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DEFECTIVE CONSENT AND CONSEQUENTIAL MATTERS
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Volume Two

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DEFECTIVE CONSENT AND CONSEQUENTIAL MATTERS

(Volume Two)

PART II

ABORTIVE CONSTITUTION OF OBLIGATION:

ENFORCED SIMULATION OF CONSENT (FORCE AND FEAR)

General

2.1. The principal concern of this Memorandum is with vitiation of consent or other expression of will as when it has been affected by constraint or misunderstanding. The effect of force and fear (vis ac metus) and extortion will be discussed mainly in that context. However, in our Memorandum No. 37¹ when dealing with the effect of certain aspects of 'error' on constitution of obligation, we indicated that we would consider separately and subsequently the circumstances in which force and fear should be regarded as relevant to exclude consent altogether - as contrasted with circumstances in which threats or extortion should justify reduction or annulment of contracts and other legal acts. Moreover, in our Memorandum No. 27² we touched on the doctrine of force and fear and indicated our view that the law needed clarification, especially with regard to third party rights.

The two aspects of force and fear

2.2. Since the more frequent aspects of force and fear or extortion in modern conditions imply reluctant consent

¹Constitution and Proof of Voluntary Obligations: Abortive Constitution, para. 1.

²Corporeal Moveables: Protection of the Onerous Bona Fide Acquirer of Another's Property, para. 18.

extorted under constraint (coactus voluit) we discuss more fully the development of this branch of the law in the context of Vitiating of Consent (Part III, infra). That discussion is, however, also relevant to the provisional conclusions which we reach in the present Part of this Memorandum. Here our sole concern is with situations where the expression of will or consent is only apparent, having been extorted from the declarant without any exercise of will on the part of the latter. It would be tedious to repeat our reasoning in two different contexts. Consequently we invite the reader to compare the separate but related treatment of different aspects of force and fear contained in Parts II and III of the Memorandum.

Vis absoluta

2.3. Legal systems on the European Continent distinguish between vis absoluta and vis compulsiva. Irresistible physical coercion which results in the mere outward appearance of a declaration of will has no legal consequences for the victim - though it may be expedient to have reduction of a writ judicially declared - and does not have to be annulled.¹ Even onerous transferees in good faith will be precluded from relying on an antecedent transaction nullified because of vis absoluta. This aspect of vis (coercion) is therefore appropriately considered in connection with constitution of obligation or constitution of any other legal act such as a conveyance, will or discharge. Examples given in French law² include the seizing of another's hand and using it as an instrument for signing a writ, obligations granted under torture and a deed obtained by hypnosis or hypnotic drugs. Some of

¹Unless in jurisdictions which preclude an individual from asserting his right without judicial intervention.

²See e.g., See B. Starck, Droit Civil: Obligations s.1377.

these examples are also adopted by the American Law Institute's Restatement of Contracts¹ as cases of "duress" which make a contract void - as contrasted with the more usual cases where "duress" only makes an agreement voidable. The Restatement also includes the example of a person adhibiting through terror his signature to a document the contents of which are not disclosed to him. Where there has been no declaration of will, but merely an apparent declaration, the ostensible legal act is an absolute nullity. It does not require annulment. It cannot be homologated. Any party with an interest, eg the victim's creditors, can rely on the nullity or have it declared. The Revenue, moreover, may regard the victim's estate as notionally unreduced by his ostensible act - at least if the assets transferred by the null act can be recovered.

2.4. Dealing with the problem of the effect of threats generally, Gloag considered that according to the authorities obligations induced by force and fear were made "void". He commented:²

"The nature of the fear which will affect the validity of a contract has been defined only in general terms; but it would appear, according to the authorities in Scotland, that proof of actual fear in the mind of the individual concerned would not be enough if the threats used would not have affected the mind of a reasonable person";

and again:³

"There is no distinction in legal effect between threats used to the granter of a bond, and threats or violence to a near relation, husband or wife, parent or child."

¹s.494.

²Contract, 2nd ed., p.488.

³p.489.

2.5. So far as title to moveables is concerned, Stair's view was:¹

"Fear and fraud have much the same effects as to singular successors, except in the case of robbery, which, as well as theft, is vitium reale in moveables; and therefore what hath been said of fraud in that point needs not here be repeated."

The existence, or otherwise, of robbery seems to us to constitute in general a sound test for distinguishing between vis absoluta and vis compulsiva so far as transfers of moveables affected by coercion are concerned. We note that in the criminal law it is not necessary in order to obtain a conviction that the victim of robbery should have shown the fortitude of an objective reasonable man, and that account will be taken of the circumstances of the crime, including the time and place of the robbery, and the sex and age of the victim.

2.6. It could be said that, while the victim of robbery, however timorous, should invariably have redress against a wrongdoer, this may result in injustice if the competition is between the deprived owner and an onerous third party acquirer in good faith. The latter might reasonably assume that no one sui iuris would permit transfer of indicia of title (in this case possession of corporeal moveables) to another without showing reasonable fortitude in defence thereof. We concluded provisionally, however, in Memorandum No. 27 that an owner's claim should be preferred in all situations where he had been forcibly or clandestinely deprived of control of his moveables, and we do not wish to reconsider this view here. However, it may be thought

¹IV.40.28.

that when the law extends its protection to timorous deprived owners in competition with onerous bona fide acquirers of moveables, such owners should be expected to act reasonably for the protection of third parties. Especially if the victim of robbery had not shewn reasonable fortitude in defence of his property, he might be expected as a condition of exercising his right to claim restitution from innocent third parties, to have acted positively after the robbery - as by notifying the police¹ or by taking steps promptly to recover his property from the robber, if his identity is known, e.g. if he has been convicted.²

2.7. The application of the doctrine of vis absoluta in situations other than deprivation of corporeal moveables is much more complex, since some physical cooperation from the victim is required to signify his assent - whether this be, for example, by gesture, telephone call or exhibiting of mark or signature. Some years ago text writers would brush the problem aside as of purely academic importance, since the thumbscrew and the rack were merely the stock in trade of Gothic romances. However, in the latter part of the 20th century this optimism has proved to be misplaced. Solutions to problems of coercion in the criminal law may justify reasoning by analogy regarding the effects of force and fear in questions of civil law. Seemingly Scots law does not accept the defence of coercion in criminal law as excluding guilt, though it may be relevant to reduce culpability.³ The House of Lords⁴ and the Privy Council⁵

¹However, notification to the police is not the equivalent of intimation to the public: MacLeod v. Kerr 1965 S.C.253.

²See also para. 2.11, infra.

³Hume, Commentaries, I pp.49-52; Gordon, Criminal Law p.385 et seq.

⁴D.P.P. for N.I. v. Lynch [1975] A.C.653.

⁵Abbott v. The Queen [1977] A.C.755.

have quite recently had to consider the defence of duress in the English criminal law, and it had been pointed out that to give too wide recognition to the defence would expose the public to added dangers, since it might prove to be a charter for terrorists, gang leaders and kidnappers. Such criminals may well put extreme physical pressure on private persons or their friends or relatives - including physical torture or threats of death or torture - to secure a written transfer of property rights. We find it extremely difficult to determine at what point consent may be regarded as altogether excluded - as contrasted with consent most reluctantly extorted. The heroism of the martyr is a very rare phenomenon. In the criminal law at all events, however, it seems to be accepted that not even fear of death necessarily deprives a threatened person of the capacity to exercise a rational will. Moreover, in the recent Australian Privy Council case of Barton v. Armstrong¹ it was established to the satisfaction of the majority that, though the plaintiff had been threatened by the defendant with death and had taken the threats seriously, he would not have succeeded in obtaining rescission had he been bound to prove that he would not have made the challenged agreement but for the defendant's threats.

2.8. Though a person of fortitude would rather suffer actual physical pain or even death than allow another dear to him to be so treated or threatened, it is difficult to conclude that such pressure on a third party can so totally deprive the persons indirectly threatened of the faculty of reason as to exclude consent altogether. It may be so in some cases; but, if so, it is at least as likely to result

¹[1976] A.C.104.

from closeness of affection for the victim as from closeness of relationship. A man might well feel more distress on account of coercion or threats towards a lady on the day before he married her than on the day before his divorce action against her was to be heard. Moreover, a very sensitive person who was philanthropic generally might feel more distress when a stranger was afflicted than would a man of coarser grain whose close relative was subjected to extreme pain or threats thereof.

2.9. We accept that in some extremely rare cases vis absoluta may exclude completely rational exercise of the will of a declarant. In such situations the ostensible act should be regarded in law as an absolute nullity. We cannot hope to catalogue all the means - psychological, chemical or violent - by which the evil ingenuity of man has in the past or may in the future compel a victim to act involuntarily against his interests. Therefore our provisional conclusion is that it should be left to unfettered judicial decision, based on evidence of all relevant circumstances, to determine whether the ostensible act of a coerced victim was, on the one hand, in no sense the expression of his will or, on the other, a reluctant declaration of his will secured by extortion. In the former case the ostensible act should, in our view, be altogether null. If the court or judge were to find that there was merely an apparent expression of will, the ostensible obligation or other legal act of the ostensible declarant should be treated as null pleno iure. Though reduction would not normally be required, it might be necessary to reduce a document or entry in a register. In other cases an action of declarator of nullity might be expedient. We invite comment.

2.10. As an alternative to this proposal that distinguishing between coercion which precludes consent and coercion which induces consent should be left to the unfettered decision of the court, we suggest for consideration that a legal act which has resulted from the application of serious physical force, or the threat thereof, to any person should be a ground of absolute nullity, rendering null the ostensible act of a person who, but for such force or threats, would not have acted as he did. Comments are invited.

2.11. Often in a situation of absolute nullity neither declarator of nullity nor reduction would be strictly necessary. It may, however, be thought that, though the law should protect the victim of an enforced simulation of consent, he should not be regarded as altogether free, if he wishes to assert the nullity, to disregard the consequences for innocent third parties of the nullity of his apparent acts. Such third parties might, for example, have taken assignments for value of ostensibly valid rights or might have altered their position in reliance upon such rights. It might therefore be reasonable to require of the victim of coercion that he take prompt steps to denounce his ostensible act after becoming free from pressure. It could be provided that if he failed to do so he should either be personally barred from asserting the nullity against onerous third parties in good faith who acquired their rights after denunciation of his act could reasonably have been made by the victim; or that he should be entitled to be restored only on condition of compensating them for outlays incurred in reliance upon the validity of the transaction which turned out to be absolutely null. Our preference, however, is simply to attach to the victim's right to plead the absolute nullity

of his act as against an onerous bona fide third party a condition that the victim should have acted reasonably in all the circumstances after the coercion ceased. By virtue of the operation of this condition the victim would be required, where possible and practicable, to have taken steps, after cessation of the coercion, to warn potential third party acquirers, as well as to have adopted such other measures as might be reasonable, such as informing the police of the coercion directed towards him, interdicting the coercer against assigning to third parties rights under the obligation, etc. In determining whether the victim had acted reasonably there would also, of course, require to be taken into consideration any reasonable apprehension that denunciation of the obligation might lead to the reimposition of pressure by the coercer or by others on his behalf. We invite comments on our proposal that, as against bona fide onerous third parties, reliance upon the nullity of the obligation should be subject to such a condition of reasonable conduct on the part of the victim of coercion.

Bills of exchange.

2.12. It has generally been assumed¹ that in England the effect of duress, even at common law, is only to make an obligation voidable, and it may be against that background that the Bills of Exchange Act 1882 was enacted. Under the provisions of that Act a holder in due course, or one who derives his title from a holder in due course, as defined in s.29, holds the bill free from any defect of title of prior parties (s.38). Among "defects of title" are included

¹Cheshire & Fifoot, Law of Contract 9th ed., pp.285-6 and authorities there cited. D.J.Lanham "Duress and Void Contracts" (1966) 29 M.L.R. 615 is strongly of the contrary opinion.

"duress or force and fear". It may be questioned whether the defects of "duress" and "force and fear" are necessarily always synonymous, but it is not altogether clear whether vis absoluta is covered by the provision regarding defect of title. In English law it would seem that an "infant" cannot be sued on a bill of exchange¹ presumably because he is incapable of consenting. It is possible to take the view that the holder in due course should obtain a good title only where the force and fear in question has induced the drawer to give his consent (in the form of signature), albeit under pressure. Where the signature has been secured without any exercise of the drawer's will at all, it might be thought that the bill should be regarded as no more valid than would be a forgery. However, the view might also be taken that trade and commerce require that the rights of holders in due course of bills of exchange be challengeable on as few grounds as possible and that it would diminish confidence in, and willingness to rely upon, commercial paper if force and fear, even of this very extreme nature, were to invalidate bills of exchange as against holders in due course. We have reached no concluded view on what the attitude of the law should be towards bills of exchange signed as a result of coercion of such severity that the drawer's consent was totally lacking, and we invite comments on the matter.

¹Op. cit., p.414.

PART III

DEFECTIVE CONSENT OR VITIATION OF CONSENT

A. GENERAL

3.1. Error, fraud and vis ac metus (force and fear) are frequently referred to as "vices (or defects) of will or consent". More correctly, however, these are factors which vitiate consent. Consensual vice may be contrasted with the real vice (vitium reale) which attaches to moveables which have been stolen. Vitiating of consent may result from misapprehension, either self-induced or induced by another. Here the will is expressed without adequate appreciation of reality. Will or consent may also be vitiated when the declarant was subjected to threats or constraint, and consequently - though capable of choosing whether or not to declare his will - was not free to declare his will as he would have wished. In legal systems which have developed their laws on Obligations from the Romanistic or Civil Law, as has Scots law, the three principal grounds of vitiating of consent and, consequently, grounds for annulling obligation (and other legal acts such as wills, discharges and transfers of property) are force and fear (vis ac metus), fraud (dolus or fraus) and error. It is apparent, however, that all modern systems participating in this civilian tradition have extended the scope of consensual vice considerably beyond the limits of these categories as recognised in Roman law - which itself supplemented them with the concept of bona fides (good faith) in contracts. Very wide constructions have been given to the received categories in some systems or they have been supplemented with additional specific grounds, as well as - in some cases - with doctrines of good faith. English law and systems derived therefrom

have evolved complex rules regarding defective consent against the background of a dichotomy between Law and Equity - each providing a variety of nominate remedies different in scope and effect. In the 19th century, civilian authors (Pothier in particular) were relied upon in judicial development of the English law regarding mistake in particular, but such reliance has been condemned in modern times. Though the actual solutions of English law and of systems derived therefrom deserve careful comparative evaluation on their merits, the techniques by which these solutions are reached differ essentially from those of civilian systems, and failure to realise this has often resulted, as will appear in our analysis, in confusion and uncertainty as to the Scots law regarding vice of consent.

3.2. Since doctrines of error, fraud and force and fear are most frequently discussed in the context of contract law, the heading of this Part of our Memorandum refers to "vitiating of consent". However, voluntary obligations may be constituted by the unilateral declaration of will of the debtor, and in this context it is more appropriate to refer to vitiating of the will so declared. It might be thought that in most circumstances, though not necessarily in all, the consequences of vitiating of will or consent should be the same whenever, but for vitiating, the law would give effect to the legal act in question. Vitiating of will or consent may arise in inter vivos legal relationships other than voluntary obligations, e.g. in traditio (delivery) of moveables or in dispositions of immoveables. Moreover, vitiating of the will may exist when the will has been declared mortis causa as in testamentary provisions. Accordingly, we examine vitiating of consent primarily in contractual situations, but then consider whether and to what extent our proposed solutions should apply to juristic or legal acts other than contracts.

3.3. A vitium reale (real vice) attaches to the subject itself as in the case of stolen property - so affecting it as to make it incapable of acquisition even in good faith and for full value - much as if it were a res extra commercium i.e. a thing excluded from business dealing. Vice of consent does not have these consequences. Moreover, it is to be distinguished from lack of consent which precludes agreement altogether. In some situations misunderstanding or compulsion may exclude altogether the valid exercise of the will and exclude consent. In Memorandum No. 37¹ we discussed dissent, "pre-contractual frustration", defective communication and other categories often considered in the context of "error" (in the broadest sense) and sought to isolate the aspects which preclude actual constitution of obligation from those which merely vitiate consent. However, though identifying the problem, we did not in that Memorandum analyse the doctrine of vis ac metus (force and fear) so as to distinguish situations in which compulsion precluded the constitution of obligation from those in which the will is merely vitiated by threats. This problem we have faced in the present Memorandum. In Part II of this Memorandum we have sought to identify those factors which preclude the constitution of an obligation or other effective manifestation of will. In the present Part III we are concerned with those aspects of force and fear which justify annulment of a legal act.

3.4. This distinction between situations of absolute nullity where consent is altogether excluded and situations of relative nullity such as result from vice of consent

¹Constitution and Proof of Voluntary Obligations: Abortive Constitution.

requires us to consider the effect of such nullities on the rights and duties of third parties. Moreover, in some instances - e.g. of fraud or force and fear - the effect of the conduct of third parties upon a transaction to which they were strangers must also be examined. Systems which have developed their doctrines of vice of consent from the same Roman sources as has Scots law mainly consider problems of relative and absolute nullity in the context of enquiring who, apart from the declarant himself, e.g. creditors or the Revenue authorities, may invoke the nullity.¹ English law and legal systems ultimately derived therefrom, because of their consensualist approach to the transfer of property rights, are more concerned with whether third party acquirers asserting such rights are protected. Hence their concern with the distinction between "void" and "voidable" contracts - and with the effect of avoidance or rescission thereof.² It may be, however, that valid rights may be acquired

¹ A transaction may, of course, be annulled on grounds other than vice of consent, and creditors in bankruptcy, for example, may seek to annul obligations of a debtor as fraudulent in relation to them.

² Note on Terminology. Because the expression "void" is not infrequently used ambiguously by Scottish institutional writers; because the expression "voidable" in English law involves some subtleties of Equity jurisprudence not fully appreciated by Scots lawyers; and because it tends to focus attention on consensual transfer of rights, we intend to use the terms "void" and "voidable" only when discussing English doctrine. In a Scottish context we shall use the terms "null", "reducible" (where appropriate) and "annullable". By "relative nullity" we imply situations in which only a declarant or his representative or one of a class specially designated by law - e.g. a creditor - may rescind or demand annulment or reduction. By contrast, in situations of absolute nullity any person with an interest may assert the nullity or inexistence of an ostensible right - despite the objection of a declarant.

despite the nullity of a transaction by which a cedent to a transferee himself acquired. Though the law of Scotland may to some extent have been influenced by English doctrine, the Scots law of rescission for vice of consent differs from that of England.¹ However, the Scots law is not altogether clear, and clarification as well as reform seems expedient. A distinction may be made, as we noted in Memorandum No. 27,² between the effect of rescission for vice of consent (e.g. misrepresentation) as a remedy brevi manu of a contracting party, and its effect on third parties who have acquired rights in good faith. The scope of judicial action in the context of vitiation for defective consent and the procedure whereby judicial annulment may be obtained merit attention, and we discuss this matter in Part VI of this Memorandum.

3.5. The effect of rescission or annulment for vice of consent on third party rights is most severe when incorporeal moveable property or rights to payment arising from a ceded obligation are concerned. The latter have the qualities both of a claim and of an asset of the creditor. Though, on the principle resoluto iure dantis resolvitur ius accipientis, annulment of an obligation necessarily cancels all rights derived from it, rules of

¹ See e.g., G.H. Treitel, An Outline of the Law of Contract, pp. 95, 6: "The validity of a contract may be affected by mistake, or error as it is called in Scots law. The development of the rules on this topic has been so different in England and Scotland that it is impossible to present a more or less integrated account of English and Scots law Such a treatment might, indeed, in many cases lead the student of Scots law to the correct practical conclusion. But it would by no means always have this effect; and it would also fail to convey the reasons underlying the Scottish decisions."

² Para. 22.

property law intervene to protect the completed title of certain acquirers of heritage and corporeal moveables. The transferee of incorporeal property is not in general so protected nor is the assignee of an obligation - whose title may be challenged on grounds competent against his cedent. It may at least be questioned whether some greater protection should not be accorded to the onerous assignee of a right to claim moveables as contrasted with the transferee of the moveables themselves. The importance of incorporeal moveable property has increased significantly in modern times, and there may possibly be some justification for developing some rules for the protection of acquirers of patrimonial rights over moveable property generally.

3.6. Linked with questions of acquisition of rights by third parties is the rule that a party seeking to annul a transaction because of a vice of consent may be barred because restitutio in integrum has become impossible. Therefore under the present law annulment is barred when, for example, contractors have completed excavation or the subject matter of a defective agreement has been resold. Though the doctrine of restitutio in integrum is not applied too literally, especially in cases of fraud, and money may be awarded as a supplementary element in restitution, the present law regarding vitiation of consent would not in contractual situations permit money to be awarded as a surrogatum for restitution when restitution in forma specifica was altogether physically impossible - as, for example, situations where performance of an obligation to render services has been completed or an obligation to abstain from competition has run its course. Nevertheless the mala fide former possessor of corporeal moveables who cannot restore them to their owner is liable

for their value as a surrogatum for the property under the general law of restitution. We conclude that the law of Scotland regarding restitutio in integrum in this context merits re-examination, and undertake such examination in Part IV - which is concerned with restitution, an obediencial obligation, to be distinguished from voluntary obligations and other voluntary legal acts.

3.7. There has latterly been a tendency in Scots law to confuse and telescope - largely through the influence of English law - the function of certain aspects of vices of consent, in particular fraud, as grounds for reducing obligations with remedies in delict based on the same or similar facts. We are concerned in this Part of our Memorandum only with the effect of vice of consent upon the validity of voluntary obligations, transfers of rights and testamentary provisions. To introduce consideration of delictual remedies at the same time would only tend to confuse the discussion. Nevertheless having attempted to clear the ground regarding the effect of misrepresentation in the context of vitiation of consent we felt bound to consider subsequently in Part V delictual aspects of misrepresentation.

B. ERROR

General

3.8. In Memorandum No. 37¹ we have considered certain situations, often hitherto classified under the heading of error, which, in our view, preclude formation of obligation.

