledge or skill", referred to by Lord Denning in *Esso Petroleum* v. *Mardon.* [2] In that case Ormrod L.J. made it clear that he did not adopt the view of the majority of the Privy Council in *Mutual Life and Citizens' Assurance Company Limited* v. *Evatt,*[3] which had been to the effect that the duty of care was limited to

[1][1978] Q.B. 574, at pp. 591–2; see also Shaw L.J. at pp. 600–1.
[2][1976] Q.B. 801, at p. 820.
[3][1971] A.C. 793.

persons who carried on or held themselves out as carrying on the business or profession of giving advice. He stated:[1] "If the majority view were to be accepted, the effect of *Hedley Byrne* would be so radically curtailed as to be virtually eliminated". The requirement of "special knowledge" was also accepted by Lord Dunpark in *Kenway* v. *Orcantic*[2] and by Sheriff Nicholson in *Foster* v. *Craigmillar Laundry*. Referring to *Esso Petroleum* v. *Mardon,* Sherriff Nicholson explained:[3]

> "In my opinion it is quite clear, if one reads Lord Denning's judgment along with the judgments in the earlier cases to which I have already referred, that the phrase is used in the sense of specialised or expert knowledge rather than in the sense of information which is merely available to one party and not to the other. It may be that cases will arise which involve a duty of care where the knowledge consists of the possession of information rather than specialised or expert knowledge, but in my opinion these would have to be cases where the information was of a highly private character which was not, and could not be, available to the other party."

In summary, one could again refer to the opinion of Ormrod L.J. in *Esso Petroleum* v. *Mardon* where he stated:[4]

> "There is no magic in the phrase 'special relationship'; it means no more than a relationship the nature of which is such that one party, for a variety of possible reasons, will be regarded by the law as under a duty of care to the other."

Taking into account the above authorities we do not think that a contractual or pre-contractual relationship would *per se* establish a "special relationship" for the purposes of delictual liability for negligent misrepresentation. Under the existing common law the full circumstances of each relationship would have to be considered with regard to satisfaction of the criteria established for a duty of care to arise. We are of the opinion that this flexibility in approach is necessary, even in cases where the parties concerned intend to contract with each other, given the wide variety of circumstances in which statements may be made. In not all circumstances will reliance on a statement be justified.

3.3 Were provisional proposal No. 45 to be considered as a potential legislative provision in itself, which if enacted would be intended to run a parallel course with that of the common law on negligent misrepresentation inducing contracts with parties other than the representor, it would require to be heavily qualified if that objective were to stand a chance of being attained. A mixture of statute and common law of that nature would, moreover, create a high risk of a uniform development of the law of misrepresentation not being achieved. Thus, whereas consultees agreed with the legal conclusion in the proposal several doubted the wisdom of a positive legislative statement of that kind. We also now share that doubt. We are, in addition, satisfied that the ambit of duty of care and related liability for negligent misrepresentation can best be developed by the common law.

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[1][1976] Q.B. 801, at p. 827.
[2]1980 S.L.T. 46, at p. 48.
[3]1980 S.L.T. 100, at pp. 103–4.
[4][1976] Q.B. 801 at pp. 827–8.

3.4 An alternative approach, though one which we do not favour, could be a statutory provision whose policy, though not wording, could be akin to that of the English Misrepresentation Act 1967. By this means one could dispense with the relatively complex delictual concepts discussed above, whereby such factors as the "gravity of the inquiry", the seeking of "considered advice", "special knowledge or skill" and the overall "special relationship" between contracting parties would no longer be relevant. This would have the practical effect, however, of extending the scope of liability for mis-statements inducing contracts given that whatever the nature of the statement, or the circumstances in which it was made, its maker would be left with the sole defence, plus the onus, of having to prove, that he had had reasonable grounds to believe that his statement was true. In addition, if the policy of the 1967 Act were to be followed, the new provisions would be restricted to representations made between contracting parties alone and thus the rules of the common law would remain for all other cases of misrepresentation. We are not satisfied, however, that any such distinction is now justified, given the content of the common law, from *Hedley Byrne* v. *Heller* onwards, which we assess should provide adequate protection for representees where reliance on a statement in all the circumstances has been reasonable. We are of the opinion that the criteria under which a duty of care arises at common law maintain a just balance between the respective obligations and rights of providers and recipients of information and we see no need, therefore, to create a special, more stringent category of liability for misrepresentation between contracting parties.