¹Constitution and Proof of Voluntary Obligations: Abortive Constitution.

These include dissensus (dissent, or absence of mutual consent regarding the essentials of an ostensible agreement) and "pre-contractual frustration" as a result of mistaken common assumption by contracting parties regarding some matter which both regard as essential to their obligation. Moreover, we considered in that Memorandum the consequences for the constitution of obligations of garbled transmission of communication. With these aspects of the law we are not concerned in the present Memorandum, but in our examination of the background of the present law regarding error as a ground of annulment there will necessarily be some overlap with the development of the law of "error" in the senses already considered by us elsewhere.

3.9. Though no two authors would agree in their treatment of the law of error in Scotland¹ and though there are irreconcilable decisions and judicial dicta in this chapter of the law, there would probably be unanimous agreement among practitioners and scholars alike that conflicting theories should be resolved and the law clarified. It might indeed be an excusable approach to ignore past development of the law of error and to offer for consideration a formulation of new solutions, independent of the present law - whatever that may be. However, we think that some examination of how the law has developed should precede recommendations for reform, since justification for such reform is implicit in that examination. Nevertheless, it

¹ See e.g. Gloag, Contract Ch. 26; J.J.Gow, Mercantile and Industrial Law of Scotland, p.52 et seq., "Mistake and Error" (1952) I.C.L.Q. 472, "Some Observations on Error" (1953) 65 Jur. Rev. 221, (1955) 66 Jur. Rev. 54; T.B.Smith, Short Commentary on the Law of Scotland p.808 et seq.; D.M.Walker, Principles of Scottish Private Law 2nd ed., Ch. 33; also W.W.McBryde, Void, Voidable, Illegal and Unenforceable Contracts in Scots Law (unpublished doctoral thesis, Glasgow, 1976) p.36 et seq., "A History of Error" 1977 Jur. Rev. 1.

is not our function, as it might be the function of a court or legal adviser to a client, to attempt reconciliation of apparently contradictory authorities, nor to predict what might be decided in an instant case under the present law. Nor would it be helpful to cite and analyse all possibly relevant authorities.

The development of the modern law

3.10. The institutional writers did not always distinguish between cases of error in the meaning of dissensus and cases where an objectively complete obligation may be annulled on grounds of error.¹ They did not distinguish clearly between dissensus, common error and unilateral error. Their use of the expression "void" is frequently ambiguous and where possible we ourselves shall not use the expressions "void" or "voidable" in our treatment except in quotations or when discussing English authority. However, the institutional writers are agreed that "essential error" or "error in substantialibus" is a ground either of nullity or for annulment of obligations. Their theory on error was consensual i.e. they were concerned with the subjective state of mind of those who purported to contract. They were writing, moreover, against a Romanistic legal background which recognised a doctrine of good faith in most contractual relationships (except "transaction" or compromise of a legal claim) and also made a vendor liable for latent defects - thus eliminating by anticipation many disputes regarding error as to the quality of the thing sold. A laxer commercial morality derived from English law has, however,

¹Stair, I.9.9; IV.40.24; Erskine, III.1.16; Bankton, I.343.67; I.409.6; I.470.63. Bell, Commentaries, I.313-314; Principles (4th ed.), note to sections 11-13.

been superimposed by the Sale of Goods Act 1893.¹ At common law real rights in corporeal property were not transferable by agreement, and the institutional writers did not confuse the effect of nullity on obligation with its effect on transfer of property rights. Indeed their discussion of error and most of the cases on error decided in Scotland are primarily concerned with the rights of the obligants, not of third parties.

3.11. By "essential error" or "error in substantialibus" the institutional writers² clearly had in mind the categories discussed in Roman law - particularly in connection with emptio venditio (sale).³ But only Bell⁴ attempted to classify these in detail, his classification being expressly approved by Lord Watson in Stewart v. Kennedy⁵:

"I concur ... as to the accuracy of the general doctrine laid down by Professor Bell ... to the effect that error in substantialis such as will invalidate consent given to a contract or obligation must be in relation to either (1) its subject matter; (2) the persons undertaking or to whom it is undertaken; (3) the price of consideration; (4) the quality of the thing engaged for, if expressly or tacitly essential; or (5) the nature of the contract or engagement supposed to be entered into. I believe that these five categories will be found to embrace all the forms of essential error"

¹See J.J.Gow op. cit., p.160 et seq.

²e.g. Stair, IV.40.21, 24 and 28; Bell, Principles (4th ed.), note to sections 11-14.

³D.18.1.9.

⁴Principles, para. 11.

⁵(1890) 17 R.(H.L.) 25 at pp.28-9.

3.12. The fourth of Bell's categories is of special interest. He was obviously influenced by Pothier, whose thought in the context was largely adopted in the French Code Civil. Pothier had written¹:

"Error annuls the contract not only when it is as to the thing itself but also when it is as to the quality of the thing which the parties had principally in mind and which constitutes the substance of the thing."

Bell's formulation discards the phrase underlined in Pothier's sentence, a phrase which has caused considerable trouble to French commentators² who have sought to broaden the interpretation of the code provisions to include the element of error in the motive of a party for contracting - possibly because express provision had not been made for cases of misrepresentation. The derivation of Bell's category seems ultimately traceable back to Grotius³ who considered that by the law of nature a promise had no force if the promisor had presumed a fact which did not exist. Pufendorf⁴ considered that the essentials of agreement included "those qualities of a thing which the contracting party had principally in mind" which Barbeyrac,⁵ translator of and commentator on

¹Traité des Obligations No. 18 (our translation); cf. French Civil Code, art. 1110.

²e.g. R. David, "La doctrine de l'erreur dans Pothier et son interpretation dans la Common Law d'Angleterre", Etudes de droit civil à la memoire de Henri Capitant", pp.145-58 (1939).

³De Jure Belli ac Pacis, II.11.6.2.

⁴See R. Feenstra, "The Dutch Kanthalos Case and the History of Error in Substantia" (1974) 48 Tul.L.R. 846 at pp.856-7.

⁵Quoted by Feenstra, sup. cit.

Pufendorf rendered as "the qualities of the thing which the parties had principally in mind". Pothier probably took over this statement and added to it. Bell rejected the addition, and provided a potential foundation for annulment of obligation if any quality which both parties recognised as essential (although not contracted for) was in fact lacking. This provided a degree of elasticity which could be relevant in some cases of non-fraudulent misrepresentation or non-disclosure, where the motive of one contracting party had been recognised by both.¹

3.13. Case law developed against the background of a consensual theory of error at least until the last decade of the 19th century. The matter is summarised by Dr McBryde² as follows:

"Thus it can be said that by the end of the eighteenth century Scots law recognised that an error in substantialibus could result in a contract being reduced even if the error was on the part of one contracting party and not induced by the other party. That proposition can be derived from Sword v. Sinclair³ and Riddell v. Grosset.⁴ It is consistent with Hepburn & Sommerville v. Campbell⁵ and Mags of Rutherglen v. Cullen⁶ which involved error on the part of both parties."

¹See Smith op. cit. p.823 et seq., and authorities there cited; also p.830.

²Op. cit., p.38.

³(1771) M.14241.

⁴(1791) 3 Paton 203.

⁵(1781) M.14168.

⁶(1773) 2 Paton 305. The facts of this case have perhaps particular interest. A contract for building a bridge was not enforced when there was found to be an error on the part of both contracting parties as to the nature of foundations required for the bridge. The portion of the contract price which had been paid was to be repaid and the builders were entitled to remove the materials already used.

It also derives support from such 19th century cases as Purdon v. Rowat's Trs.¹ and Steuart's Trs. v. Hart.² We shall in due course express reasons for doubting whether in modern conditions an unqualified consensualist approach to error as a vice of consent is acceptable, but we do not doubt that this was in fact the basis of decision in decided cases and has not been conclusively discarded. To quote Dr McBryde again³:

"Some objections may be raised to giving effect to unilateral error which do not apply in cases of bilateral error. The party in error may be in error as a result of his own carelessness. Should that have any effect? A theory of error based on consensus would suggest not. In Sword v. Sinclair the unilateral error was caused by a principal's mistake. An action on the contract failed against both the principal and the agent who contracted on his behalf. If the other party is aware of the error, does that have any effect? Again in a theory based on consensus this should be irrelevant. Either there is essential error or there is not However, in Steuart's Trs. v. Hart the sellers of ground were under unilateral essential error as to the amount of feu duty. The sale and subsequent disposition were reduced, but the Court were much influenced by the fact that the defenders knew of and took advantage of the seller's error."⁴

Error in law has, however, been considered somewhat differently. If it has been shared by both parties to a contract or induced by one of them it can constitute a ground for reduction of contract, but unilateral uninduced errors of law might but would not normally suffice.⁵

¹(1856) 19 D.206.

²(1875) 3 R.192.

³Op. cit., p.41. However, as the author makes clear in a footnote, in civilian terms the error must be both essential and real and reasonable (iustus error). See also Smith op. cit., pp.818-9; and per Lord Dunpark in Steel v. Bradley Homes (Scotland) Ltd. 1972 S.C. 48.

⁴It may be stressed that, in this case, the contract was reduced on terms which the court considered equitable.

⁵e.g. Scrabster Harbour Trs. v. Sinclair (1864) 2 M.884 per Lord Kinloch at p.887; Kippen v. Kippen's Trs. (1874) 1 R.1171 per Lord Justice-Clerk Moncreiff at p.1179.

3.14. Not until the end of the 19th century did Scots law entertain a doctrine that - fraud apart - an obligation could be reduced because of error caused by misrepresentation unless that error fell within the categories of essential error as specified by Bell. Non-fraudulent misrepresentations of one party might, of course, be relevant evidence as to the state of mind of the errans. In Oliver v. Suttie¹ the Lord Ordinary considered that there was "no room or authority or sound principle for any mid plea between fraud and unintentional error." However, the possible relationship between essential error and non-fraudulent misrepresentation was recognised, e.g. by Lord Kinloch in Wilson v. Caledonian Ry Co., when he stated²:

"Essential error is a well established ground of reduction. It is properly connected with misrepresentation, in the case of an onerous contract, in which both parties are not said to have been deceived, but one to have misled the other."

Misrepresentation evolved as an aspect of essential error. In Woods v. Tulloch³ the four judges of the First Division upheld Lord Kyllachy's opinion that, since the averments relating to error in quality of the subjects did not amount to essential error, the action for reduction of a contract allegedly induced by the seller's misrepresentation must fail. To be relevant non-fraudulent misrepresentation must induce

¹(1840) 2 D.514 at p.516.

²(1860) 22 D.1408 at p.1410; see also Couston v. Miller (1862) 24 D.607 Hogg v. Campbell (1864) 2 M.848.

³(1893) 20 R.477. It is perhaps somewhat surprising that the error averred in this case was not regarded as essential. The estate of 125 acres had been represented as comprising 132; and the rental represented to amount to £157 amounted to only £120.10s.

essential error: it had no effect otherwise. Though this view cannot be harmonised with later dicta and legal writing, the decision itself has never been overruled.

3.15. The House of Lords decisions in Stewart v. Kennedy¹ in 1890 and Menzies v. Menzies² in 1893 constitute a watershed in the development of the Scots law of error, and it is by no means clear where the new channels of development have led. Stewart had signed an offer to sell an entailed estate to Kennedy "subject to the ratification of the Court", and this offer had been accepted. Stewart had contemplated that under the missives he was bound to proceed under the Entail Act 1882. The Court held, however, that the phrase "subject to the ratification of the Court" must apply to a sale under the Entail Amendment Act 1853. Under this Act, the consent of the next heir of entail, who had objected to the sale, could be dispensed with on payment of the value of his interest. Stewart, who had not realised that the sale was subject to this monetary burden, brought an action for reduction of the missives on a number of grounds. He was in effect alleging unilateral essential error as to the meaning of a deed - a ground which the courts would not readily recognise as a ground for reduction. The Lord Ordinary refused issues on error - "But a contract deliberately executed in the terms which the parties intended cannot be set aside on the ground that one of them misunderstood its legal effect." The First Division, Lord Shand dissenting, adhered. Lord President Inglis and two other judges held that there was no essential error, and moreover took the view that a contract cannot be reduced

¹ (1890) 17 R. (H.L.) 25.

² (1893) 20 R. (H.L.) 108.

because one party misconstrued its terms. Lord Shand, however, preferred the subjective approach rather than the more objective approach favoured by the majority. He thought that there had been no consensus in idem in essentialibus. One party thought that the sale was subject to a suspensive condition, while the other thought that the only condition was potestative. While one party thought that the price was subject to reconsideration by the Court, the other considered that it was fixed by the missives.

3.16. In the House of Lords, Lord Herschell thought that there was in fact error as to the price, but approved of the Lord President's view that it would be dangerous to allow a person to challenge his contract on the ground that he had misconstrued it. In his speech he said of the authorities that¹

"it was always considered essential that the error which was said to be taken advantage of by one party to reduce the contract should have been induced by the other party to it."

It may be doubted whether the authorities justified that conclusion.² Lord Watson's speech was of special importance. Having expressed approval of Bell's five categories of essential error which either per se or when induced give a right to reduce he commented³:

¹At p.27.

²See in particular Purdon v. Rowats Trs. (1856) 19 D.206 at p.222; McLaurin v. Stafford (1875) 3 R.265; Steuart's Trs. v. Hart (1875) 3 R.192. The respondent's own argument seems to have recognised that "In old cases essential error induced by representation has been tried under the issue of essential error, but it would not be now". 15 App. Cas. 108 at p.115.

³At p.29.

"Without venturing to affirm that there can be no exceptions to the rule, I think it may be safely said that in the case of onerous contracts reduced to writing the erroneous belief of one of the contracting parties in regard to the nature of the obligations which he has undertaken will not be sufficient to give him the right [to reduce], unless such belief has been induced by the representations, fraudulent or not, of the other party to the contract."

Dr McBryde's comment and analysis may be quoted¹:

"This is unexceptionable if it is taken with its qualifications, namely (1) there may be exceptions, (2) the dictum applies to onerous contracts, (3) it applies to contracts reduced to writing and (4) the error is by one party as to the nature of the obligation. As will be seen, the second qualification has been given effect to, but the others, of which the most important is the fourth, generally have been ignored. The importance of the fourth qualification is seen from the subsequent parts of Lord Watson's speech. He thought, following Lord Shand and contrary to the majority of the First Division, that the pursuer's error was error in the substantial but ... such error was not a ground for annulling the contract because this would 'destroy the security of written engagements'. The parties to a contract were bound by the interpretation which a Court placed on the contract. Such error induced by the other party was, however, a relevant ground of reduction."

The House of Lords accordingly allowed to the pursuer his issue of essential error induced by the defender's agent. Though Lord Watson apparently considered that essential error per se was a ground for reduction (but not in the circumstances of the particular case) his speech, read with Lord Herschell's dictum, was capable of the construction that in circumstances other than fraud a general distinction was to be drawn between the effect of induced and non-induced error.

¹Op. cit., pp.51-2.

3.17. This trend was developed further by Lord Watson's speech in Menzies v. Menzies.¹ This was an action for reduction of an agreement to disentail. One of the grounds of reduction was the pursuer's ignorance (induced by the defender's law agent) of his power to raise money on his spes successionis. Lord Watson held the averments relevant and observed²:

"Error becomes essential whenever it is shewn that but for it one of the parties would have declined to contract. He cannot rescind unless his error was induced by the representations of the other contracting party, or of his agent, made in the course of negotiation, and with reference to the subject matter of the contract. If his error is proved to have been so induced the fact that the misleading representations were made in good faith affords no defence against the remedy of rescission. This principle has been recently affirmed by the House in Adam v. Newbigging (1888) L.R. 13 App. Cas. 308; Stewart v. Kennedy (1890) L.R. 15 App. Cas. 108, 17 R. (H.L.) 25 - a Scotch case; and in Evans v. Newfoundland Bank decided this week."

This dictum was, in McBryde's phrase³:

"potential dynamite. Firstly, it was expressed in wide terms which lay it open to the criticisms of a similar expression of Lord Herschell in Stewart v. Kennedy. If it were to be treated as a general principle it would destroy the law on unilateral essential error and, indeed, it was inconsistent with Lord Watson's speech in Stewart. Secondly, it can be read as incorporating into Scots law the English doctrine of innocent misrepresentation. To speak of Adam v. Newbigging and Stewart v. Kennedy in the same breath was to cause a confusion which is still with us."

¹(1893) 20 R. (H.L.) 108.

²At p.142. . . .

³Op. cit. p.54.

3.18. At common law in England non-fraudulent misrepresentation was formerly relevant only if it became a term of the contract, and the common law of mistake was close to the Roman law as stated in the Digest.¹ In Equity, however, rescission was granted if a contracting party could establish that there had been misrepresentation of some material fact and that he had contracted relying on the misrepresentation. After the Judicature Act 1873 rescission could be granted at common law. However, the remedy of rescission was not an aspect of the law of mistake. Nevertheless in Menzies Lord Watson would seem to have amalgamated a reference to "essential error" (with a very different meaning from that expressed in Stewart v. Kennedy) with the English equitable remedy of rescission. Considerable confusion has resulted. First, it has been asserted that essential error is not relevant unless induced or shared by the parties. Most of the relevant authorities for this view are considered by Lord Dunpark in Steel v. Bradley Homes (Scotland) Ltd.² - but it has been recognised that Lord Watson did not state so absolute a rule.³ Secondly, it has been suggested that essential error has an effect on gratuitous obligations different from that which it has on onerous transactions. Though it may well be justifiable to grant reduction of a gratuitous transaction on grounds of uninduced essential error, it does not follow

¹ See e.g., Kennedy v. Panama etc. Mail Co. (1867) L.R. 2 Q.B. 580 per Blackburn J. at pp.587-8.

² 1972 S.C. 48.

³ See e.g., Ellis v. Lochgelly Iron & Coal Co. 1909 S.C. 1278 esp. per Lord President Dunedin at p.1282; Smith, op. cit. p.812 et seq. Steuarts Tr. v. Hart (1875) 3 R. 192, though doubted by some commentators was referred to without disapproval in the House of Lords in Anderson v. Lambie 1954 S.C. (H.L.) 43.

even from Lord Watson's dicta that the remedy should be refused in all onerous transactions. Recent dicta tend, however, to state the dichotomy between gratuitous and onerous obligations without qualification.¹ Thirdly - by contrast with the standards stated in Woods v. Tulloch² - it seems to be accepted that when there has been non-fraudulent misrepresentation "error becomes essential whenever it is shewn that but for it one of the parties would have declined to contract."³ There is therefore in this regard no distinction to be made between fraudulent and non-fraudulent misrepresentation. In Westville Shipping Co. v. Abram Steamship Co.⁴ and in Ritchie v. Glass,⁵ for example, it was recognised that the meaning of "essential error" in Bell's sense was very different from that of Lord Watson in Menzies. Lord Carmont, who decided Ritchie v. Glass in the Outer House, ventured to doubt the soundness of Woods v. Tulloch, yet it has not been without influence on judicial thinking in the 20th century.

¹ See e.g., McCaig's Tr. v. University of Glasgow (1904) 6 F. 918; Hunter v. Bradford Property Trust Ltd. 1970 S.L.T. 173 esp. at pp. 177, 181 and 184.

² (1893) 20 R. 477.

³ Menzies v. Menzies (1893) 20 R. (H.L.) 108 at p.142.

⁴ 1922 S.C. 571 per Lord President Clyde at p.579.

⁵ 1936 S.L.T. 591; see also McCulloch v. McCulloch 1950 S.L.T. (Notes) 29.

3.19. Among text writers Professors Gloag¹ and Walker² clearly accept the doctrine of a discrete category of innocent or negligent misrepresentation derived from English law. Gow³ does not. Smith⁴ considers that Lord Watson's reference in Menzies to "essential" error was per incuriam, and that though the classic formulations of the doctrine of so called "innocent misrepresentation" in the English cases of Redgrave v. Hurd and Adam v. Newbigging have influenced Scottish doctrines regarding reduction for error in motive induced by misrepresentation, the Scottish rules seem to have evolved independently. It is entirely consistent with Scottish legal principles that no man should have the assistance of a court of law to insist on a contract which he has secured by misrepresentation. In Mair v. Rio Grande Rubber Estates⁵ Lord Shaw uttered a dictum which represents an attitude latent in the older common law of Scotland:

"Fraud is not far away from - nay, indeed, it must be that it accompanies - a case of any defendant holding a plaintiff to a bargain which has been induced by representations which were untrue; for it is contrary to good faith and it partakes of fraud to hold a person to a contract induced by an untruth for which you yourself stand responsible."

3.20. It can scarcely be questioned that the present state of the Scots law on error is unsatisfactory. The basic terminology is confused; different doctrines of uncertain origin combine or conflict. A return to an unqualified consensual theory would be impracticable in modern conditions,

¹Contract, p.471.

²Principles, (2nd ed.) pp.592, 1147.

³e.g., Mercantile and Industrial Law of Scotland, pp.58-60.

⁴Op. cit., p.829 et seq.

⁵1913 S.C.(H.L.) 74 at p.82.

since it would be productive of uncertainty in commercial and private dealings. However, it may be that this theory can be more easily justified in cases where there has not been actual reliance by a party to or beneficiary under a transaction in which the grantor had laboured under unilateral uninduced error. Moreover, it may be thought that the law should take account of whether or not error had been caused or induced by a contractant. It may also be questioned whether it is necessary to have two standards of error and whether error in motive can always realistically be distinguished from error in essentialibus. It may be helpful, therefore, to consider comparatively the solutions of other legal systems and current proposals for reform.

The comparative context

3.21. In their highly regarded work on comparative law Einführung in die Rechtsvergleichung¹ Professors Zweigert and Kötz open their section on Mistake, Deceit, Duress as follows:

"Not every error entitles a promisor to evade the consequences of his promise. On this all legal systems are agreed. Equally there is no doubt that in exceptional circumstances a promisor who has made a mistake may be able to shift its consequences to the other party, even at the cost of frustrating the other party's reliance on the validity of the promise. Where the dividing line is to be drawn between errors of which the law will take account and those which it will disregard is a question as old as it is controverted."

¹Vol. II, p 82, translated by J.A.Weir as An Introduction to Comparative Law, published in 1977 by the North-Holland Publishing Co., Amsterdam. Much of the material for this comparative survey is based on that work and on the comparative study prepared by the Max-Planck Institut for UNIDROIT, Les Conditions de Validité au Fond des Contrats de Vente (1964) U.D.P. 1963 - Etudes - XVI/B Validité - Contrats de Vente - Doc..1, reprinted in Unification of Law, UNIDROIT year-book 1966, pp.175-410.

3.22. German law. German law in B.G.B. art. 119 makes a distinction between error in the transaction,¹ which is relevant, and error in motive,² which normally is not, though by art. 119 para. 2, as interpreted in case law, annulment is granted for errors of motive if they concern qualities of a person or thing "which are normally regarded as essential". German law adopts an extreme consensual approach to error, ignoring the question whether the promisor was at fault in being mistaken and whether the mistake was ascertainable by the other party or caused by him. However, adjustment of relations between the parties is a condition and consequence of annulment of obligation, German law giving to a promisee a claim for the loss which he has sustained in reliance on the obligation which has been annulled (B.G.B. art. 122).

3.23. Swiss law. Swiss law too by Obligationenrecht arts. 23 and 24 distinguishes between error of motive and error of transaction and goes on to provide that only essential error may be taken into account. Error in motive in general is not regarded as essential. The categories of essential error comprise error regarding the nature of the transaction, error as to the identity of the other party and error as to the object of the contract - and also error if it concerns the quantity to be provided under the contract or a particular feature of the contract "which the mistaken party, in accordance with good faith and normal commercial practice regarded as a necessary foundation for the contract". The last of these categories, fundamental error (Grundlagenirrtum) is the most important, being treated as an error of motive

¹Where a party's declaration does not accurately reflect his intention, and he consequently finds himself party to an obligation with a content other than what he intended.

²Where declaration and intention correspond, but the intention itself is based upon an erroneous appreciation of the facts.

which, by way of exception from the general rule, is taken into account. For an error to be fundamental a subjective and objective element must concur: the errans must have regarded the misconceived fact as the necessary basis for the transaction and it must be one which businessmen would normally so regard. The courts in this connection may consider which party should bear the risk of error and whether the error should have been known to the other party. Only when the errans has behaved negligently is he obliged to indemnify the other on annulment, usually on the basis of culpa in contrahendo, i.e. compensation for actual loss - as contrasted with loss of profit - or for the negative interest.

3.24. Austrian law. In Austrian law an error in the reasons for contracting is in principle irrelevant (A.B.G.B. art. 901 sent. 2) and error is treated as relevant only if it "concerns the principal object or an essential attribute of that to which the intention of the declaration was principally directed and expressed" (A.B.G.B. art. 871). Even so, however, the errans cannot claim annulment unless he can prove one of three facts: (1) that the other party caused the error; or (2) that the error must have been apparent to the other party in all the circumstances; or (3) that the error was notified to the other party timeously, i.e. before that other had acted in reliance on the obligation, as by incurring expense in connection with performance or reselling or hiring an article acquired under the contract. A party may be held to have "caused" the other's error even though he has behaved neither deliberately nor negligently.

Any behaviour which causes error will suffice, including silence if a contracting party should have informed the other that assumptions which he would normally make about certain facts relating to the transaction, e.g. solid construction, were in fact erroneous. The courts have, moreover, extended the meaning of error being "apparent to the other party" to include situations where he would have known had he exercised normal care. By contrast with German law, which compensates a party for loss suffered in reliance on an obligation which is later annulled for error, Austrian law gives no such compensation. This is because in the relatively rare cases where annulment is competent either the promisee has suffered no significant reliance damage (because notified timeously) or deserves no special protection because he was either responsible for causing the error or for not being aware of it.

3.25. French law. Error as a vice of consent (as contrasted with erreur obstacle) is regulated by Art. 1110 of the Code Civil, which is substantially based on Pothier's formulation. Error as to the person is a ground for annulment only in the case of transactions where the personality of the co-contractant was a determining consideration. The main provision, however, is:

"Error is a cause of nullity of agreement only when it is as to the very substance of the thing which is the object of agreement".

As we noted¹ when discussing Bell's fourth category, he rejected Pothier's addition of the words "which constitutes the substance of the thing." However, Pothier's addition

¹Supra, para. 3.12.

was apparently incorporated in the Code article. Nevertheless it has not in practice been construed¹ to mean "the material of which the thing is made". Carbonnier² writes:

"The substance is not the material of which the object of the contract is made It is the substantive quality, essential of the thing, the quality which determined the party to contract and which was for him the compelling and determinant reason for contracting. There are errors regarding material which are not errors as to the substance Conversely there are errors as to the substance which do not imply errors as to the material Generally such error is unilateral It is not necessary that it should have been common to both contracting parties."

Error constitutes the determining motive and justifies annulment if the errans would not have concluded the contract but for the mistake; it is not sufficient that he would have concluded it on different terms. Though it is accepted that the error must be as to a "qualité substantielle", there is little uniformity in analysing this concept, and it cannot be easy to predict how the Cour de Cassation would determine a specific case.

3.26. Netherlands law (current and proposals for reform)³ The present Dutch Civil Code, art. 1358, is a translation into Nederlands of art. 1110 of the French Civil Code; but it has been interpreted almost beyond

¹ See e.g., J. Carbonnier, Droit Civil, vol. II Les Obligations, pp. 348-9.

² Our translation.

³ R. Feenstra, "The Dutch Kantharos Case and the History of Error in Substantia" (1974) 48 Tul. L.R. 846; also unpublished paper by Dr. Fokkema, Professor of Comparative Law in the University of Leiden kindly supplied by the author.

recognition. However, by contrast with developments in France, where a subjective or "will" theory has influenced interpretation, the Courts of the Netherlands have attached more importance to the factor of reliance. Dr. Fokkema notes that the Netherlands Supreme Court has tried to develop a series of guiding rules for annulment as follows:

1. The error must concern facts and circumstances (which may be extrinsic to the object of the contract) regarded as essential by the party in error - in the sense that he would not, or would not on the same terms, have entered into the contract if he had not erred.
2. The other party to the contract must have been in a position to know at the time of contracting that the facts or circumstances were essential to the errans in the sense explained.
3. By the nature of the contract the risk of error must not have been upon the errans.
4. (a) A person contemplating a contract is under a duty vis-à-vis the other to take steps-within reasonable limits - to avoid giving his consent on the basis of incorrect assumptions. Where such steps are not taken, the principle of bona fides may bar the errans from claiming annulment.
(b) This duty to the other party does not go so far as to imply that one is not justified in relying on the accuracy of information given by that party. Indeed it is contrary to good faith to assert that the errans should not have relied on information supplied by his co-contractant. Thus error based on misrepresentation justifies annulment.
(c) It is also inconsistent with good faith to assert that the errans is responsible for his own error when the co-contractant ought to have supplied him with some information to prevent him from forming a mistaken idea on the matter in question.
5. Error regarding future events is ineffective in itself, but it may be relevant when, as is often the case, it is the consequence of past or present circumstances.
6. Error of law may justify annulment.

However, a new Dutch Civil Code is in the process of preparation and enactment. The late Professor E.M.Meijers (who was, until his death, entrusted with preparing the new Code) made certain proposals, but these have subsequently been varied in Draft Bills for Reform of the Civil Code which were presented in 1971 and 1976. Significantly, both Meijers and the authors of the recent Bills are agreed that, though rules regarding fraud, coercion and abuse of circumstances can be applied uniformly to all juristic (legal) acts in the field of patrimonial rights, it would be unwise to generalise the rules on error. They deal with these separately in the context of contracts, partition and wills.

3.27. The Meijers Draft contained two articles, 6.5.2.11 and 12. The former of these dealt with two situations in which the error is in effect imputed to the co-contractant, i.e. misrepresentation, and cases where the co-contractant was aware at the time of contracting that the mistaken party was labouring under error and that, but for such error, he would not have entered into the contract or, at least, not on the same terms. The latter article, which did not refer to error as such, provided a second ground for annulment, namely when the contract was based on a supposition of such importance that the co-contractant could not reasonably be entitled to hold the other to his contract if the supposition turned out to be false. (This is a development of the German doctrine of "subjective fundamental condition", subjektive Geschäftsgrundlage).

3.28. The Revised Bill of 1976 (see the Appendix to this Memorandum) sets out somewhat different proposals. The new art. 6.5.2.11 would recognise error as justifying annulment in cases where a contract has been made under the influence of error and, but for this, would not have been made in these terms:

- (a) if the error was due to information supplied by the co-contractant;
- (b) if the co-contractant, on the basis of what he knew or should have known about the misunderstanding of the errans, should have supplied information to correct the error;
- (c) (subject to qualification) if the co-contractant had acted on the same erroneous assumption as the errans.

Such annulment cannot be founded on error which concerns future circumstances exclusively, or when it would normally be assumed that the risk of error should rest on the errans. Article 6.5.2.12 provides for annulment of a contract purporting to be founded on a pre-existing legal relationship if in fact that relationship is lacking, while 6.5.2.12a provides that the right to annul under the preceding articles lapses if the co-contractant promptly proposes a modification of the contract which would offset the loss which the errans would otherwise sustain. Moreover, the court in its discretion may modify a contract affected by error instead of annulling.

3.29. It will be apparent that both the Meijers draft and the 1976 draft retain rules 1, 3 and 5 as formulated by the Netherlands Supreme Court (Hoge Raad).¹ Moreover, the proposed provisions are to be applied by way of analogy to other bilateral and multilateral juristic (legal) acts so far as is consistent with the nature of such acts, and may also be applied by the courts by way of analogy in connection with other juristic acts (e.g. unilateral acts).

¹ See para. 3.26, supra.

3.30. Italian law. The rules of the Codice Civile (of 1942) arts. 1427 - 1433 have been influenced by Austrian and Swiss Law as well as by decisions of the French Courts. They reject the notion of error in a party's motive for contracting as sufficient per se to justify annulment, and take account of error only if it is essential in terms of art. 1429 and if the co-contractant could have been aware of such error. A mistake is essential if it concerns the nature or object of a contract, or the identity or qualities of the subject matter of the contract or of the other party, provided that they were factors determining the decision to contract, either objectively or in the circumstances of the case. An error of law is regarded as essential if it was the only or principal reason for entering into the contract. Moreover, a party seeking annulment must show that the error would have been apparent to the co-contractant if he had exercised reasonable care. Thus it has been held that if a picture bought as a real Picasso turns out to be a forgery, the purchaser could only rescind if the vendor could have known that it was a forgery. Since the vendor was himself a painter, it was held that in the circumstances he could and should have been aware of the forgery.

3.31. Quebec (proposals for reform)¹. The Committee dealing with Obligations for the Commission for the Reform of the Quebec Civil Code propose certain draft articles and comment thereon. Article 29 provides:

"Consent must be free and enlightened. No consent is valid if given by a person who, when giving it, is deprived of discernment".

¹Civil Code Revision Office Report on Obligations No. XXX (1975), art. 29.

Article 30 specifies that "Consent may be vitiated by error, fear or lesion". The comment explains that fraud itself is not a defect of consent, since consent is affected only by errors arising from fraud. It is thus dealt with under the general heading of error, either simple or induced by fraud. Article 31 reads:

"Error vitiates consent if it bears on the nature of the contract, the identity of the thing which is the object of the contract, or any principal consideration of the contract."

The Comments explain inter alia:

"Simple error vitiates consent in the three cases indicated here, namely where it bears on the nature of the contract, the identity of the object, or a principal consideration for the commitment. The Committee did not consider it necessary to repeat the error bearing on substance ... because jurisprudence has covered under this heading errors bearing on the identity of the thing and errors bearing on the principal consideration of the commitment, as the case may be.¹ The omission in the text of any reference to error with regard to the economic value of payments is intentional. In contemporary positive law, such an error is not regarded as a defect of consent."

Article 32 states:

"Any error induced by the fraud of a contracting party vitiates consent whenever, but for such error, the other party would not have contracted. Any fraud committed by a third person is deemed committed by the contracting party if he was or should have been aware of it."

The Comments explain that:

"Where error is induced by fraud, the type or extent of the error is unimportant as long as it has a determining effect on the consent."

¹ Compare discussion of this point in the context of French and Netherlands law supra, paras. 3.25 - 3.29.

Article 33 provides: "Fraud may result from silence or from concealment". However, the Comments express the view that in principle mere silence and concealment do not constitute fraud - though in certain circumstances, as case law has indicated, they may. At this stage we may note that the proposed Quebec solution goes considerably less far in protecting an errans than do other modern proposals, e.g. in the context of non-fraudulent misrepresentation and taciturnity with regard to the probable misunderstanding of the other contracting party.

3.32. Anglo-American solutions. Zweigert and Kötz in dealing with mistake in their comparative law treatise observe at the start of their discussion of English and American law:¹

"The doctrine of mistake in the law of England and the United States is rather complex. The first striking feature about the Common law is that, unlike continental systems, it makes a separate category of those cases where the mistake is caused by an inaccurate statement or misrepresentation by the other party. If the other party made the misstatement with the deliberate intention of misleading or deceiving, this is a fraudulent misrepresentation, which entitles the mistaken party to the contract to rescind the contract and claim damages, but even if the other party was in perfect good faith, that is it was an innocent misrepresentation, the mistaken party may still rescind if he acts quickly enough."

There then follows a discussion of the effect of the Misrepresentation Act 1967..

¹Op. cit., vol. II, sec. 8 IV.

3.33. English law. Various interpretations of the English law on mistake and misrepresentation are found, for example in the leading treatises by inter alia Atiyah and the editors of Cheshire and Fifoot, and Anson on Contract. As we noted in our Memorandum No. 37:¹

"The division of opinion in the Court of Appeal in Magee v. Pennine Insurance Co.² still leaves it to some extent uncertain how far equity has superseded the English common law in the field of mistake affecting formation of contract."

We cannot be more confident regarding the relation between law and equity in the context of rescission, but believe that there is fairly considerable support for the view expressed by Denning L.J. in F.E.Rose Ltd. v. W.H.Pim Ltd.³:

"Once the contract is outwardly complete, the contract is good unless or until it is set aside for the failure of some condition on which the contract depends, or for fraud, or on some equitable ground."

The dichotomy between law and equity and the delineation of their respective spheres and the interaction of their remedies would make it impracticable for any national law without such a tradition to seek a model for reform in the English system. The justice of some of the results achieved may, however, sometimes provide helpful indications. No lawyer who does not work within that system could venture to conjecture what the Master of the Rolls might include within the expression "some equitable ground". It seems to have affinities with, though not to be identical with, a general doctrine of good faith such as is recognised in continental systems and is, to some extent, a doctrine of Scots law.

¹ Para. 8. See also paras. 6-9 for discussion of the English law regarding mistake.

² [1969] 2 Q.B. 507.

³ [1953] 2 Q.B. 450 at p.460.

3.34. Zweigert and Kötz observe¹:

"By 'mistake' the Common Law means only such errors as are not caused by misstatements. In this area the doctrine of error in English law is particularly complex because the Common Law courts and the Equity courts treated cases of mistake differently and these divergent views still coexist in judicial decision and legal writing The Courts of Equity were rather readier than the Courts of Law to take account of mistakes More recently there has been a tendency to extend the devices which were developed 'in equity'.... It remains true, however, that it is only in the rarest cases that even the Courts of Equity will rescind a contract on the ground of a mere unilateral mistake not caused by the other party."

3.35. The law in the United States. These authors go on to compare the situation in the United States²:

"American law has an equally strong tendency to limit the cases where contracts may be avoided for error, but it does not make all the fine and sometimes strained distinctions of English law So far as can be seen, American courts which have to decide cases involving mistake are ready to entertain all the considerations which can reasonably be adduced in this context. The veniality of the error of the mistaken party, whether the other party should have realised it, the extent to which the other party had acted or acted reasonably in reliance on the mistaken party's promise, the possibility of resuming the status quo ante - all these circumstances play a part in proportion to their importance in cases of the type before the Court."

They note that the view that unilateral mistake is in principle without effect is losing ground in the United States.

¹Op. cit., vol. II, pp.89,90 .

²Loc. cit.

3.36. Since the publication of Zweigert and Kötz's book, the American Law Institute in 1975 has circulated for discussion its Tentative Draft No. 10 on Chapter 12, Mistake, for the Restatement (Second) of the Law of Contracts. It is concerned only with the relevance of "mistake" in the context of annulment or avoidance, and not with problems concerning the formation of contract. The Introductory Note to the tentative draft comments:

"The law of contracts supports the finality of transactions lest justifiable expectations be disappointed. This Chapter deals with exceptional situations in which the law departs from this policy favoring finality and allows either avoidance or reformation on the ground of mistake. As s.293 makes clear, the word 'mistake' is here used to refer to a belief that is not in accord with existing facts."

The comment on section 293 notes that:

"Facts include law. The rules stated in this Chapter do not draw the distinction that is sometimes made between 'fact' and 'law'. They treat the law in existence at the time of the making of the contract as part of the total state of facts at that time."

3.37. Under section 294 of the Draft, mistake by both parties makes a contract voidable if three conditions are met. First, the mistake must relate to a basic assumption on which the contract was made; secondly, the party seeking avoidance must show that the mistake has a material effect on the agreed exchange of performances; and thirdly, the mistake must not be one as to which the party seeking relief bears the risk. The expression "basic assumption" has the same meaning as in Chapter 11 in connection with "impracticability" and "frustration".

3.38. "Voidability", because of mistake by one party only, is regulated by section 295, which may be quoted in full:

"Where a mistake of one party at the time a contract was made as to a basic assumption on which he made the contract has a material effect on the agreed exchange of performances that is adverse to him, the contract is voidable by that party if he does not bear the risk of mistake under the rule stated in s.296 and

- (a) the effect of the mistake is such that enforcement of the contract would be unconscionable, or
- (b) the other party had reason to know of the mistake or his fault caused the mistake."

3.39. Section 296, which deals with when a party bears the risk of mistake, is in the following terms:

"A party bears the risk of a mistake when

- (a) it is allocated to him by agreement of the parties, or
- (b) he is aware, at the time the contract is made, that he has only limited knowledge with respect to the facts to which the mistake relates, but treats his limited knowledge as sufficient, or
- (c) it is allocated to him by a term supplied by the court on the ground that it is reasonable in the circumstances to do so."

3.40. The Comment to s.295 stresses that, in order for a party to have the power to avoid a contract for a mistake that he alone made, he must at least meet the same requirements that he would have had to meet had both parties been mistaken. In addition, he must show that to enforce the contract would be unconscionable. The reason for requiring this additional element when one party alone seeks avoidance is that avoidance will more clearly

disappoint the co-contractant than if he too had been mistaken. It is envisaged that the standard of "unconscionability" should be similar to that taken into account in considering the terms of a contract at the time of formation:

"The mistaken party bears the substantial burden of establishing unconscionability and must ordinarily show, not only the position he would have been in had the facts been as he believed them to be, but also the position in which he finds himself as a result of his mistake. For example, in the typical case of a mistake as to the price in a bid, the [bidder] must show the profit or loss that will result if he is required to perform, as well as the profit that he would have made had there been no mistake."

Lastly in this context, we note section 299 on the effect of the fault of the party seeking relief:

"A mistaken party's fault in failing to know or discover the facts before making the contract does not bar him from avoidance or reformation under the rules stated in this Chapter, unless his fault amounts to a failure to act in good faith and in accordance with reasonable standards of fair dealing."

3.41. Israeli law. The legal system of Israel is, like those of Scotland and Quebec, a "mixed system" drawing upon Anglo-American and Continental civilian sources, and these latter are in the ascendant in contemporary developments in contract law. Recently Israel has enacted several comprehensive statutes in the field of contract law which reflect extensive comparative research and appreciation of modern economic conditions. In the Contracts (General Part) Law 1973 the English law of mistake is replaced by new provisions reflecting modern European thinking¹ on error.

¹See in particular Gabriela Shalev and Shael Herman "A Source Study of Israel's Contract Codification" (1975) 35 Louisiana L.R. 1091.

Underlying the specific provisions with regard to "mistake" the General Law by s.12 introduces the general doctrine of good faith: "In negotiating a contract, a person shall act in a customary manner and in good faith." As Dr Shalev and Professor Herman explain:¹

"Many factual situations covered by section 12 can trigger other provisions of the law. For example, a contract negotiated in bad faith can result from mistake or misrepresentation; In what area, then, does section 12 function? The section can operate as an alternative or supplementary basis for relief. Because the defects in contract formation enumerated in Chapter Two of the General Law allow only the limited remedy of rescission, a party may rely upon section 12 if he wants damages, not rescission. Or section 12 may supplement another section, thereby allowing an injured party to claim both damages and rescission at the same time."

Commenting generally on the articles on mistake, these authors note² that s.14 of the General Law

"allows rescission in consequence of a mistake where it may be assumed that, but for the mistake, a party would not have entered into the contract."

This they explain is an elegant, modernised version of Toullier's description of cause or motive which appeared shortly after the promulgation of the Code Napoleon's provisions regarding error. They criticise s.14 for treating mistake of fact and law as equally valid grounds for rescission. They submit that some qualification of the general rule is necessary: for example, an extra-judicial settlement or compromise made to avoid litigation should not be liable to rescission on the basis of mistake of law. Significantly "transaction" or compromise is excluded by Scottish institutional writers from the general category of bona fide contracts and is expressly designated as stricti iuris.

¹At pp. 1098-99.

²At p.1099.