3.5 A further alternative would be for such a statute to have a wider field of application so as to cover all forms of misrepresentation, whether involving another contracting party or not. But a provision of that kind would greatly increase the scope of liability for misrepresentation and we would be concerned lest this might operate as a serious disincentive to the production or dissemination of information.[1] Moreover, to allow for limitations on liability by some statutory formula capable of being applied to a wide variety of circumstances would be very difficult. Indeed we see no justification for attempting to supplant the existing common law of negligent misrepresentation when so far, the rule in *Manners* v. *Whitehead* apart, it has operated satisfactorily and is continuing to evolve.[2]

Removal of the Rule in *Manners* v. *Whitehead*

3.6 Having rejected the options stated above as unnecessary and undesirable, we return to what appears to be the only significant weakness in the common law, which is the anomaly created by the continued authority of *Manners* v. *Whitehead,* whereby a party cannot recover damages for loss sustained through having been induced to enter a contract by the negligent misrepresentation of another party to the contract and is restricted in his right of delictual claim to that of damages for fraudulent misrepresentation alone. As we have noted, this is at odds with the general development of the law which otherwise does countenance delictual actions for negligent misrepresentation. Given our view

[1]See W Bishop, "Negligent Misrepresentation Through Economists' Eyes", 1980, 96 L.Q.R. 360.

[2]See *Twomax* v. *Dickson McFarlane & Robinson,* 1983 S.L.T. 98; and *JEB Fastners Ltd.* v. *Marks Bloom & Co.* [1981] 3 All E.R. 289; [1983] 1 All E.R. 583.

that, this anomaly apart, the common law operates satisfactorily we have reached the conclusion that the only reform required is the abolition of the rule in *Manners* v. *Whitehead.* This would accord with the views of consultees and, moreover, with the opinions of the judges who recently have had to face this difficulty in litigation before them. **Accordingly we recommend that:**

where a party to a contract has been induced to enter it through negligent misrepresentation made by or on behalf of another contracting party he should not be disentitled from recovering damages from that party on the sole ground that the misrepresentation was not fraudulent; and any rule of law to the contrary should cease to have effect.

APPENDIX A

Negligent Misrepresentation (Scotland) Bill

ARRANGEMENT OF CLAUSES

Clause

DRAFT

OF A

BILL

TO

Amend the law of Scotland relating to negligent misrepresentation.

BE IT ENACTED by the Queen's most Excellent Majesty, by and with the advice and consent of the Lords Spiritual and Temporal and Commons, in this present Parliament assembled, and by the authority of the same, as follows:

Damages recoverable for negligent misrepresentation inducing contract without proof of fraud.

1.—(1) A party to a contract who has been induced to enter into it by negligent misrepresentation made by or on behalf of another party to the contract shall not be disentitled, by reason only that the misrepresentation is not fraudulent, from recovering damages from the other party in respect of any loss or damage he has suffered as a result of the misrepresentation; and any rule of law that such damages cannot be recovered unless fraud is proved shall cease to have effect.

(2) Subsection (1) applies to any proceedings commenced on or after the date on which it comes into force, whether or not the negligent misrepresentation was made before or after that date, but does not apply to any proceedings commenced before that date.

Citation, commencement and extent.

2.—(1) This Act may be cited as the Negligent Misrepresentation (Scotland) Act.

(2) This Act shall come into force at the end of the period of 3 months beginning with the day on which it is passed.

(3) This Act extends to Scotland only.

EXPLANATORY NOTES

Clause 1

Subsection (1) implements the recommendation of this report to remove the anomaly in the law which is to the effect that if a negligent misrepresentation has induced a contract with a party other than the misrepresentor the misrepresentor can be sued for his negligence but that remedy is excluded if the contract is made with the misrepresentor himself, for in those circumstances only his fraudulent statements will render him liable in delict. The Clause removes the requirement that fraudulent misrepresentation be established in all delictual actions for damages where a misrepresentor has induced another to contract with him and thus enables the misrepresentor to be sued for his negligence according to the general principles of the common law.

Subsection (2) gives the reform outlined above retroactive effect as regards any negligent misrepresentation made before the coming into force of subsection (1), but will not affect any proceedings commenced prior to that date. The reform is designed to remove a clear inequity and anomaly in the present law and retroactivity should not, therefore, affect any reasonable reliance interests of misrepresentors. A distinction is made, however, for parties already involved in litigation.

APPENDIX B

List of those who submitted comments on Consultative Memorandum No. 42.

Committee of Scottish Clearing Bankers
The Hon. Lord Dunpark
Faculty of Advocates
Faculty of Law, University of Aberdeen
Faculty of Law, University of Glasgow
General Register Office for Scotland
Law Society of Scotland
Scottish Law Agents Society

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