3.42. We reproduce the exact text of s.14 of the Israeli Contracts (General Part) Law.

- "(a) Where a person has entered into a contract in consequence of a mistake and it may be assumed that but for the mistake he would not have entered into it, and the other party knows or should have known this, he may rescind the contract.
- (b) Where a person has entered into a contract in consequence of a mistake and it may be assumed that but for the mistake he would not have entered into it, but the other party did not know and need not have known this, the Court may, on the application of the party who was mistaken, rescind the contract if it considers it just so to do. Upon doing so, the Court may require the party who was mistaken to pay compensation for the damage caused to the other party in consequence of the making of the contract.
- (c) A mistake is not a ground of rescission of the contract under this section if the contract can be preserved by rectifying the mistake and the other party, before the contract has been rescinded, gives notice that he is prepared to rectify it.
- (d) For the purposes of this section and of section 15, "mistake" means a mistake of fact or of law, but does not include a mistake as to the expediency of the transaction."

3.43. UNIDROIT proposals regarding error in sale of goods. As we have observed, a very extensive comparative law survey was carried out for UNIDROIT in connection with its efforts to secure the codification of the law regarding international sales of goods. On 31 May 1972 the Governing Council of UNIDROIT, on which the United Kingdom Government is

represented, approved the text of a "Draft of a Law for the Unification of Certain Rules Relating to Validity of Contracts of International Sale of Goods."¹ We have already discussed in our Memorandum No. 37² the proposed draft articles presenting rules of construction when it is alleged that an apparent agreement is affected by latent ambiguity or latent mutual misunderstanding; and it is only where the application of these rules does not succeed in placing a definite meaning upon the words used that no contract is held to exist. Articles 6 - 10 set forth rules relating to error (mistake):

"Article 6

A party may only avoid a contract for mistake if the following conditions are fulfilled at the time of the conclusion of the contract:

- (a) the mistake is, in accordance with the above principles of interpretation, of such importance that the contract would not have been concluded on the same terms if the truth had been known; and
- (b) the mistake does not relate to a matter in regard to which, in all the relevant circumstances, the risk of mistake was expressly or impliedly assumed by the party claiming avoidance; and
- (c) the other party has made the same mistake, or has caused the mistake, or knew or ought to have known of the mistake and it was contrary to reasonable commercial standards of fair dealing to leave the mistaken party in error.

Article 7

1. A mistake of law shall be treated in the same way as a mistake of fact.

¹Etude XVI/B, Doc. 22, U.D.P. 1972.

²Para. 13.

2. A mistake in the expression or transmission of a statement of intention shall be considered as the mistake of him from whom the statement emanated.

Article 8

A mistake shall not be taken into consideration when it relates to a fact arising after the contract has been concluded.

Article 9

The buyer shall not be entitled to avoid the contract on the ground of mistake if the circumstances on which he relies afford him a remedy based on the non-conformity of the goods with the contract or on the existence of rights of third parties in the goods.

Article 10

1. A party who was induced to conclude a contract by a mistake which was intentionally caused by the other party may avoid the contract for fraud. The same shall apply where fraud is imputable to a third party for whom the other party is responsible.

2. Where fraud is imputable to a third party for whose acts the other contracting party is not responsible, the contract may be avoided for fraud if the other contracting party knew or ought to have known of the fraud."

Policy considerations regarding error as a vice of consent.

3.44. Having considered the somewhat confused background of the Scots law relating to annulment on grounds of error, the trend of development in other long established legal systems - including systems where case law has virtually submerged code provisions - and recent statutory recasting of the laws regarding error and proposals for reform, we have to formulate

our own options for proposed reform. As we have stressed already we are concerned in this Memorandum only with error as a vice of consent justifying reduction. We are not concerned with situations where misapprehension may preclude formation of contract.

3.45. Error in transaction and error in motive. In Menzies v. Menzies¹ Lord Watson in the context of reduction and rescission considered that it sufficed to show such error that but for it one of the parties would have declined to contract. As subsequent dicta have recognised, such error need not be regarding the parties or subject matter of the contract itself.² Such a standard went beyond the categories of "essential error" expressly recognised by Bell - though the fourth of Bell's categories provided a potentially broader foundation for developing a doctrine recognising the general relevance of error in motive than did the French civil code, art. 1110 which was derived from a common source. The "quality" engaged for "if expressly or tacitly essential" need not be restricted to a physical quality of a corporeal thing - and indeed the word "quality" itself is somewhat inapt when the subject matter of agreement is not a res corporalis but, e.g., partnership or agency. In Gordon v. Hughes³ an estate was sold in the belief that it carried to the purchaser a sufficient qualification to vote as a freeholder. The court would

¹(1893) 20 R. (H.L.) 108.

²See per Lord President Clyde Westville Shipping Co. v. Abram Shipping Co. 1922 S.C. 571 at p.579; Ritchie v. Glass 1936 S.L.T. 591.

³June 15, 1815 F.C.

clearly have ordered reduction had that been the remedy sought. However, though in Bell's fourth category a mental state is required of both parties quoad expectations with regard to the contract, the error itself may be unilateral, and may in effect be error in motive.¹

3.46. Zweigert and Kötz, after surveying the solutions of various legal systems to the problems of error, conclude by attempting an analysis and evaluation of the rules. They offer relevant comments on the distinction which is often drawn between "error in motive" and "error in transaction" and observe (as translated)²:

"Whether or not the distinction between error in motive and error in transaction is psychologically meaningful, it is very doubtful whether it is legally useful No reasonable layman would accept these distinctions for a moment. From the point of view of justice mistakes of both categories may be equally important. Moreover, when one considers the matter more closely, every error in transaction involves an error in motive as well, and many pure errors of motive are so important that they have to be treated as errors in transaction to permit the mistaken party to rescind [I]n countries where this distinction obtains, most jurists make a distinction between motives which coexist with the contractual promise (relevant error) and motives which have already ceased to exist at the time the contract was formed (irrelevant error of motive). From the psychological point of view the distinction is unsound, since antecedent motives do not simply die off but survive and accompany the making of the promise. The distinction between the decision to contract and the act of contracting, widespread though it is, is fundamentally factitious, and the distinction between error of content and error of motive is not juridically sound or useful."

¹See Gow, Mercantile and Industrial Law of Scotland pp.59-60.

²Vol. II, pp.91,2.

Our proposals.

3.47. We too consider that little good is served by the casuistic distinctions often made in considering error as a ground for annulling obligation, and find at least some support¹ in Scottish authorities for recognising within limits a doctrine of error in causa or motive. To rationalise and recognise the doctrine would do no violence to the structure of the law. However, though we could without difficulty recommend recognition of a fairly broad formulation of error as a ground for annulment, the scope for its application must, in our view, be much more limited than would accord with a pure "consensualist" approach to the law of obligations in general and to error in particular. Generally speaking, unless there are good reasons for recognising exceptions, it might seem appropriate to treat instances of error in obligations on the same footing as the other errors which a man may make in life - whether on the golf course, in his selection of a partner for life or in business, or in seeking his way through an unfamiliar town or countryside. In short one normally has to bear the consequences of one's own mistakes. However when, for example, error is caused by or connived at by another, or an agreement has been a gratuitous or family matter, or where annulment may not affect seriously the reliance interest of a co-contractant, there may be justification by way of exception for modifying the general rule that in cases of error the errans must accept the consequences. In short, our provisional proposals contemplate a broad formulation of a concept of error as a ground of annulment and a narrow application of that concept in practice.

¹ See e.g. Ross v. Mackenzie (1842) 5 D. 151; Dickson v. Halbert (1854) 16 D. 586; Mercer v. Anstruther's Trs. (1871) 9 M. 618; Baird's Trs. v. Baird (1877) 4 R. 1005.

3.48. Restrictions on the scope of annulment. Error very broadly defined, and not merely errors falling within certain specified and limited categories, should provide potential grounds for annulment; but no error, of whatever type, would justify actual annulment unless stringent conditions were satisfied. However, before turning to a discussion of our proposed broad initial formulation of when error should be legally relevant and of the conditions which would still have to be met before annulment would be possible even granted the presence of such error, we think it important, first, to define more closely what it is that we mean by "error"; secondly, to delimit more clearly the area in which our proposals regarding annulment for error would operate; and thirdly to describe briefly what should, in our view, be the required method of annulment of an obligation which is, under our proposals, liable to be annulled.

3.49. When in this Memorandum we speak of the presence of error we mean one or other of two situations. The first of these is where the declaration of a party whereby he bound himself fails to correspond with his true intention. This may, for example, be because a court subsequently accords to the expressions which he employed a meaning other than that which he himself attached to them; or simply because he misunderstood the clear meaning of the words which he used. Thus, for example, a person who has made an offer, which has been accepted, to purchase "the estate of Dallas" may believe that that expression carries with it a certain parcel of land which, according to its true meaning as ascertained by the court, it does not. The result of such error (usually referred to as "error in transaction") is that (unless the law relating to annulment for error provides him with a remedy) the party finds himself bound to perform an obligation the content of which is other

than he believed (and intended) it to be.¹ The second type of situation which we classify as "error" and to which our proposals relate arises where a party's declaration accurately reflects his intention, but that intention was formed as a result of his mistaken appreciation of reality as at the time of the declaration of will or consent. Thus, for example, a person who has made an offer, which has been accepted, to purchase "the estate of Dallas" may have done so in the mistaken belief that the estate was suitable for dairy farming, or in the mistaken belief that a decision had been taken to close down an airport adjacent to the estate. There is no error such as to provide a basis for annulment in this second type of situation unless there existed, at the date of the expression by the party seeking relief of his consent, a discrepancy between the facts (or law) as he assumed them to be and as they actually were. Consequently a party's erroneous belief as to future trading conditions or prospects (e.g. that the stock market would rise; that the price of copper would fall; that the minimum lending rate would rise) would not amount to error for the purpose of our proposals (though a misapprehension regarding a present fact on which the errans based a belief as to future trading prospects - e.g. that no import licence was required in order to sell British refrigerators in Greenland - could do so).

¹ See also our earlier Memorandum No.37, Constitution and Proof of Voluntary Obligations: Abortive Constitution, paras. 26 and 27. It should also be noted that we do not in the present Memorandum seek to deal with the problem which arises where parties have reached agreement, but that agreement is inaccurately recorded in the document in which their contract is embodied. We intend, in a later Memorandum, to consider this matter and to discuss whether rectification of the writing, rather than simply reduction of it, should be competent in Scots law.

3.50. We also think it appropriate to make it clear at this point that our proposals regarding annulment for error are intended to come into operation only where the risk of such error as is alleged to exist has not been assumed by, or allocated to, one or other of the parties either by express provision in the contract or by implication of law from the nature of the contract, its terms and the circumstances in which it was concluded.¹ Just as parties may foresee, and make provision for what is to happen to their respective duties to perform on the occurrence of, an event which would otherwise have had the result of discharging their contract by frustration, so it is open to the parties to provide for themselves what the effect on their obligation will be if it turns out to have been concluded on the basis of a mistaken appreciation of reality on the part of one or other or both of them; and their provision may take the form that the contract shall remain in being and be performed notwithstanding that the consequence of the error is to render performance by one party more onerous or performance in his favour less valuable or beneficial to him, and that in the absence of their express agreement the party detrimentally affected could have sought and obtained annulment of the obligation.

3.51. Equally, although the obligation does not in so many words state that the risk of error shall lie with one of the parties, it may nevertheless be the clear implication from its terms and the circumstances in which it was concluded that it is not to be open to annulment on account of the misapprehension of one or other or both of the parties.

¹See, to this effect, e.g., the UNIDROIT Draft Uniform Law, Article 6(b); the American Law Institute's draft Restatement (Second) of Contracts, Chapter 12 (1975), s.296.

For example, it might be stipulated in the notice of tender in relation to a contract for the construction of a stretch of motorway that tendering contractors should conduct their own surveys, tests and investigations of the nature of the land over which the road is to pass. In such a case if the contract were concluded on the basis of mistaken assumptions about the nature of terrain, it would nevertheless not be open to annulment, since the contractor would be held to have assumed the risk. Similarly, even if both parties to a contract of sale or lease mistakenly believed that a piece of machinery was suitable for a particular purpose, the lessee or purchaser would not be able to obtain annulment for error if the contract contained a term to the effect that the lessor or seller does not warrant its suitability for any particular operation. Conversely, where the truth of a fact has been warranted or vouched for in a contract, whether expressly or by implication, by one of the parties (e.g. that an article or service provided is suitable for a particular purpose or has certain qualities; that a vessel to be salvaged is lying at a stated depth; that a commodity supplied can be sold in a particular market under a particular description) then the risk that one of the parties was, or both were, in error as to that fact would, save in highly exceptional cases, lie on the party who had vouched its truth and the contract would not be open to annulment for error, the parties being left to resort to whatever remedies might be available for breach of contract. Again, a party would generally be regarded as having assumed the risk of error and so be unable to obtain annulment where he was aware at the time of conclusion of the agreement that his knowledge with respect to the facts to which the error relates was limited, but he nevertheless

chose to go ahead and bind himself. In such cases the contract has for him a speculative element: he takes a chance and assumes a risk and cannot escape from the obligation when it transpires that the facts were not as he believed them to be or hoped that they were.

3.52. It is only where the risk has not been expressly or impliedly allocated to one of the parties that our later proposals concerning relief on account of error come into play. We do not, as at present advised, think it useful to attempt to indicate with any greater particularity than is displayed in the two preceding paragraphs what types of contracts should be regarded as placing the risk of error upon one or other of the parties to them. Our view, on which comments are invited, is that, with such guidance as has been provided, it can be left to the court to decide whether the nature of any particular contract is, or the circumstances surrounding its conclusion are, such that the errans should be regarded as having impliedly assumed the risk of error. We appreciate, however, that some of those consulted may think that it would be preferable as conducive to greater certainty to specify in advance categories or types of contracts (e.g. sales or leases of heritage; sales of goods; contracts of employment) in which the risk of error of particular kinds should be regarded as falling upon one party or the other. We would welcome, from those who are of this opinion, suggestions - with reasons for their particular selection - concerning which types of contracts should be specified and the party upon whom the risk of error should be placed.

3.53. A further preliminary question then arises: granted that grounds for annulment exist, what steps should the errans be required by law to take in order to bring the obligation to an end? Under the present law he can do so, provided the requirements for annulment are satisfied, by simple notification to the other contracting party. It may be that legal action will be taken by the errans (e.g. an action of reduction; an action for declarator that he has effectively annulled the obligation) or by the other contracting party (e.g. an action for declarator that the obligation subsists in spite of a purported annulment; an action of damages for breach of contract based upon the errans's notification of annulment and consequent refusal to perform); but the generally accepted view is that brevi manu annulment is sufficient and is effective.¹ Our provisional view is that this should no longer be the case and that judicial decree (or decree arbitral, if it has been agreed that disputes be submitted to arbitration) should be required for annulment of an obligation on the ground of defective consent. Once an obligation is recognised as having in fact come into being in favour of a party - i.e. the will or consent of the obligor is not so totally lacking that the obligation is treated by the law as absolutely null or void ab initio - then we do not think that the unilateral act of one of the parties to it, not acquiesced in by the other, should be capable of bringing the obligation to an end.

3.54. Our proposals in many cases envisage that, even though grounds for it exist, annulment will not be available as of right but should be granted at the

¹But cf. Bell, Principles, 4th ed., note to sections 11-14.

discretion of the court and, if appropriate, on terms (e.g. that the party desiring annulment compensate the other). In such situations judicial intervention would clearly be required in any event in the absence of agreement between the parties as to both the justifiability of annulment and the terms on which it should take place. But even in those relatively rare cases in which annulment should, in our view, be obtainable as of right we think that judicial intervention, or the agreement of the parties, should be necessary for the obligation to be effectively annulled. All obligations involve at least two parties and, in the absence of provision to that effect in the obligation itself, should not be capable of being extinguished, otherwise than by performance, through the unilateral act of one of them not acquiesced in by the other. Litigation is, even under the existing law, inevitable if the parties are not agreed as to the justifiability of annulment: either the party seeking annulment will bring an action of reduction (or an action for declarator that his brevi manu annulment effectively ended the obligation) or the other party, on receiving notification of the purported annulment, will bring an action to enforce, or for damages for breach of, the contract (or an action for declarator of its continued subsistence). That being so, we think it right that it should be the actual bringing of the obligation to an end which is a matter for judicial decree, and not merely the regulation of the consequences of doing so (or attempting to do so) as under the present law. We envisage that decree might be obtained in a substantive action by the errans concluding for annulment or equally might be sought by him by way of defence or counterclaim to an action for enforcement, or for damages for breach, of the contract brought against him by the other party.

3.55. At present annulment is not competent unless restitutio in integrum has remained possible and the parties have either not acted upon the obligation at all or, if they have, can nevertheless be put back into their respective pre-contractual positions (e.g. by handing back money paid or articles delivered under the contract). This restriction on annulment clearly provides one justification for recognising brevi manu non-judicial action: a party with grounds for annulment must be allowed to take effective steps rapidly before the other party has acted upon the obligation in such a way that restitutio in integrum has become impossible and annulment is in consequence barred. We, however, propose at a later point (see paras. 4.1 to 4.5, infra) that it should no longer be a bar to annulment that restitution in forma specifica is not possible, and that it should in future be competent for annulment to be granted on terms which provide for payment of a monetary surrogatum for restitutio in integrum. If this proposal were adopted, it would no longer be a matter of such crucial importance to an errans, as it is under the present law, to be able to take effective action at the earliest possible moment in order to prevent the other party from acting on the obligation. Nevertheless, speed in the resolution of the dispute will often still be highly desirable and we do, therefore, propose the introduction of a new, accelerated form of judicial annulment procedure which would enable a party to obtain a decree of annulment very rapidly indeed (see Part VI, paras. 6.10 to 6.13, infra).

3.56. We also think a party claiming judicial annulment of an obligation should be required to have sought it within a reasonable period of discovering the facts upon which he bases his claim. This does not mean that he is to be compelled to resort to our proposed new accelerated procedure nor that he is not to be free, if he wishes to take that risk, simply to refuse (or cease) to perform and wait to be sued for breach of contract by the other party, in which action he may then counterclaim for annulment. All that is meant is that a court, no matter the nature of the proceedings in which it is seized of the issue, should not decree annulment unless the claim for it has been made within a period that, in all the circumstances, is reasonable. A party, on discovering that he has grounds for annulment, should be required to make up his mind without unreasonable delay as to whether he wishes to take advantage of those grounds. He should not, we think, be entitled to sit back and do nothing for an indefinite period (during which the other party is perhaps proceeding to perform, or is making preparations to perform, the contract) and then - perhaps after a change in market conditions - take steps to bring the obligation to an end. We invite comment on our proposal that annulment should require to be judicially decreed; and that decree of annulment should not be granted unless sought within a period after discovery of the facts on which the claim is founded that is, in all the circumstances, reasonable.

3.57. We also think it would be advisable explicitly to provide that an obligant seeking annulment should, unless the justifiability of annulment is conceded by the other party, (a) be required to disclose how he came to hold his erroneous belief, or the grounds on which he held it and (b) be able to demonstrate that those grounds were reasonable and probable. This, in our view, would be a valuable safeguard

3.55. At present annulment is not competent unless restitutio in integrum has remained possible and the parties have either not acted upon the obligation at all or, if they have, can nevertheless be put back into their respective pre-contractual positions (e.g. by handing back money paid or articles delivered under the contract). This restriction on annulment clearly provides one justification for recognising brevi manu non-judicial action: a party with grounds for annulment must be allowed to take effective steps rapidly before the other party has acted upon the obligation in such a way that restitutio in integrum has become impossible and annulment is in consequence barred. We, however, propose at a later point (see paras. 4.1 to 4.5, infra) that it should no longer be a bar to annulment that restitution in forma specifica is not possible, and that it should in future be competent for annulment to be granted on terms which provide for payment of a monetary surrogatum for restitutio in integrum. If this proposal were adopted, it would no longer be a matter of such crucial importance to an errans, as it is under the present law, to be able to take effective action at the earliest possible moment in order to prevent the other party from acting on the obligation. Nevertheless, speed in the resolution of the dispute will often still be highly desirable and we do, therefore, propose the introduction of a new, accelerated form of judicial annulment procedure which would enable a party to obtain a decree of annulment very rapidly indeed (see Part VI, paras. 6.10 to 6.13, infra).

adopted in determining whether an error is legally relevant is: "Would the obligation have been concluded only on materially different terms (or not at all) if the party in error had known the true position?" It may be thought that this test goes somewhat farther than that set forth by Lord Watson (see paragraph 3.17, supra) which may be read as requiring, before error can be regarded as "essential", that it must be such that the party labouring under it would have declined to contract at all had he known the true position. The Israeli Contracts (General Part) Law 1973 is to the same effect, as are the most recent proposals for the new Netherlands Civil Code. We think, however, (and the same view is taken in the recent draft Uniform Law on the validity of contracts for the international sale of goods produced under the auspices of UNIDROIT) that there can be situations in which a party in error would be justified in claiming annulment even though he could not show that, but for the error, he would not have contracted at all: he would still have contracted - but he would not have made that particular contract. An example of such a situation might arise where the owner of a house is determined at all costs to buy a field adjacent to his house in order to prevent development of the site and so protect his view. The owner of the field informs him that he has already received a very high offer of £x from a speculative builder, and the house owner consequently offers an even larger sum, which is accepted. It subsequently transpires that the information about the earlier offer was untrue (not necessarily fraudulent). It seems right that annulment should be possible in these circumstances even though the buyer cannot establish that but for the misinformation he would not have contracted to buy the field at all. It may well be that when Lord Watson stated that error became essential whenever "but for it one of the parties would have declined to contract" he in fact

meant "would have declined to contract in these terms" rather than "would have declined to contract at all". In any event, we prefer the former test. Comments are therefore invited on our proposal that the basic test for the existence of legally relevant error should be whether the party seeking annulment would have contracted only on materially different terms (or would not have contracted at all) if he had been aware of the true position.

3.59. This test requires the party seeking annulment to establish that, if he had known the true position, he either would not have contracted at all or would have done so only on materially different terms. In order to satisfy a court of this it would, we think, be necessary for the errans to do more than merely state that he would not have contracted on the terms which he did if he had not been labouring under the error. He would, in addition, have to show that the circumstances - including the detriment to him of having to perform in the conditions as they in fact are and not as he mistakenly believed them to be - render the obligation something materially different from what was erroneously supposed. We think that this objective element is inherent in the test as we have formulated it. It would, however, be possible to underline its presence by recasting the test to require the errans to show, not that he himself would have contracted only on materially different terms, but that a reasonable man in the same external circumstances as the errans would have contracted only on materially different terms. We invite comments on whether our proposed basic test should be couched in these objective terms.

3.60. Causation. Leaving aside, for the present, discussion of possible limits on rights of annulment because, for example, of difficulty in effecting restitutio in integrum or because a co-contractant offers performance of the contract in conformity with the assumptions of the errans, we now proceed to consider what factors should justify a claim for annulment for legally relevant error. The first factor which seems to us to justify a party to an obligation in seeking annulment on grounds of error is because his error was caused by the other party. We shall consider presently the possible role of fraud as a separate category, but for present purposes regard it as merely one aspect of the causing of error by a co-contractant. His conduct may be deliberate, negligent or neutral so far as culpability is concerned. He may, for example, have given information, which is in fact based on the erroneous report of an expert in whom he had reasonably placed confidence, without disclosing the source. Error caused by fraud is universally accepted as a ground for annulment. The element of causation of error as a relevant factor in permitting annulment was recognised in the law of Scotland long before attempts were made to infiltrate English doctrines of so-called "innocent" or negligent misrepresentation into Scots law. He who has caused another's error, it may be thought, should not be permitted in law to maintain an advantage thus obtained. The protection of his reliance interest would not be justified in the circumstances. Indeed one of the merits for Scots law in a solution recognising causing of error as a relevant consideration would be that Anglo-American doctrines of misrepresentation (which are not aspects of "mistake" in Anglo-American law) would cease to complicate the law of error in Scotland. Contractual and delictual concepts would be kept clearly separate, and the Scots law on error would return without qualification to the mainstream of civilian development. The consequences of

culpable misrepresentation could, as we discuss in Part V, be regulated appropriately by the law of delict, and hybrid solutions comparable with those of the Misrepresentation Act 1967 would be avoided.

3.61. We note that in Austrian law, which has maintained a rather restrained approach to error compared with most continental systems, the ground of annulment for error caused by the co-contractant is recognised even when the latter acted in good faith.¹ Even silence can cause a mistake in the sense of this article if the co-contractant should have informed the errans that the assumptions he would normally make about certain facts related to the transaction were erroneous, e.g. the sale of an antique dining table and chairs - of which one was a replacement of the original by a modern copy. Other modern proposals for reform of the law of error recognise this general ground of causing error, e.g. draft Netherlands Civil Code.² Article 6(c) of the UNIDROIT Draft Uniform Law also permits annulment where "... the other party has made the same mistake, or has caused the mistake." This formulation was the result of a wide consensus of legal opinion, and indeed it was apparently as acceptable to Anglo-American as to continental opinion. No restrictions are placed on the powers of a court or judge to determine how the co-contractant caused the errans to err.

¹A.B.G.B., art. 871.

²Art. 6.5.2.11.

3.62. We too think that concealment, and even mere silence, should be regarded as factors capable of causing error in appropriate circumstances - as where a seller, although aware of the fact, does not disclose that a painting signed "Constable" is in fact a modern copy. More generally, a party's silence should be regarded as having caused the other's error whenever there was a duty incumbent upon the former to speak, a duty which arose because the latter was entitled to look to him for his information and his failure to speak allowed a false impression to be conveyed. It is, we think, for the courts to say just when the circumstances are such that a duty of this nature arises. Suffice it for us to say that, with Bell,¹ we do not think that the existence of a positive duty to speak is in Scots law confined to those contracts classified in England as uberrimae fidei. (Significantly, before the English terminology came into use in Scotland, insurance contracts were regarded as simply requiring the display by the parties of "good faith", the application of this general concept envisaging not that as regards some types of contract a man would be more honest than in others, but that an honest man would be more candid in some circumstances than in others.)

3.63. Accordingly, because of the merits of the solution as such; because of its consistency with principles of Scots law; because its adoption would eliminate confusion with the English law regarding misrepresentation; and because of widespread contemporary and comparative support, we offer for comment the proposal that an obligant, whose error falls

¹Principles, 4th ed., para. 13; Commentaries, I.263.

within the scope of our proposal in para. 3.58, should be entitled to decree of annulment if he can establish that his error was caused by a co-contractant, or by a person for whose conduct the co-contractant was responsible.

3.64. Shared erroneous assumption. In our Memorandum No. 37 on abortive constitution of obligations we discussed situations amounting to pre-contractual frustration in which we thought that ignorance of both parties of some fundamental matter might prevent formation of obligation altogether. With such situations we are not here concerned. In our view annulment should be possible if the errans can show that his error was in fact shared by his co-contractant, whether or not the co-contractant also wishes reduction. The doctrine that common error may justify reduction by one party has long been recognised in Scots law. Although the defender's reliance upon the obligation is upset by permitting annulment in such circumstances, it seems to us that this is justified since, by definition, his reliance was upon an obligation which (along with the party seeking annulment) he believed had a different content or meaning or effect. When the common error is discovered we do not think that the party to whom the unbargained-for advantage has thus adventitiously enured should necessarily be permitted to retain it. For him to seek to do so might often, in our view, smack of bad faith. We wish to stress, however, that in many cases of shared or common error, the risk of the parties' belief as to facts being inaccurate will have been impliedly allocated to or assumed by one or other of them by virtue of the nature of the contract, its terms and the circumstances in which it was concluded (see paras. 3.50 to 3.52, supra). Thus, for example, where both parties to the sale of a vessel under construction at the shipyard

have failed to investigate its state of completion but have chosen to rely upon the accuracy of an oral report thereon by a casual visitor to the yard, a court might very well hold that, since the true facts could have been readily ascertained, buyer and seller had each impliedly assumed the risk that the facts were not as they thought them to be, and the contract was consequently not liable to annulment for shared error. We also appreciate that an error may have come to be shared because the party who originally laboured under it infected the other with his mistaken belief. In such circumstances our proposals regarding caused error (para. 3.63, supra), and not those relating to shared error, are applicable.

3.65. As in all cases of annulment on the ground of defective consent, we think that judicial decree (or decree arbitral where the parties have agreed to submit disputes to arbitration) should be required in order to bring an obligation to an end because of shared error, in the absence of agreement between the parties as to the justifiability of annulment. But here, unlike the position in cases of caused error, we think that annulment should not be granted as of right but should be subject to the discretion of the court; and that the court should, furthermore, be entitled to attach terms or conditions to a decree of annulment of an obligation. Except where one party has (whether fraudulently, negligently or innocently) caused the other's error, there should, in our view, be a discretion vested in the court to refuse annulment even though the party seeking it has fulfilled all of the conditions mentioned earlier in this Part of the Memorandum. This discretion the court would exercise in the light of the conduct of the parties both before and after the conclusion of the obligation, and in the light of the likely consequences for each of them of

the granting or refusal of decree of annulment. Thus, for example, we can envisage a court, in a few exceptional cases of common error, saying that an errans, although not in the circumstances to be regarded as having impliedly assumed the risk of error, should not be granted annulment because (a) he failed to take certain obvious steps before contracting which would have revealed to him the true state of the facts and (b) bringing the contractual relationship to an end would have exceptionally grave consequences for the other contracting party (who might e.g. have entered into valuable sub-contracts on the faith of the principal contract).

3.66. In less extreme cases - and these, we think, would be of much more frequent occurrence - a court might come to the conclusion that annulment could appropriately be granted, but only on terms. Thus, for example, in a case of shared error where the co-contractant was in no way at fault in relation to the mistake, yet refusal to annul the contract would result in very severe loss to the errans, a court might well think it right to grant annulment on condition that the errans compensate the other party in respect of any actual loss or expenditure or outlays incurred by him on the faith of the obligation. This would be in accordance with the course followed in Steuart's Tr. v. Hart.¹ The consequence of this would be that the co-contractant's negative (or reliance) interest was protected on annulment, but not his positive (or expectation) interest. Again, the condition attached to annulment in a particular case might be that the errans

¹(1875) 3 R. 192.

should enter into a new contract with the other party which gives effect to the parties' true common intention, or which fulfils the legitimate expectations entertained by the parties, at the time of conclusion of the original contract. This might be a particularly appropriate condition in a situation where, for example, the co-contractant, on discovering the common error, was prepared to accept a modification of the contract which would safeguard the interests of the errans, but the latter sought to take advantage of the error as a device for escaping from a relationship about which he had simply had second thoughts. We therefore provisionally propose that annulment should be competent, at the discretion of the court and, if thought appropriate by the court, on terms, where the legally relevant error upon which a party relies was shared by the other contracting party. Comments are invited.

3.67. Knowledge. If a contracting party knows that the other is entering into a contract with terms which he would not accept but for an error under which he is labouring, most modern legal systems would regard taciturnity in the circumstances as justifying the errans in claiming reduction. The reliance interest of the co-contractant, who maintained silence in such a situation when information by him could have eliminated the error, is thought less deserving of protection than the interest of the errans to be relieved from unexpected prejudice. In Steuart's Trs. v. Hart¹ a sale and disposition were reduced upon terms on the grounds of the seller's error, but the court was clearly influenced by the fact that the defenders knew of and took advantage of that error. Quite apart from the possibility

¹(1875) 3 R. 192, cited with approval in Anderson v. Lambie 1954 S.C. (H.L.) 43.

that a general doctrine of good faith may still underlie the law of obligations in Scotland, crafty and calculating connivance at the self-deception of another has not been viewed favourably by the courts.

3.68. The present and potential roles of a doctrine of good faith in the Scots law of obligations comprehend a wider range of situations than error and will be examined, we hope, in a later Memorandum. In the present context we merely note that certain modern authors, largely basing themselves on the common law of sale and 19th century authority before the impact of English influence, claim that bona fides is relevant to the question of error. Thus Dr. Gow asserts¹:

"Operating alongside error, and perhaps supplementing it, is the doctrine of bona fides, of particular importance in sale and allied contracts Furthermore the concept of bona fides together with the fact that there never has been in Scotland a distinction between 'law and equity' has the consequence that the court has not shrunk from reducing obligations where there has been unconscionable dealing, misrepresentation or unconscionable concealment."

Deliberate silence in knowledge of another's error is probably already disapproved under the present law but in mercantile contracts at all events parties normally negotiate at arms length, and it is said that there is no general duty to disclose relevant facts. There are, however, certain contracts known to English lawyers as uberrimae fidei (of the most abundant faith) where a

¹Mercantile and Industrial Law of Scotland p.59; also pp. 160-1; see also Smith, op. cit., p.830.

special duty to disclose all material facts is cast on one or both parties. If they fail so to do, the consequences are as for misrepresentation. Gloag and other Scottish text writers¹ have adopted this category for Scots law. While it seems reasonable to expect full disclosure of material facts in contracts such as insurance and partnership, it may be doubted whether a numerus clausus of contracts expressly identified as uberrimae fidei is accepted or should be accepted in Scots law. It is significant that, as we have already observed (para. 3.62, supra), Scottish judges in the 19th century² usually referred in connection with contracts of insurance to "good faith" or "bona fides" which was a concept regarded by the institutional writers as applicable to contract law generally. Uberrima fides is a term of art in English law but is not of civil law origin. It is somewhat strange to find the superlative adjective unless there is a general doctrine of good faith in negotiating contracts - which English law does not recognise. It may well be that in Scots law there is a general duty to disclose material facts when they are specially within the knowledge of one contracting party and the other must consequently rely on him for information. The matter has been well put by an author who has commented on efforts to introduce the category of contracts uberrimae fidei into the Roman Dutch systems of Southern Africa³:

"The Roman bona fides is a unitary concept; the law with a somewhat benign optimism endows its average man with a generous measure of prudence and honesty, and he is

¹ See e.g. Contract, 2nd ed., p. 496 et seq; Walker, Principles, p.589 et seq.

² See e.g. Life Association of Scotland v. Foster (1873) 11 M. 351 esp. per Lord President Inglis at p.359.

³ M.A. Millner "Fraudulent Non-Disclosure" (1957) 74 S.A.L.J. 384.

expected to govern his conduct in both respects by a single unvarying standard. But just as the amount of care which he exercises varies with circumstances, so does the amount of candour which informs his negotiations. The negotiations preceding a contract uberrimae fidei do not create a situation in which a man should be more honest than on other occasions, but one in which an honest man would be more candid."

We consider that, though dicta could be quoted in support of a laxer standard of morality,¹ it is consistent with the principles of Scots law that one of the situations in which an honest man should be candid is when he is aware that the other party is in error, and that lack of candour in these circumstances should justify the errans in claiming annulment, even though it cannot be said that his error was caused by the silence (see paragraph 3.62, supra).

3.69. We note that this attitude is reflected in most recently formulated legislation or proposals for legislation on error - indeed they carry matters rather further in that they attach like effect to actual knowledge and imputed knowledge of one party's error by the co-contractant. The Israeli Contracts (General Part) Law 1973, in addition to s.12(a) which requires a party to act in customary manner and in good faith in negotiating a contract, provides by s.14(a):

"Where a person has entered into a contract in consequence of a mistake and it may be assumed that but for the mistake he would not have entered into it, and the other party knows or should have known this, he may rescind the contract."

To like effect is the Draft for a new Dutch Civil Code (B.W. art. 6.5.2.11.1(b)):

¹Brownlie v. Miller (1880) 7 R. (H.L.) 66.

"If the co-contractant, in connection with what he knew or ought to know about the error, should have informed the party in error".

The tentative Draft No. 10 on Chapter 12, Mistake, of the Restatement (Second) of Contracts of the American Law Institute, sec. 295 recognises the voidability of a contract by reason of the mistake of one party when "(b) the other party had reason to know of the mistake ...". Article 6(c) of the UNIDROIT Draft Law recognises the competence of annulment of a contract for mistake when:

"the other party ... knew or ought to have known of the mistake and it was contrary to reasonable commercial standards of fair dealing to leave the mistaken party in error."

3.70. We are unaware of Scottish authority for the proposition that reduction on ground of unilateral error should be permitted because the co-contractant should have been aware of the other party's error. There is a dictum of Lord Shand to the effect that if it was a contracting party's own fault that he did not realise the other's meaning he may be barred from pleading his ignorance.¹ Moreover reduction was on occasion permitted in the 19th century on grounds of unilateral error if it was iustus et probabilis irrespective of the other party's knowledge, actual or imputed.² At all events, it is possible to take the view that weight should now be given to the fact that the most modern formulations of leading commercial nations accept the possibility of annulment if the co-contractant should have been aware of the error. However, if annulment on this basis were to be accepted in our law we think that it should be qualified by

¹Stuart & Co. v. Kennedy (1885) 13 R.221 at p.223.

²e.g. Earl of Wemyss v. Campbell (1858) 20 D. 1090.

reference to customary or reasonable standards of fair dealing. Thus it may be the custom, e.g., in certain types of commercial transactions - or it may be reasonable for the parties to an individual transaction of a particular type to agree - that the parties negotiate and contract on the basis that each relies upon his own existing knowledge, or will make his own enquiries, and does not desire, or expect, information to be disclosed by the other. Clearly, in such circumstances the fact that one party's error was, or ought to have been, known to the other should not render the obligation annulable.¹

3.71. Accordingly, we provisionally propose that annulment should be competent (at the discretion of the court and subject, where appropriate, to terms) where a party's legally relevant unilateral error was known to the other party and it was contrary to customary or reasonable standards of fair dealing to leave the mistaken party in error. Comments are invited. We have ourselves reached no concluded view on whether annulment should also be competent where the co-contractant did not in fact know of the errans's mistake, but ought reasonably to have been aware of it. We do not, however, reject such a solution and invite comments on this matter also.

3.72. Fundamental subjective error. If the policy were to be followed of protecting the reliance interest of the creditor in the obligation and consequently denying annulment for error except in situations where the creditor had caused or knew or should have known of the error, we should have completed our examination of exceptions to the

¹See also paras. 3.50 to 3.52, supra.

general rule that an obligant must bear the consequences of his own mistakes. This is in effect the solution reached by the UNIDROIT Draft Law and by the most recent proposals for the revision of the Netherlands Civil Code. Though it seems to us that this policy may well be justifiable in the context of international contracts of sale and possibly in relation to some commercial transactions, we consider that there may be cases - especially in the nature of non-commercial obligations - where the law should confer on a court a discretion to annul for unilateral error subject to terms for compensating the disappointed creditor. Professor Meijers's currently rejected solution for the Netherlands would have justified reduction of a contract if it has been based on a supposition of such importance that the creditor could not reasonably hold the errans to his obligation if the supposition turned out to be unfounded. The same idea seems to lie behind the American Restatement (Second) proposal (sec. 295) that avoidance should be granted if "the effect of the mistake is such that enforcement of the contract would be unconscionable." The Israeli Contracts (General Part) Law 1973 enacts in s.14(b):

"Where a person has entered into a contract in consequence of a mistake, and it may be assumed that but for the mistake he would not have entered into it, but the other party did not know and need not have known this, the Court may, on the application of the party who was mistaken, rescind the contract if it considers it just so to do. Upon doing so, the Court may require the person who was mistaken to pay compensation for the damage caused to the other party in consequence of the making of the contract."

As we have noted Austrian law permits reduction for error if the errans notified the co-contractant before the other had acted in reliance on the agreed obligation.

3.73. The competence of reducing an onerous bilateral obligation because of unilateral error - but upon terms of compensation fixed by the court - has been recognised in our law.¹ In our examination of Scots law since Stewart v. Kennedy² we observed, however, that since that case annulment on the ground of unilateral error per se has usually been granted only in the case of gratuitous contracts and that dicta have suggested that this is a rule of law not applicable in the case of onerous transactions.³ This seems to go beyond what the authorities warrant, though certainly the fact that an obligation is gratuitous is a consideration to be weighed in determining whether it is just to grant reduction. In situations involving the condictio indebiti for payment made in error, a remedy may, subject to equitable considerations, be given in onerous transactions.⁴

3.74. It may be observed, moreover, that a creditor in an onerous obligation might well sustain no prejudice if it were annulled before he had acted in reliance on it, or (apart from loss of expected profit) might lose little if he had merely advertised or negotiated for resale before the obligation was annulled. Conversely, the

¹Stewart's Tr. v. Hart (1875) 3 R.192.

²(1890) 17 R. (H.L.) 25.

³See e.g. Hunter v. Bradford Property Trust Ltd. 1970 S.L.T. 173. See also discussion in relation to error of law, infra.

⁴British Hydro-Carbon Chemicals & B.T.C. 1961 S.L.T. 280; Glasgow Corp. v. L.A. 1959 S.C. 203; Credit Lyonnais v. Stevenson (1901) 9 S.L.T. 93.

creditor in a gratuitous obligation might suffer grave economic prejudice if, after he had acted in reliance on it, it were to be reduced on grounds of error. He might, for example, have contracted to buy a house or to enter into a partnership or to marry on the faith of the obligation undertaken in his favour. As a background to discussion we now advance a number of (actual and hypothetical) factual situations involving uninduced unilateral error. We do not suggest that in all of them annulment would be the appropriate solution. We merely contend that, as regards some of them at least, annulment is not clearly inappropriate. In each case the parties may be assumed to have acted in good faith and without reason to suspect the obligant of error.

(a) Elaborating on an example suggested by Carbonnier, one may consider the case of a widower whose only son is officially reported killed in action. On that assumption he donates the bulk of his property, or promises a substantial donation to be payable by annual instalments to a military charity in memory of his son. The son, who has in fact been wounded and held prisoner by a belligerent (which does not regard the Convention regarding prisoners of war) returns home two years later. If only expectation of money payments to augment general funds are involved, some might consider that reduction of the promised benefaction would be justified. If a new wing to a military hospital has been erected, the benefaction could not be set aside; but what if work had been commissioned at the suggestion of the benefactor but not started; or if architects have been instructed to draw up plans?

(b) Zweigert and Kötz take as an illustration the purchase of a wedding present for a wedding which unknown to the purchaser, has been cancelled. The wedding present might have been selected from a "bride's list" at a specified store, and the purchaser might be an elderly bachelor godfather of the bride, who would have no use for the article selected.

(c) A young woman, on reaching majority, without taking legal advice renounces in favour of her father a provision under her late mother's will, believing that only the life interest and not the fee was involved.

(d) A businessman grants a franchise or distributorship on favourable terms to an individual whom he believed had sustained injury when endeavouring to rescue a child from a river. The businessman subsequently discovers that the real rescuer had modestly disclaimed participation, while the person who had been thereafter granted the franchise had through inebriety fallen into the water and had been struggling up the bank after the attempted rescue.

(e) A retail company's advertising manager, in error because instructions to him have been delayed in the post, concludes on behalf of the company a contract for the printing and distribution of posters and leaflets featuring a particular branch. In fact, the company's directors have already decided, though not announced, that that branch should be closed down within the following four weeks. An advertising campaign encouraging the public to patronise it would therefore be not merely valueless, but actually detrimental to the company. Particularly if no major steps had been taken by the printer for executing the order and the retail company had acted promptly to inform him of the situation, annulment of the contract on terms which compensated the printer for any outlays might be thought to be a reasonable, indeed economically the least wasteful, solution.

(f) A child is presented to an elderly man as the only son of his deceased brother. He makes provision for him accordingly. Subsequently,¹ it is discovered that the supposition was false.

(g) The governing body of an important academic institution discuss possible successors to the Principal, who is retiring. The name of X is suggested and is received with unanimous approbation. The administrative officer is instructed to invite X to accept the appointment. He, believing that the X who was considered suitable was the famous retired general of that name, writes to him and the general accepts the appointment. In fact the governing body had contemplated the appointment of Dr. X.

(h) A law firm and their clients wish to instruct Mr. A, advocate, to act for them because of his unique knowledge of an ancient legal system which they consider relevant to their case. Their Edinburgh correspondents on their behalf instruct another Mr. A, advocate, who is better known in professional circles but whose practice is mainly in the criminal courts and in reparation actions.

¹See discussion, Kames Equity 4th ed., p.201.

3.75. Our tentative conclusion regarding unilateral error would be to empower the court in its discretion to grant annulment, where appropriate upon terms regarding compensation, on the pattern of s.14(b) of the Israeli law quoted in paragraphs 3.42 and 3.72, supra. We should not discriminate between gratuitous and onerous obligations. Accordingly, we propose provisionally that legally relevant uninduced unilateral error should be a ground for annulment at the discretion of the court and, where appropriate, on terms determined by the court.

3.76. A possible alternative scheme. Our provisional proposals envisage that in cases of shared error, of unilateral error known to the other contracting party and of "pure" or uninduced unilateral error, annulment should be not a matter of right but of judicial discretion exercisable, where appropriate, on terms. We appreciate that some of those whom we consult may be of opinion that our proposals give insufficient concrete guidance to legal advisers as to when annulment will be appropriate and, by conferring a substantial measure of discretion upon the courts, import into contractual relations what they consider an undesirable degree of uncertainty and instability. Some may argue that there are relatively few obligations in respect of which one party or the other cannot point to some matter in relation to which he was labouring under a misapprehension of some kind and seek to assert that it constituted error sufficient to vitiate consent. Consequently, they might say, practically every contract would be at least potentially amenable to annulment if the court chose so to exercise its discretion. We should, as at present advised, consider these fears to be unrealistic and not such as to have troubled lawmakers in a number of very successful commercial countries. It can, moreover, be said with some confidence that the area of uncertainty which the existence of the discretion created would be very limited:

a number of important and formidable hurdles would have to be surmounted before a pursuer could place himself in a position to be able to request a court to exercise its discretion in his favour and annul an obligation. First of all, the error would have to amount either to a failure of the declaration whereby he bound himself to correspond with his true intention, or to a mistaken appreciation of reality as at the time of the declaration of his will (paragraph 3.49, supra); secondly, the risk of such an error as is alleged to have arisen must not have been allocated to or assumed by the errans expressly or by implication of law (paragraphs 3.50 to 3.52); thirdly, annulment must be sought by the pursuer within a reasonable time after his discovery of the error (paragraph 3.56); fourthly, the errans must disclose the grounds on which he held his mistaken belief and be able to demonstrate that those grounds were reasonable and probable (paragraph 3.57); and fifthly, he must show that performance of the obligation in the circumstances as they in fact are would be something materially different from performance in the circumstances as he mistakenly thought them to be (paragraph 3.59). Not until these conditions had been satisfied in respect of a legally relevant error (paragraph 3.58) would a court be able to begin to determine whether, in all the circumstances, annulment should be decreed and, if so, on what terms.

3.77. Those whom we consult who think that our proposals would as they stand give rise to an unacceptable amount of uncertainty might prefer that it should be provided specifically that certain categories of error (e.g. error as to the quality or quantity of the subject matter of the contract; error as to the identity of the other party to the contract) should not form a basis for annulment either

at all, or in relation to some one or more of the four types of error which we have described (i.e. caused error; shared error; unilateral error known to the other party; uninduced unilateral error). We would welcome reasoned comments from those who take this view and also suggestions concerning what specific categories of error should be regarded as excluded from forming grounds for annulment. Again, some of those whom we consult may agree with our view that annulment should generally be at the discretion of the court, but think that guidelines for the exercise of that judicial discretion might beneficially be provided (e.g. that annulment should normally not be decreed where the co-contractant had acted in reliance upon the obligation; that annulment should not generally be granted in the case of obligations of a commercial, as distinct from a consumer, character). Comments would be appreciated from those who favour this approach, along with suggestions relating to what the guidelines should be and how they should be formulated.

3.78. Error of law. Most modern formulations including the American Restatement, the recent Israeli Contract Law and the UNIDROIT Draft Law do not discriminate as regards effect between error of fact and error of law. There is a relationship between the obediēntial obligation of repetition of payments made in error (enforced by the condictio indebiti) and error in the law of obligations generally. We shall consider the condictio indebiti - which involves certain equitable limitations - in the context of unjustified enrichment. For the present it may suffice to note that a legal system which grants repetition for payments made due to error in law - which was not caused, shared or connived at by the recipient - might be expected to recognise also annulment of obligations because of error in law, in certain situations at least. Until 1830 Scots law seems to have

contracting parties have been in error as to their legal rights the courts in Scotland have in the past granted reduction.¹ Some might think that unilateral error in law of one party caused by or known to (in fact or by imputation) a co-contractant should by like reasoning also justify reduction. However, unilateral error which has neither been caused by, nor is known to, a co-contractant might perhaps be thought to be in a somewhat different position. A party cannot, unless in quite exceptional circumstances, plead that he was ignorant of the meaning of the deed which he has signed,² nor can one party to a deed found on his own misinterpretation.³ "Error in point of law is generally insufficient."⁴ "The general rule is ... that an error in law will not avail to set aside an agreement or contract."⁵ In Stewart v. Kennedy⁶ Lord Watson stated the general rule, subject to possible exceptions, that an erroneous belief of one of the contracting parties in regard to the nature of the obligation which he had undertaken in a contract reduced to writing would not justify reduction on grounds of unilateral error per se. It may, however, be thought by some that the fiction that everyone is presumed to know the law - which may be essential for the administration of criminal justice - is no longer altogether acceptable in the context of the law of obligations.

¹Dickson v. Halbert (1854) 16 D.586; Mercer v. Anstruther's Trs. (1871) 9 M.618 (seven Judges).

²Maclagan v. Dickson (1832) 11 S.165.

³Bankier v. Robertson (1865) 3 M.536 per Lord Kinloch at p.537.

⁴Scrabster Harbour Trs. v. Sinclair (1864) 2 M.884 at p.887.

⁵Kippen v. Kippen's Trs. (1874) 1 R.1171 at p.1179.

⁶(1890) 17 R.(H.L.)25 at p.29.

3.80. We have formed no concluded view on whether annulment should be competent for errors of law on the same basis as for errors of fact. On the one hand, such a provision might perhaps be thought liable to undermine the general principle that persons are presumed to know the law - a legal fiction relevant, however, primarily in the criminal law. On the other hand, it can be argued that there is no good reason why annulment should not be possible (at the court's discretion and subject, if appropriate, to terms) where a party has entered into a transaction having fundamentally misunderstood its tax implications - a misunderstanding which may have been induced by, or shared by, the other party, or may be purely unilateral. We invite comments on whether in the context of annulment for defective consent errors of law should be treated in the same way as errors of fact.

3.81. If the answer to this question is in the affirmative, we would welcome views on whether there are any types of obligations in respect of which it should be specifically provided that annulment for error of law is not to be competent. One category of obligation which some might think should not be annulable for error of law might be agreements for the compromise of disputes to avoid, or in the course of, litigation. As regards the vast majority of such compromise agreements we think that a court would in any event decide that annulment should not be granted since such was the nature of the contract that each party must be regarded as having impliedly assumed the risk of his understanding of the applicable law being erroneous. In the very few cases in which annulment would not be excluded on this basis the view might be taken that there should be no absolute rule that compromise agreements are not potentially annulable for error of law: if, for example, an insurance claims investigator

induces an injured workman to compromise a personal injury claim by misrepresenting (perhaps quite innocently) the applicable law, it may be thought that there is no sufficient reason why annulment of the agreement should not be possible. Comments are invited on whether compromise agreements, or any other specific category of obligation, should not be open to annulment on the ground of error of law, on the assumption that, in general, errors of law will not be treated differently from errors of fact.

3.82. Amendment or modification¹ by the court. It may be that decree of annulment on grounds of error is too extreme a remedy in situations where a co-contractant is prepared to uphold the contract on the basis of the erroneous assumption of an errans. The Israeli Contract Law, s.14(c) provides:

"A mistake is not a ground of rescission of the contract under this section if the contract can be preserved by rectifying the mistake and the other party before the contract has been rescinded gives notice that he is prepared to rectify it."

Article 15 of the UNIDROIT Draft Law provides that if the co-contractant declares himself willing to perform the contract as it was understood by the errans, the contract shall be regarded as concluded as the latter understood it. The declaration must be made promptly, but, if so made, the errans loses his right of reduction and any other remedy under the contract. The current Netherlands proposals are to the same effect: under art. 6.5.2.12a.1 the right to reduce a contract in virtue of articles 11 and 12 is excluded if the party not in error proposes a modification of the effects of the contract which would make good the loss which

¹We have, in this context, avoided use of the expression "rectification of obligations". That term is normally used where parties have reached an agreement, consent to which is in no way defective, but that agreement has been inaccurately recorded in a written document. We are here concerned with a different problem, namely where the record of the agreement is accurate, but agreement in those terms was arrived at only because of a mistaken appreciation of reality.

the party entitled to reduce would suffer as a result of the contract if it were to be carried into effect. The Netherlands Draft Code also confers powers of modification or amendment on the Court, article 6.5.2.12a.2 providing:

"Moreover, on demand of one of the parties, the court can, instead of declaring the contract avoided, modify its effects so as to make good the loss."

3.83. We are inclined to think that it would be valuable for the Scottish courts to be endowed with such a power of modification, and we invite comments on whether it should be introduced. Its introduction would mean, for example, that if the seller of a franchise or distributorship in relation to a particular branded product induced the purchaser to believe that the purchaser's exclusive territory covered the whole of a given district, or that the commission on sale of the product amounted to X% on a specified turnover, whereas under the contract only part of the named district was allocated to the purchaser or the true commission was considerably less than X%, the court, instead of annulling the contract, would have the power to maintain it in existence and modify or amend its terms to make them reflect the situation as the purchaser had originally supposed it to be. Those who do not favour this proposal might, however, be prepared to support a more limited type of modification or amendment under which a court would have the power to delete from the contract a clause affected by error if, in all the circumstances, that clause was clearly distinct and severable, and the whole obligation was not affected by the error. In the present law, severance of this nature is sometimes possible in the case of a contract containing an invalid penalty clause. There was support for an analogous rule in the

Scots Act of 1592 "Against Unlawful Conditions in Contracts and Obligations".¹ This Act altered the basic civil law rule that while impossible or unlawful conditions in testaments are deemed to be inserted by mistake and therefore are treated as pro non scripto, such conditions avoid obligations. Mackenzie² comments:

"and yet in this Act the Obligation subsists in Contracts; and the impossible, or unlawful Conditions thereto adjected, and not the Contract itself, are irritated and declared null."

This is, in effect, an application of the "blue pencil rule" by statute. We therefore also invite comments on the desirability of introducing this limited form of judicial modification of contracts affected by error, namely the deletion of clearly severable clauses.

3.84. The recently-published draft articles of the Netherlands Civil Code also contain a provision to the effect that annulment may be excluded if the party against whom annulment is sought proposes a modification of the effects of the contract which would make good the loss that would be suffered by the party in error if the contract were to be maintained in being. In other words, the party confronted with a claim for annulment offers an amendment of the terms of the obligation to the party seeking annulment in order that the legitimate expectations which the latter entertained at the time of conclusion of the obligation and which would otherwise be defeated as a consequence of his error, may be fulfilled. Thus, reverting to the examples provided in the preceding paragraph, the seller of the franchise or distributorship, on learning of the misapprehension under which the

¹1592 c.56 (A.P.S.); c.138(12 mo).

²Observations on the Acts of Parliament, 1686, p.268; Works, vol. 1, p.323.

purchaser laboured on receiving notice of the latter's claim for annulment, might offer to amend the terms of their contract so that the purchaser was allocated as his exclusive territory the whole of the named district and so that the commission payable would in fact be X% of the turnover and not a lesser amount. An obligant who, in the face of such a proposal, nevertheless insisted upon annulment might reasonably, we think, be suspected of lacking good faith. We therefore propose that annulment of the original obligation in such circumstances should be competent only on condition that the party seeking it enter into an obligation modified as proposed by the other party (see also paragraph 3.66, supra).

3.85. Our proposals regarding annulment for error have been made in the context of voluntary obligations concluded inter vivos, i.e. contracts and unilateral binding promises. The proposals might, however, also be extended by analogy to unilateral juristic acts such as donation and transfers of property. We have ourselves reached no concluded view on this matter and would welcome comments. In the present Memorandum we are not concerned with the effect of error in mortis causa deeds. To such cases different considerations of policy may well apply and additional practical difficulties may exist, e.g. the testator being dead, evidence of the nature of the error and how he came to hold it may be more difficult to obtain and less reliable..

C. FRAUD

3.86. As we have noted, the proposed revision of the Quebec Civil Code would eliminate fraud from the nominate categories of factors vitiating consent since in this context it is only relevant if it causes error. If our provisional proposals regarding the effects of "caused

error" were to prove acceptable, it would probably be superfluous to retain "fraud" in Scots law as a nominate category among the factors vitiating consent, though for some purposes proof of fraud might remain relevant. Thus, whereas it may in some circumstances be acceptable for a party to contract to avoid the consequences of his negligent conduct, he cannot lawfully so contract in relation to fraud. In Scots law, as in Roman law, fraud or dolus is both a ground for delictual action and also a factor which, because it may cause error, is to be taken into account in the context of formation and reduction of obligations. Fraud is a term of wide and varied meaning. In the context of delict it may be said that the categories of dolus as an aspect of culpa are never closed. It is one of the two mental states which underlie virtually all forms of delictual conduct. Moreover, in the context of voluntary obligations, its scope is wider than fraudulent misrepresentation. Thus in the form of fraus creditorum it may be relevant in relation to a bankrupt's transactions.

3.87. It is therefore somewhat surprising in view of the long history of fraud in Scots law with its roots in the civil law to note the tendency of some Scots lawyers, especially legal writers on the topic, to follow English models somewhat uncritically. The student of English law is well aware that the tort of deceit in England traces its origins no further back than a decision of the Court of King's Bench in 1789.¹ It was intended to avoid some of the consequences of the Statute of Frauds 1677 (an exclusively English Act) and although some of these were

¹Pasley v. Freeman (1789) 3 Term Rep. 51.

dealt with by Lord Tenterden's Act 1828, the tort of deceit continued to flourish in English law thereafter. The House of Lords decision in Derry v. Peek¹ was concerned with the tort of deceit, and how discussion of that question came to be involved with consideration of "fraud in equity" would seem to be of little interest or concern to Scots lawyers. The Courts of Equity in England, which could grant rescission but not damages, had elaborated grounds for rescission - some of which implied deliberate deception and some of which did not - known collectively as "fraud in equity", but these were quite unrelated to the common law remedy of deceit.² This chapter in English legal history, it might have been supposed, has little relevance for Scots law, yet authors on the Scots law of fraud have sometimes invoked English authority, especially Derry v. Peek, with uncomprehending reverence - the classic example probably being the different treatment accorded to "Fraud" in Green's Encyclopedia on the one hand and in the Encyclopedia of the Laws of Scotland on the other. In the former, a pre-Derry v. Peek edition of Spencer Bower dealing mainly with "fraud in equity" is quoted in extenso; while in the latter the learned author accepts as Scots law the tort of deceit as expounded in Derry v. Peek. Such is not our approach to the topic. So far as concerns Lord Thurlow's assumption³ that Scots law

¹(1889) 14 App. Cas. 337.

²Likewise in construing the Limitation Act 1939, s.26, the expression "concealed fraud" is used in its widest sense to include any unconscionable dealing between parties who stand in a special relationship to each other. See Salmond on Torts (17th ed. by R.F.V.Heuston) at p.601. See also King v. Victor Parsons & Co. [1973] 1 W.L.R. 29 p.33, per Lord Denning M.R.: "The word 'fraud' here is not used in the common law sense. It is used in the equitable sense to denote conduct ... such that it would be 'against conscience' for him to avail himself of [it] ...". And at p.35: "It is unconscionable conduct such as to disentitle them from relying on the statute."

³Elphinstone v. Campbell (1787) 3 Paton 77 at p.83.

recognises a distinction between legal and non-legal fraud, we agree so completely with the late Professor A. Dewar Gibb's statement¹ that this "dogmatic assertion has no justification" that we do not consider it necessary to recommend legislative intervention to make this clear.

3.88. Fraud has long been an important concept in Scots law. The institutional writers discuss it² mainly in relation to delict, but also consider its relevance for annulment of obligation. Erskine's definition³ of fraud as a "machination or contrivance to deceive" we would accept as probably the most serviceable which could be devised. It reflects the same civilian tradition exemplified in French, Italian, Dutch and Spanish law. While the "Germanic" systems stress the causing of error by fraud, the systems with which Scots law has closer affinity stress the type of conduct causing error (or, of course, founding delictual liability). Thus the French Code Civil refers in art. 1116, to "manoeuvres"; the Italian Codice Civile in art. 1439 to "raggire"; the Dutch Burgerlijk Wetboek in art. 1364 to "kunstgrepen"; and the Spanish Codigo Civil in art. 1629 to "maquinaciones insidiosas". However, those different approaches to definition do not produce differences of result.

3.89. It is generally accepted in European systems that, if fraud is proved, there is no need to distinguish between error in essentialibus and error in motive and between material and immaterial error. Bell in his Commentaries⁴, it is true, observes:

¹Law from over the Border, p.39.

²Stair, I.9.9, IV.40.21; Erskine, III.1.16,17; Bankton, I.259.66; Bell, Com. 1.262, Principles s.13.

³III.1.16.

⁴1.262.

"Hence the distinction of fraud into that 'quod causam dedit contractui' and that 'quod tantum in contractum incidit'. Fraud of the former kind annuls the contract; fraud of the latter species gives only an action for restitution or damages."

This doctrinal distinction is also maintained in the French Code Civil art. 1116 and in some other systems.¹ It seems to us undesirable that when error caused by fraud is proved, a court should be required to undertake a retrospective and hypothetical investigation as to what the parties would have agreed had fraudulent manoeuvres not been involved. Lord McLaren in his note to Bell's Commentaries doubts² the soundness of the distinction made between fraud quod causam dedit contractui and fraud quod tantum in contractum incidit, and Gloag has also ventured to express doubt regarding it.³ If, as we have provisionally proposed (in paragraph 3.63, supra), an errans may claim annulment if his co-contractant has "caused" his error, and if legally relevant error in the context of annulment is given the meaning we propose in paragraph 3.58, supra, the validity of Bell's distinction would no longer be relevant. However, on the assumption that fraud will remain as a separate ground of vitiation of consent, we invite comments on whether Bell's distinction, if already part of our law, should be retained, and if not at present recognised, should be introduced.

¹ See also Italian Codice Civile art. 1440; Spanish Codigo Civil art. 1270 para. 2.

² Loc. cit.

³ Contract, p.479.

3.90. It may be desirable to clarify one matter relating to the question whether a fraudulent misrepresentation "caused" the error of a party claiming reduction. In Barton v. Armstrong,¹ a case concerning the English and Australian law of duress, Lord Cross, who gave the advice of the majority in the appeal to the Privy Council, referred to the similarity in effect in Scots law of metus and dolus and cited Stair in this connection. He took the view that if the invalidating cause had been a fraudulent misrepresentation made to the plaintiff, the defendant

"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 the foundation can stand'. per Lord Cranworth L.J. in Reynell v. Sprye²."

This dictum was applied by analogy to duress in the instant case. If this in effect rejects for English law the doctrine of refusing to accord effect to dolus incidens (or quod tantum in contractum incidit) we have already questioned whether this doctrine should be received into Scots law. We assume that Lord Cranworth's dictum would be read subject to the qualification that if the deception were of a very trivial nature and exercised only a minimal influence on a contracting party's mind, the court might apply the maxim de minimis non curat lex.

3.91. Dr. McBryde's recent research has illuminated the place of fraud in Scots law past and present, and, with his

¹[1976] A.C. 104 at p.118-9.

²(1852) 1 De G.M. & G. 660 at p.708.

leave, we quote him at some length. Discussing the historical perspective, he writes:¹

"The truth is that fraud was given a wide meaning. Under the heading 'Fraud' Morison reports 68 cases. The actings treated as fraudulent are divers and classification is difficult. We consider, however, that allegations of fraudulent representation and concealment account for 19 cases, contracts by insolvents 26, and allegations of facility 10. A balance of 9 cases involve various underhand dealings which do not readily fit these categories. A further 5 are not concerned with fraud. This analysis does not show the relative frequency of types of cases, for Morison reports only a minute fraction of the cases before the Court. It does show that fraud has a wide meaning. In some cases there is proof of fraudulent intent, but clear proof of deceit did not always amount to fraud One characteristic is a tendency to infer fraud. No clear indication is given of those circumstances in which fraudulent intent must be proved and those in which it may be inferred. Bankton provides a useful list of the circumstances in which fraud is inferred. A common feature is that, on the whole, they would be dealt with today other than by the common law of fraud. Two important categories, mainly transactions with weak persons and with insolvents, have developed their special rules"

And at a later point Dr McBryde comments:²

"It became settled that fraud to be relevantly averred must be expressed in specific averments. The mere use of the word 'fraud' is insufficient³ nor can fraud be averred⁴ by innuendo. 'We must know precisely what the things are, and what the acts are which are alleged. What was it? Did he nod or wink, or what was it that led them to believe?'⁵

¹Thesis, pp.72-3.

²Op. cit., pp.74-5.

³See e.g. Ehrenbacher & Co. v. Kennedy (1874) 1 R. 1131 per Lord President Inglis at p.1135.

⁴Gillespie v. Russell (1856) 18 D.677 per Lord President McNeill at p.682.

⁵Drummond's Trs. v. Melville (1861) 23 D.450 per Lord President McNeill at p.463.

"Although fraud has a wide meaning it can be treated in three categories, fraudulent misrepresentation, fraudulent concealment, and a residual, much ignored category, of unfair activities."

3.92. There is important discussion in Scottish 19th century cases of the extent to which lack of honest belief was fraud,¹ and, though a divergence of opinion was apparent between the Scottish judges in the Court of Session and the English judges in the House of Lords in Scottish appeals¹, it might be thought that the Scottish cases provided such guidance as was required. However, Professor Gloag, who had pioneered attempts to introduce the English law of "innocent misrepresentation" into the Scottish law of contract, was no less zealous in his attempts to anglicise fraud. Dr. McBryde deals with this succinctly:²

"Professor Gloag considered that the general trend of Scottish decisions was reflected in the English case of Derry v. Peek. Lord Herschell's dictum in that case has often been quoted and, indeed, sometimes as if it were the sole content of the Scots law of fraud. If this were so it would be a remarkable result. Derry v. Peek was a decision on the English common law of deceit and in equity fraud had a wider meaning."

3.93. We have already noted³ the particular circumstances in which the tort of deceit emerged in English law long after the concept of fraud had been operative in Scots law,⁴

¹ e.g. Western Bank of Scotland v. Addie (1865) 3 M.899; (1867) 5 M. (H.L.) 80; Brownlie v. Miller (1878) 5 R.1076; (1880) 7 R. (H.L.) 66; Lees v. Tod (1882) 9 R.807. Contrast, for example, the two reports of Western Bank of Scotland v. Addie sup. cit.

² Op. cit., p.76.

³ Supra, para. 3.87.

⁴ See discussion e.g. by Gow, op. cit., pp.58-9; Smith, op. cit. p.829 et. seq.

but we are not at present concerned with problems of delictual liability. Error resulting from misrepresentation is already recognised as justifying annulment and we are unaware of any dissatisfaction with the present law of fraud considered as a factor vitiating consent - except possibly (as we shall consider later in the wider context of the effects of annulment on third parties) when it may be pleaded against an innocent and onerous assignee of an obligation or of incorporeal moveable property.¹ Bell hinted² at the possibility that fraud, unlike error and coercion, might create a vitium reale - as it did at one time in Roman-Dutch law, presumably because of its association with the concept of theft. This, of course, would mean that, as in the case of theft, so in the case of goods obtained by fraud, no acquirer of the goods, even if in good faith and taking for value, would be able to acquire good title to them: the original, fraudulently dispossessed, owner would be entitled to recover them from whomsoever had possession of them. We can find no other institutional or judicial support in Scots law for such a doctrine; but we would, of course, consider any reasoned views which may be expressed to the effect that fraud should, like theft, result in a real vice affecting the goods so obtained.

3.94. We recognise that in Scots law, as Dr. McBryde has clearly demonstrated, fraud may be relevant in the context of juristic or legal acts such as contracts in situations other than fraudulent misrepresentation vitiating consent. For some of these situations - e.g. those involving

¹ See e.g. Scottish Widows Fund v. Buist (1876) 3 R. 1078 per Lord President Inglis at p.1082.

² Principles, note to sections 11-13 (4th ed., 1839).

fraudulent preferences or dealings with facile persons - specific rules have been developed. Others, such as contracts contra fidem tabularum may be dealt with as vitiated by public policy - or because of fraud.¹ Putting forward a white bonnet at an auction² - which is a machination or contrivance to deceive - is dealt with as an aspect of fraud, though not as vitiating consent in the same way as inducing contract by a fraudulent statement. Dr. McBryde points out³ that there are dangers in supposing that Scottish and English terminology regarding fraud coincide:

"Despite the wide nature of Scots fraud, the English use of fraud in equity is even wider. In Scotland, breach of fiduciary duty and fraud are distinguishable. In England breach of fiduciary duty is sometimes regarded as a type of fraud in equity. This has led in Scotland to the adoption of the English term 'fraud on a minority' in relation to oppression of shareholders.⁴ In English law this use of the expression 'fraud' has a meaning wider than deceit or dishonesty, and has a meaning nearer abuse of power."

The doctrine of "fraud on a power" also derives from English Chancery practice and is not a true species of fraud in the sense of dolus.⁵ We mention these matters, not to suggest alterations in the law, but to reinforce the view already

¹Laughland v. Millar, Laughland & Co. (1904) 6 F.413 esp. at p.417.

²Shiell v. Guthrie's Trs. (1874) 1 R.1083 per Lord President Inglis at p.1089; cf. breach of fiduciary duty: Wright v. Buchanan 1917 S.C. 73 esp. per Lord Skerrington at pp.89-90.

³Op. cit. p.84.

⁴See e.g. Harris v. Harris Ltd. 1936 S.C. 183 per Lord Murray at p.202. Lord Murray was less convincing in his comparison between fraud in Scots law and deceit in English law. In Oliver's Trs. v. W.G.Walker & Sons (Edinburgh) Ltd. 1948 S.L.T. 140 Lord Mackintosh felt compelled to follow the majority view in Harris.

⁵McLaren, Wills & Succession p.1107; Dykes Supplement, p.258; McDonald v. McGrigor (1874) 1 R. 817 per Lord Neaves at p.822.

expressed that in this field of the law English authorities, if relied on, must be used with greater circumspection than is manifested in some of our legal treatises. We share Dr. McBryde's opinion¹:

"There are ... limitations to the idea that in Scots law 'fraud is infinite'. Within those limits there remains a residual power which is flexible enough to be used to attack any 'machination or contrivance to deceive' even although it cannot be classified as a representation or concealment. The categories of fraud should never be closed."

3.95. Our view is that fraud, as a separate ground of annulment of obligations, should cease to exist and should in future be comprehended within the broad category of "caused error". Nevertheless, we think it right at this point to advance a proposal based upon the assumption that a separate category of fraud will continue in being. In view of the fact that in Derry v. Peek it was the narrow common law species of fraud, relevant only in the law of tort, that was in issue, we think it unlikely that a Scottish court would today accept the definition of fraud there laid down as of any relevance in Scotland in relation to fraud as a ground for annulment of voluntary obligations. However, given that the Derry v. Peek definition of fraud has been referred to in Scottish textbooks in a contractual context, we wonder whether, if fraud is to remain as a separate ground of annulment, it would be beneficial by statutory provision to negative any supposed restriction of the meaning of fraud in Scotland to the Derry v. Peek formula. Comments are invited.

¹Op. cit., p.85.

D. FACILITY AND CIRCUMVENTION

3.96. Facility and circumvention as a ground of annulment developed from the Scots law of fraud. Again we are obliged to Dr. McBryde's scholarly research for the only clear account available tracing the development of the doctrine. In his words:¹

"There was much confusion between fraud and facility in the period up to the middle of the 19th century. The early position seems to have been that fraud was necessary for reduction, but fraud could be inferred readily and fraud was found in circumstances which today would be treated at most as cases of improper influence on facile persons. Thus a deed from a dying person which was not read by her was held on those two facts to have been elicited by fraud and circumvention.² If a weak person entered a grossly unequal bargain,³ fraud and circumvention might be presumed³ The attitude of presuming fraud is repeated in the middle of the 18th century."

Thus in the case of an heiress, who was addicted to drunkenness and was prepared to dispose of lands for trifling sums, the court reduced dispositions granted by her to innkeepers although there was no evidence that she had been imposed on or circumvented in any way. The reporter⁴ considered that it was "unjust to take advantage of weak persons, who cannot resist certain temptations." In Gibson and Ors. v. Watson and Ors.⁵ the House of Lords held in effect that

¹Op. cit., p.92 et seq.

²Galloway v. Duff (1672) M.4959.

³Maitland v. Fergusson (1729) M.4956; aff'd by H.L.,
1 Paton 73.

⁴Mackie & Husband v. Maxwell, (1752) M.4963.

⁵(1823) 2 W. & S. 648.

ignorance of the effect of a deed justified reduction if the granter was of weak mind albeit not incapax. In Scott v. Wilson¹ Lord Pitmilley insisted on proof of fraud and circumvention as well as of facility and lesion.

"If facility and lesion were great, slighter proof of fraud and circumvention would suffice, but that was the only limitation which he would allow."²

McBryde comments³:

"In retrospect it is clear that Lord Pitmilley's view could not last. The readiness with which fraud had been inferred in cases involving facile persons made it a very different form of fraud from that required in the absence of facility. When it was settled that fraud needed specific averments, it must have been difficult to reconcile this with cases of facility in which the proof of fraud was absent, but fraud was inferred."

Eventually in Clunie v. Stirling⁴ it was decided that separate issues should be granted as to facility and circumvention on the one hand and fraud on the other - though Lord Cockburn pointed out⁵ that "the two pass into each other by such shadowy gradations that they are often difficult to be distinguished." Moreover, since circumvention and facility have a bearing on each other the result is that if there is strong evidence of facility there is less need for evidence of circumvention, and

¹(1825) 3 Mur. 518.

²McBryde, op. cit., p.94.

³Loc. cit.

⁴(1854) 17 D.15.

⁵At p.20.

conversely.¹ Further, specific instances of facility need not be proved, if general lack of will power can be shown.²

3.97. After it had been decided that facility and circumvention raised different problems from fraud, from which it had developed, the distinction was focussed in the form of issue settled by the mid-19th century, namely³:

"Whether on or about ... the pursuer was weak and facile in mind, and easily imposed on; and whether the defenders or any of them ... taking advantage of the pursuer's said facility and weakness did, by fraud or circumvention, procure deed ... to the lesion of the pursuer?"

Dr. McBryde comments⁴:

"Not only was this the usual form of issue, but the Court of Session refused to alter it" resisting pressure from the House of Lords to do so.⁵

3.98. Although Lord Anderson considered that the issue should refer to fraud and circumvention united conjunctively,⁶ this view conflicted with most of the authorities cited to him and with the views of Lord President Inglis and Lord President Dunedin.⁷ In fact two elements - fraud and circumvention -

¹Munro v. Strain (1874) 1R.1039.

²Gibson's Ex. v. Anderson 1925 S.C. 774.

³McCulloch v. McCracken (1857) 20 D.206; Mann v. Smith (1861) 23 D.435; see also Bryson v. Bryson mentioned in Taylor v. Tweedie (1865) 3 M.928 per Lord Justice Inglis at p.931.

⁴Op. cit., p.96.

⁵Love v. Marshall (1870) 9 M.291 at p.294,5.

⁶McDougal v. McDougal's Trs. 1931 S.C. 102 at p.116.

⁷Munro v. Strain (sup. cit.); Horsburgh v. Thomson's Trs. 1912 S.C. 267, 49 S.L.R. 257, 259; Lord Advocate v. Davidson's J.F. 1921 2 S.L.T. 267; Gibson's Ex. v. Anderson 1925 S.C. 774 at p.775; Ross v. Gosselin's Ex. 1926 S.C. 325 at p.329.

do not need to be proved. Circumvention is a form of fraud - but not, at least according to the weight of authority, in the form of deceit which, because of its importance in the context of misrepresentation, has tended to become the focus of attention. However, the House of Lords in its most recent pronouncement¹ on the law has indicated that, at least where the granter of a deed is alive, circumvention requires proof of deceit or dishonesty.² The case under consideration was unusual in that the party said to be suffering from facility was the defender and the averments of facility were of doubtful relevancy. In this situation facility and circumvention merge into fraud.³

3.99. Our view, as we explain later in this Memorandum, is that it would be preferable if facility and circumvention (and also undue influence, and one form of extortion) were replaced by a more generalised and comprehensive ground of annulment. But if facility and circumvention is to be preserved as a separate ground upon which annulment can be sought, we think that the reference to "fraud" in the issue is misleading and should be eliminated. And while we regard as valuable the recent stressing by the House of Lords of the requirement that dishonest advantage must be shown to have been taken of the obligor's weakness, we also think that it should be made clear that dishonesty can, in appropriate cases,

¹Mackay v. Campbell 1966 S.C. 237, 1967 S.C. (H.L.) 53.

²Although in McKellar v. McKellar (1861) 24 D.143, Lord President McNeill described circumvention as "legal or constructive fraud".

³See dictum of Lord Sorn in Cleugh v. Fleming 1948 S.L.T. (Notes) 60, approved by Lord Cameron in Mackay v. Campbell 1966 S.L.T. 329 at p.333.

be inferred from the circumstances in which an obligation was concluded, without the necessity of proving actual concrete instances of dishonest or deceitful conduct. Thus, repeated and ultimately successful solicitation from a weak and facile person of an agreement highly favourable to the other party might in certain situations give rise to an inference of dishonesty. Comments are invited.

E. UNDUE INFLUENCE

3.100. Undue influence is a technical term of English law which has been partially accepted in Scots law. In English law the term "undue influence" bears a meaning in disputes regarding wills different from that which it has in transactions inter vivos.¹ Only in the testamentary context is an element of coercion a necessary part. Such cases are covered in Scots law by the doctrine of facility and circumvention, though some Scottish dicta² might support the view that undue influence in the sense of coercion would avail to reduce the will of a testator who has not been facile. In inter vivos transactions 'undue influence' in English law does not rest upon coercion but³

"rests on the existence of a personal influence over the mind; on a personal relationship to which, if abused, the maxim 'equity acts in personam' applies in the name of conscience. The court interferes, not because the influence of the ascendant party is wrong in itself, but to prevent that influence being used to the detriment of the weaker party."

¹ See Smith, A Short Commentary on the Law of Scotland, p. 840 et seq; W.H.D. Winder "Undue Influence in English and Scots Law" (1940) 56 L.Q.R. 97..

² Weir v. Grace (1898) 1 F.253 at p.277; Forrests v. Low's Trs. 1907 S.C. 1240 at p.1258.

³ Winder, op. cit., at p.99.

3.101. By contrast with English law, Continental European systems draw a sharp distinction between coercion and abuse of a necessitous condition (or "exploitation"). Legal systems based on the English model do not make the distinction because duress is very narrowly construed, being restricted in effect to cases of extortion by physical violence or imprisonment. As Lord Cross commented in Barton v. Armstrong¹:

"The scope of common law duress was very limited and at a comparatively early date equity began to grant relief in cases where the disposition in question had been procured by the exercise of pressure which the Chancellor considered to be illegitimate."

Consequently certain situations which would be dealt with in European systems under the heading of metus, violence, menace, Drohung are dealt with in English law under the category of undue influence. Although this concept of undue influence is mainly used in the context of abuse of a relationship such as parent and child, guardian and ward, lawyer and client, it is protean and can extend to instances of taking unfair advantage of a person's necessitous situation - such as would be dealt with in some continental systems under the category of "exploitation". It may well be that as Continental influence in Scots law declined in the 19th century and English influence developed, the Scottish courts realised that the traditional grounds of vitiating consent, if narrowly construed, were inadequate. There was, however, uncertainty as to how the law could best be developed. It would have been possible to extend further the concept of extortion in Scots law and also, perhaps, if the introduction of a new category

¹[1976] A.C. 104 at p.118.

was expedient, to consider continental doctrines regarding exploitation of a necessitous condition. However, since English authorities were accessible, and acceptable in the ultimate appellate court, an attempt was made to graft onto Scots law the doctrine of "undue influence".

3.102. In Tennent v. Tennent's Tr.¹ Lord President Inglis had classified the grounds for reduction of deeds as incapacity, force and fear, fraud and essential error, adding:

"Beyond these categories, I am not myself, as a lawyer - as a Scottish lawyer - acquainted with any other ground of reduction applicable to deeds."

However, in Gray v. Binny² he was prepared to adopt the Lord Ordinary's reasoning:

"Where a relation subsists which imports influence, together with confidence reposed, on the one side, and subjection to the influence and the giving of the confidence on the other, the Court will examine into the circumstances of any 'transaction of bounty' ... and will give relief if it appears to have been the result of influence abused or confidence betrayed."

Lord Shand in the First Division also referred to the connection between a relationship arising from dominant and ascendant influence on the one hand and confidence and trust on the other and the granting of a material and gratuitous benefit to the ascendant party by the other; Lord Deas, without dissenting, considered that the instant case could have been tried on an issue of facility and circumvention. The doctrine of undue influence has been recognised in Scotland in respect of the parent-child relationship³ and in

¹(1868) 6 M.840 at p.876.

²(1879) 7 R.332, at 338, 9.

³Gray v. Binny, supra.

respect of the relationship between law agent and client.¹ It has been suggested that the doctrine might be extended to other relationships.² In Forbes v. Forbes³ Lord Guthrie examined the case law on undue influence in Scotland and declined to extend the application of the doctrine. Its scope and status continue uncertain, and it is by no means established that a Scottish court would construe "undue influence" to mean exactly the same as the concept would mean in English Chancery practice.

3.103. As we have already stated, we think that undue influence (and certain other grounds of annulment) should be replaced by a more comprehensive category. However, if undue influence is to be retained as a ground upon which a court may be asked to annul, it may well be thought that the existing authorities leave its scope and precise area of application somewhat undefined and lacking in clarity. We would welcome information about whether this apparent lack of clarity has given rise to difficulties in practice; and also on whether situations or relationships have been encountered which the doctrine does not at present cover and which ought to be covered, and vice versa.

F. FORCE AND FEAR: EXTORTION

3.104. Scots law regarding force and fear is, as is the case with Continental European legal systems, derived ultimately from the Roman law on metus, as received in the Middle Ages. It may well be that the text of the Corpus Juris was not a complete statement of the law which had

¹Logan's Trs. v. Reid (1885) 12 R.1094.

²Gloag, Contract, 2nd ed., pp.528-9.

³1957 S.C. 325; see also Allan v. Allan 1961 S.C. 200.

developed at the time of its compilation and reflected the attitudes of an earlier and harsher period. However, the Roman foundation upon which European systems built gave a remedy metus causa only where the threat of harm would have intimidated a man of robust character - vir constantissimus.¹ Moreover, to be relevant, a threat must have been of physical harm. Economic pressure would not suffice. A delictual action was competent in default of restoration, an exceptio metus was competent to resist a claim under an obligation which had been extorted, while restitutio in integrum lay not only against the actual wrongdoer but also against third parties who had actually been enriched in consequence of the extortion.² At a later stage of development of Roman law than that encapsulated in the Digest's treatment of metus, through the condictiones - particularly the condictio doli and condictio ob turpem causam - other forms of extortion were recognised and redressed, but these³ "left no imprint on the formal statements of doctrine in the Corpus Juris". Roman law distinguished (as do systems derived therefrom⁴) between vis absoluta and vis compulsiva. Where vis absoluta is present there is no manifestation of the will at all and consequently the ostensible transaction is non-existent. These situations we have considered earlier in this Memorandum.⁵

¹D. 4.2.5.6.

²See generally D.4.2. and Buckland Textbook of Roman Law (3rd ed. by P.Stein) p.593.

³J.P.Dawson "Economic Duress and the Fair Exchange in French and German Law" (1937) 11 Tul. L.R. 345 at p.348.

⁴B.Starck Droit Civil: Obligations, s.1377.

⁵Supra, Part II.

By contract vis compulsiva implies that consent has been given, albeit produced through threats of harm, including threats to life. Here there is defective or vitiated consent, and such situations alone are treated in modern civil codes under the categories of vice of consent and violence (metus). The extorted obligation may be annulled: it is not null pleno iure.

Institutional opinion.

3.105. Force and fear (vis ac metus) was a significant source of litigation in Scotland in the period covered by Morison's Dictionary of Decisions (16th to early 19th centuries) but diminished strikingly with the abolition (with certain exceptions) of civil imprisonment in 1881.¹ Stair first deals with "Extortion" (including vis ac metus) in his title on Reparation:²

"Extortion signifies the act of force, or other mean of fear, whereby a person is compelled to do that, which, of his proper inclination, he would not have done."

Despite the statement that "such deeds and obligations, as are by force and fear, are made utterly void"³ the whole context refers to reduction and annulment - which is inconsistent with absolute nullity. Nor would the Roman law on which Stair expressly relies justify a solution of absolute nullity except in cases of vis absoluta

¹Bell, Com. I.315; W.W.McBryde Void, Voidable, Illegal and Unenforceable Contracts in Scots Law (Thesis 1976), p.34.

²I.9.8.

³Loc. cit. This language could be construed as "annullable". An annulled deed becomes (i.e. is made) "utterly void". If Stair meant "inexistent", then any interested party, e.g. a creditor of a contracting party, could rely on the nullity.

and possibly in cases of status. Stair's observations go beyond the Roman law on metus in recognising that

"extortion will be more easily presumed and sustained in the deeds of persons, who are weak and infirm of judgment or courage, as said is, than of those who are knowing and confident."

Whatever the effect of extortion on obligations, Stair had no doubt¹ that in the interests of commerce good title to corporeal moveables might be acquired by bona fide purchasers despite the use of force and fear upon the original owner, unless the coercion amounted to robbery.

3.106. Erskine, who in his first reference² telescopes discussion of violence and threats, can also be cited on either side of the argument whether force and fear is in Scots law a ground of absolute nullity or only of reduction. Against the side-note "fraud and circumvention" Erskine comments³:

"All bargains which, from their very appearance discover oppression, or an intention in any of the contractors to catch some undue advantage from his neighbour's necessities, lie open to reduction on the head of dole or extortion, without the necessity of proving any special circumstance of fraud or circumvention on the part of that contractor."

However, this doctrine only applies when the deed carries "in its bosom plain marks of oppression."

This passage corresponds to Continental developments of a doctrine of "exploitation of state of necessity". It suggests that a court may adopt one of two approaches to an unconscionable contract: either to refuse its effect because its terms are unconscionable, or to presume that a contract containing such terms could only have been impetrated by extortion or deception.

¹IV.40.21 and 28.

²III.1.16.; IV.1.26.

³IV.1.27.

3.107. Bell¹ under the heading "Constraint" is also somewhat ambiguous, but, while possibly supporting the doctrine of absolute nullity,² he regards judicial reduction as necessary to secure that effect and holds that this vice does not prejudice bona fide, onerous third party acquirers of real rights in heritage, corporeal moveables or of negotiable instruments. He is somewhat equivocal (as indeed were Pothier and the French Code Civile) as to the standard of constancy to be expected of a person subjected to constraint. In general, ordinary constancy and resolution are expected, but account may be taken of subjective factors such as age, sex and condition. He notes particularly the exposure of married women to domestic tyranny by their husbands without "any means of exposure or of protection" - the battered wife syndrome among the propertied classes. Bell accepted that to justify the plea of constraint the threats used must have been of an illegal act, though he considered that the threat of lawful civil imprisonment would justify a plea if used to extort more than the debt which would warrant it. Bell cited authority for the proposition that reduction for extortion could be based upon threats in relation to property and not only with regard to the person.³ Following the rule in Roman law, Bell held⁴ that a remedy was competent against

¹Com. I, 314, Principles s.12 and note to sections 11, 12, and 13 in 4th ed. (the last to be edited by the author).

²Quoting Stair I.9.8; see para. 3.105, supra.

³See Principles, s.12 ref. in footnote (e) (4th ed.).

⁴Com., I.315.

third parties who had profited by the unlawful act - presumably on the basis of quantum lucratus - but also held¹ the apparently irreconcilable view that force and fear constituted a "radical defect" or vitium reale. It may be that he considered that there were two categories of force and fear.

3.108. Bankton discusses² the topic of "Extortion" at some length and indeed is the one institutional writer who clearly distinguishes vis absoluta (absolute force) from threat of harm. In the latter case

"the fear occasioned by it does not exclude all consent. The person put in fear chooses the least of two evils, rather to part with his right, than suffer pain, or the like grievance threatened; and, as the law expresses it, Quamvis, si liberum esset, nolisset, tamen coactus voluit. Force therefore excludes that liberty of acting which is requisite to support all contracts; and as such deeds were rescinded by the action, Quod metus causa, among the Romans, so they are set aside with us, by an action of reduction on that head before the Court of Session, whereby the partly lesed is relieved, and the offender subjected to his damages."

Among the categories of recognised objects of threats justifying annulment Bankton includes "loss of estate". A remedy is competent not only to the victim of force but also to those who have interposed to relieve him. A party seeking reduction, e.g. of a sale which he was forced to make, must give restitutio in integrum. In the case of bona fide third party acquirers of rights, by contrast with the case where stolen property has been acquired, a person basing his claim on force and fear can only recover on the basis of reimbursing the third party the price paid.

¹I.299.

²I.255.50 et seq.

Non-institutional views.

3.109. Gloag¹ considered that the institutional writers are to be construed to the effect that an obligation or contract induced by threats of injury is "void", but thought that it would be open to the courts to consider whether a disposition of property granted under apprehension of inconvenient consequences not amounting to physical violence would be merely reducible in a question with an onerous and bona fide third party. Dr. McBryde² considers that there is a case for distinguishing between the effects of actual physical force and lesser coercion. Earlier case law which often involved physical constraint³ supports the view that a reduction on grounds of vis ac metus could be sought even against onerous third parties. However, subsequently the case law has seldom been concerned with force but rather with "concussion" or "extortion".⁴ In Sinclair v. R. McLaren & Co.⁵ Lord President Cooper commented:

"It is now one hundred and twenty years since Bell remarked in his Commentaries that force and fear is 'in modern times seldom a ground of reduction' and since then there have been few reported cases or none in which force and fear has been sustained as the sole ground of reduction."

¹Gloag, Contract 2nd ed., p.488.

²Op. cit., p.36.

³e.g. Stuarts v. Whitefoord (1677) M.16489.

⁴Sutherland v. Mackay (1834) 8 S.313; Priestnell v. Hutcheson (1857) 19 D.495.

⁵3 June 1952, unreported.

In Bradford Property Trust Ltd. v. Hunter¹ threats, had they been established, of illegal or unwarrantable action were regarded as justifying annulment rather than nullity of obligation.

3.110. More recently Lord Maxwell in Hislop v. Dickson Motors (Forres) Ltd.² considered the plea of force and fear in an action by a woman against her former employers who, she said, had by threats extorted from her inter alia a signed withdrawal form on a deposit account and subsequently a signed blank cheque on her current account. Lord Maxwell considered a large number of authorities, but did not regard them as helpful in dealing with the facts which he found proved. He did not find that the defenders had in fact threatened to report the pursuer to the police in respect of alleged embezzlement, but would not have considered this as illegitimate if made in good faith and if the intention was to recover no more than was in fact due.³ He did not consider English authority as a safe guide in view of the scope of equity jurisdiction and the different basis of prosecution in England. In his view, moreover, there was a distinction to be drawn between yielding to threats and submitting to such pressure as overpowered the mind. He commented:

"While the writers and cases on this branch of the law deal largely with threats, there is a broader underlying principle that deeds will be reducible and payments recoverable when they have been extracted by pressure of a certain degree. In general the pressure must be such

¹1957, reported 1977 S.L.T. (Notes) 33.

²10 July 1974, unreported.

³Mackintosh v. Chalmers (1883) 11 R.8; Education Authority of Dumfriesshire v. Wright 1926 S.L.T. 217.

as would overpower the mind of a person of ordinary firmness so that there is no true consent. In considering this it is necessary to take into account factors special to the case, such as the sex of the victim and her position relative to the person applying pressure.¹ It is I think arguable that when dealing with the particular pressure involved in threats and also perhaps when there is actual imprisonment² the requirement of the overpowering of the mind of reasonable firmness has been somewhat departed from,³ but in other cases in my opinion it is still the law."

Accordingly, he held that the pursuer had made the first payment voluntarily despite the situation of confrontation by her employers. However, he took a different view regarding the signing of a blank cheque at the second confrontation:

"I am of the opinion that against the whole background and in the light of the sudden reappearance of the Dickson brothers, armed with knowledge of an account which the pursuer had never volunteered and demanding that she admit the truth, the action of the pursuer in signing a blank cheque cannot reasonably be considered a truly voluntary act on her part, but was rather the submission to pressure which might in the whole circumstances well have overpowered the mind of a woman of normal firmness finding herself in such a situation. While the pursuer in fact signed the cheque, I consider the abstraction by the defender of the funds in her current account is more akin to a forceful seizure of those funds than a voluntary payment of them by her."

¹Stair, IV.40.25,26; Erskine III.1.16; IV.1.26; Bell, Principles para. 12; Gloag, Contract, 2nd ed., p.488.

²Mackintosh v. Chalmers.

³Bell, Commentaries 7th ed., I.315.

3.111. Apart from threats of violence and of use of diligence to extort more than the amount due, it has been held a relevant ground of reduction that the pursuer was threatened with loss of employment.¹ Moreover, it has been held from an early date that if a party's goods are seized unwarrantably, an obligation granted to secure their release is reducible.² However, on the whole the Scots law on force and fear has not been developed by modern case law and the authorities are redolent of a bygone age. In particular there has been no real development of what is known to American lawyers as "economic duress" or - an aspect developed also on the Continent - threats related to property rather than to the person.

3.112. Extortion (or exploitation). Though the expression "extortion" is often used by Scottish judges and authors rather than "force and fear" when threats have been made to secure an obligation or property, the same term is also used in a somewhat different sense to imply exploitation of the necessities of another. Thus, for example, Stair³ held that a sale might be reduced or adjusted if some special necessity of the buyer had placed him at the seller's mercy. Erskine laid down⁴ that:

"All bargains which, from their very appearance discover oppression, or an intention in any of the contractors to catch some undue advantage from his neighbour's necessities, lie open to reduction on the head of dole or extortion, without the necessity of proving any special circumstance of fraud or circumvention on the part of the contractor."

¹Gow v. Henry (1899) 2 F. 48.

²See Gloag, Contract 2nd ed., pp.489-90 and cases there cited.

³I.10.15.

⁴IV.1.27.

Gloag¹ also notes that:

"There is a certain amount of authority to lend support to the argument that a contract, where it is clear that a gift was not intended, may be so inequitable in its terms as to be reducible, though the relationship of the parties may not be such as to involve any fiduciary duty by the one to the other, and although neither improper practice by the party who gains, nor defect in legal capacity in the party who loses, can be established."

Apart from moneylending contracts of an extortionate character before the Moneylenders Act 1900 came into force,² the cases on this branch of the law are on the whole prior to the ascendancy of the "sanctity of contract" attitude to contract which reached its zenith in the 19th century.³

Future possibilities: our approach.

3.113. It seems to us that there have been substantial social and commercial changes since the "sanctity of contract" theory reached its zenith and that present aspects of Scots law, covered by the headings of "force and fear", "extortion", "facility and circumvention" and "undue influence" merit re-examination and redefinition in a modern context. In particular the limits of legitimate economic pressure need to be considered. We must at least consider future possible recognition - perhaps within limits - of a general doctrine of good faith or unconscionability in contractual and other relationships, comprehending constitution, performance and enforcement of obligations. However, we think it may be expedient to state

¹Contract, 2nd ed., p.492.

²Young v. Gordon (1896) 23 R.419; Gordon v. Stephen (1902) 9 S.L.T. 397.

³See e.g. Murray v. Murray's Trs. (1826) 4 S.374 and authorities there cited.

first our views on the assumption that there may be no substantial legislative change in the law for some time, but that, in the limited context of vitiation of consent, the law on consent elicited under pressure may be restated and rationalised. The scope and effect of the category of threats (metus) should be reconsidered, and thereafter the need for a further ground of vitiation of consent beyond error, fraud (if not to be subsumed under caused error) and threats may be examined. The present law could be restated in clearer form, and in a way that would not be inconsistent with future recognition of more comprehensive means of controlling unfair dealing.

G. THREATS

The comparative context.

3.114. In attempting to restate a definition of extortion of consent by threats of physical force or personal or economic prejudice, it may be helpful in focussing the issues to consider some recent formulations of other systems drawing on the same sources as Scots law.

a. Israel

The Israeli Contracts (General Part) Law 1973, s.17 provides:

"(a) A person who has entered into a contract in consequence of duress, by force or threats applied to him by the other party or a person acting on his behalf may rescind the contract.

(b) A bona fide warning of the exercise of a right does not constitute a threat for the purposes of this section."

b. UNIDROIT Draft Law.

"Article 11. A party may avoid the contract when he has been led to conclude the contract by an unjustifiable, imminent and serious threat.

Article 12. 1. Avoidance of a contract must be by express notice to the other party.

3. In the case of threat, the notice must be given promptly, with due regard to the circumstances, after the threat has ceased."

c. Draft for a new Netherlands Civil Code (B W)

"Article 3.2.10. 1. A juristic act is annulable if it has been brought about by threat, fraud or abuse of circumstances.

2. There is a threat when some person induces another to perform a juristic act by menacing him or a third person unlawfully with some prejudice to person or property. The threat must be such as would influence a person of reasonable judgment."

d. Quebec (Proposals for Reform of the Civil Code - Obligations.)

"Article 34. Fear of serious harm vitiates consent when induced by violence on the part of either contracting party. Such fear also vitiates consent when the violence is exercised by a third person for the purpose of prevailing upon the victim to contract.

Article 35. In the determination of fear, the court takes into consideration the circumstances and condition of the persons.

Comments: This article restates in a new, more general form the traditional rule of Article 995 C.C. which provides that in ascertaining whether fear has had a determining influence on consent, the judge must take into consideration the circumstances peculiar to the case, the personal characteristics of the contracting party (age, education, character, and so on), and the circumstances resulting from the relations between the person posing the threat and the victim of fear. The Committee thought it best to use the general expression condition of the persons so as not to restrict the court's appraisal merely to the factors listed in Article 995 C.C.

Article 36. Fear produced by the abusive exercise of any right or power vitiates consent.

Comments: This article covers particularly the traditional concept of reverential fear and legal constraint, but in line with recent tendencies in jurisprudence, it broadens the scope of Articles 997 and 998 C.C.

Article 37. Apprehended harm may relate to the contracting party or to a third person."

The effect of coercion.

3.115. We have already in Part II of this Memorandum, when discussing forced or simulated consent such as would preclude the formation of obligation, considered some matters which are also relevant in the present context. We then discussed, for example, the relevance of force exercised on a third person. Further, we suggested that the question whether there was a coerced expression of will by the victim or merely simulated expression of will under compulsion should be left to judicial determination. In Hislop v. Dickson Motors (Forres) Ltd.¹ Lord Maxwell was not considering the effect of the pressure exercised on the pursuer in a question involving the rights of an onerous third party, but, against the background of his careful examination of the evidence, we think that he would have been hesitant to hold that the plea available against the defenders in the action would have availed against third parties. Where it can be said of a contractant coactus voluit - he consented under compulsion - then the general doctrine accepted in modern legal systems is to regard the transaction as annulable and not as a complete nullity. Despite conflicting views among the Scottish authorities, we think that this may well have been the position in Scots law for some time. But in view of the fact that institutional opinion is unclear and equivocal, we think that a statutory provision to this effect would be desirable. We also think that, on proof that the use of threats or coercion by the co-contractant contributed to cause

¹See para. 3.110, supra.

the victim to oblige himself in a way which he would not otherwise have done, he should be entitled to annulment. As in cases of caused error, and unlike the position in cases of shared and unilateral error, the court should have no discretion to refuse annulment. Comments are invited. We assume, following on from this, that it would be generally agreed that annulment should be competent against a contractant who, although not himself guilty of making threats, knowingly took advantage of threats made by a third party. Comments are, however, invited on this matter also.

The degree of coercion.

3.116. Especially if the issue of extortion is to be litigated between the victim and the person who used unlawful threats, we do not think that the traditional requirement of reasonable constancy is necessary. However, we shall be considering later in this Memorandum what the effect of annulment because of error, threats or other vitiating ground should be on onerous bona fide third party assignees of personal obligations (as contrasted with transferees of real rights or negotiable instruments.) If the view were taken in that connection that the law should be altered to protect them in the same way as bona fide purchasers of corporeal property are protected, then we think that it would probably be unnecessary to specify a standard of constancy on the part of a victim of threats who had granted the obligation later assigned to an onerous bona fide transferee. However, if the law is not to be altered to protect bona fide onerous assignees, we think that if a claim for annulment is later directed against them by the victim of threats who granted the obligation, they should be protected at least to the extent proposed in

draft Article 35 of the Quebec Civil Code. The Court should take into consideration the circumstances and condition of persons - if not an objective standard of reasonable firmness - on the part of the victim in deciding whether annulment should be granted. However, somewhat in the same manner of thinking as Lord Cross in Barton v. Armstrong,¹ we do not see good reason for giving a party who had applied illegal threats the opportunity to argue that, though his threats might have had some effect, the victim should not have been influenced by them. We envisage, of course, that the threats in question would not be trivial, such as a court would exclude on the principle de minimis non curat lex. We invite comment. We assume that those who think that, in general, onerous assignees should not be affected at all by the defective consent of the debtor to the obligation (which we discuss infra, paragraphs 3.134 to 3.138) would nevertheless agree that even an onerous assignee should be affected by the threats by which the original obligation was extorted if he was aware of the use of these threats. Comments are, however, invited.

3.117. We have already seen that it is not clear in the present law what type of threats - beyond threats of physical violence - are relevant as a ground of annulment. There are isolated instances in which account has been taken of threats to the victim's economic interest in his employment, or to property interests. But it is by no means certain how far the present law regards as legitimate the imposition of economic pressure upon a person to induce him to contract, or how far it would go to provide a remedy in cases of "economic

¹[1976] A.C. 104 at p.118.

duress", such as a threat to cut off a person's supply of a commodity necessary for his business, or his access to credit, unless he enters into a contract on terms disadvantageous to him. Our view is that where an obligation has been concluded through the use by one party against the other of threats of harm to the person, or of serious harm to any lawful personal or economic interest of that other, then the obligation so extorted should be annulable. If a person undertakes an obligation because of threats of harm directed not against the obligor himself but against a third party, we think that annulment of the obligation should be competent where the threat, if implemented, would affect any important personal interest of the third party, or any important economic interest of the third party if, in the latter case, the obligor stands in a close social or economic relationship to the third party. Our intention here is that an obligation should be annulable if extorted from the obligor by means of threats of serious personal injury, or death, to any third party, even one not linked in any way to the obligor. We think it right that annulment should be competent in the case of an obligation concluded under the threat that otherwise the occupants of a highjacked aeroplane will be killed, or a kidnapped child will be murdered or mutilated. It should not, in our view, be a requirement that the kidnapped child, or any of the aircraft passengers, be in any way related to or connected with the obligor. Where, on the other hand, the threat under which the obligor enters into the contract is one of harm not to the person but to the property or economic interests of a third party (e.g. a threat that his windows will be smashed; that his factory will be burned down; that he will be put out of business through having his supply of an essential commodity,

or his access to credit, cut off) we think that annulment should be possible only where the third party whose property or economic interests are thus threatened stands in a close social or economic relationship to the obligor who sought to protect him (e.g. is a member of his family; his partner; his principal supplier; an important customer). Where there is no such relationship, it might, in our view, justifiably be thought that the obligor is not acting reasonably in regarding the third party's economic interests as more worthy of protection than his own, and should consequently not be entitled to seek annulment. Comments are invited.

3.118. Under the provisions of the Israeli Contracts (General Part) Law 1973, a bona fide warning by a person that he intends to exercise a legal right (e.g. to institute legal proceedings for recovery of a debt) does not constitute a threat for the purposes of the annulment of an obligation thereby induced. The proposals for the revision of the Quebec Civil Code, however, specifically provide that fear produced by the abusive exercise of any right or power vitiates consent. We approve of both the general principle embodied in the Israeli law and the qualification or proviso found in the Quebec draft article, and we provisionally propose their adoption in Scots law. Whereas a creditor has a right to seek payment and a right to warn the debtor of his intention to resort to the means provided by the law to enforce payment, if these rights are exercised oppressively, annulment of any obligation so induced should be possible. There are methods of seeking payment or exacting payment, even of sums legally due, which should not be permitted to succeed, e.g. the adoption or the threat of "strong-arm tactics"; the adoption of methods of collection designed to frighten the debtor or to overawe him, such perhaps as

persistently calling upon him late at night. The facts of the recent case of Hislop v. Dickson Motors (Forres) Ltd¹ provide a good example of annulment granted because of a creditor's oppressive exercise of his right to obtain payment of a sum due. The concept of oppression is already recognised to a certain extent (e.g. in relation to irritancies) in the Scots law of obligations; and we think it can safely be left to the court to determine whether a creditor's right to seek payment has, in the circumstances of any particular case, been exercised oppressively. Comments are invited.

3.119. The UNIDROIT draft Uniform Law permits annulment only if notification of intention to annul a contract secured by threats is given to the party against whom annulment is sought promptly after the threat has ceased. We have reached no concluded view on whether such a notification requirement should be imposed in Scots law. If notification were to be introduced we think that it should require to be given "within a reasonable time" after the cessation of the threat, rather than "promptly" thereafter. On the whole, we are not at present convinced that compulsory notification serves a useful purpose, but we invite comments on the matter.

H. LESION.

3.120. There are ill-defined grounds of annulment in Scots law which are discussed among the nominate categories but do not fit easily into any. They might be regarded

¹See para. 3.110, supra.

as aspects of a general concept of fair dealing and good faith which had lingered on in an essentially commercial era of contract law. If those members of the House of Lords in McKendrick v. Sinclair¹ who concluded that a remedy cannot be lost by desuetude are right, it can be asserted with some confidence that a general doctrine of good faith as such in contract has not been expressly repudiated in the Scottish courts. Be that as it may, among the various unshepherded - or loosely shepherded - nominate grounds of annulment related to a doctrine of good faith may be included reduction for facility and circumvention, "extortion" in the secondary sense discussed in paragraph 3.112, supra, i.e. taking advantage of another's necessities without actual coercion or deception, and "undue influence" so far as that stray from Chancery pastures has been found grazing in Scotland. It might be of advantage to bring these ideas together under a specific provision of the law, and perhaps dispense with the loosely classified categories at present recognised. We do not canvass further the merits of the ideas behind these categories, which we have discussed earlier in this Memorandum, because we have no reason to believe that they are challenged. If they are, we should welcome detailed criticism.

Comparative considerations.

3.121. England.² It seems to be generally accepted in English law, and indeed Scottish experience is in accord, that the traditional categories of mistake, fraud and duress (error, fraud and vis ac metus) are not adequate to cover all situations in which obligations should be annulled because consent has not been wholly free from constraint or

¹1972 S.C.(H.L.) 25 at pp.53, 54.

²For a short account see e.g. Cheshire and Fifoot Law of Contract 9th ed., Part IV, Chapters 1-3. The detail is discussed in treatises on Equity jurisprudence.

adequately informed. English law makes use of a wide range of devices developed in Equity which, though appropriate in an English context, are not exportable to a system which has not recognised the dichotomy of Law and Equity.

3.122. We note, however, recent developments pointing to the adoption of a general concept of "unconscionability" in contracts.¹ This concept has affinities with similar doctrines in other jurisdictions which do not recognise the dichotomy of Law and Equity. For example, in Schroeder v. Macaulay² Lord Diplock observed:

"It is, in my view, salutary to acknowledge that in refusing to enforce provisions of a contract whereby one party agrees for the benefit of the other party to exploit or to refrain from exploiting his own earning-power, the public policy which the court is implementing is not some 19th century economic theory about the benefit to the general public of freedom of trade, but the protection of those whose bargaining power is weak against being forced by those whose bargaining power is stronger to enter into bargains that are unconscionable. Under the influence of Bentham and of *laissez-faire* the courts in the 19th century abandoned the practice of applying the public policy against unconscionable bargains to contracts generally, as they had formerly done to any contract considered to be usurious; but the policy survived in its application to penalty clauses and to relief against forfeiture and also to the special category of contracts in restraint of trade."

¹ See Cheshire and Fifoot, pp.288-9; Lloyds Bank Ltd. v. Bundy [1975] Q.B. 326; Schroeder Music Publishing Co. Ltd. v. Macaulay [1974] 3 All E.R. 616; Clifford Davies Management Ltd. v. WEA Records Ltd. [1975] 1 All E.R. 237 (As Dr. W.W. McBryde points out, 1976 J.L.S.S. 324, "These approaches are based on a different history of equity jurisdiction from that applicable in Scotland"). See also dictum by Brightman J. in Mountford v. Scott [1974] 1 All E.R. 248 at pp. 252-3: "A court would not permit [an] educated person to take advantage of the illiteracy of the other." For a general discussion in an English context, see S.M.Waddams, "Unconscionability in Contracts" (1976) 39 M.L.R. 369.

²[1974] 3 All E.R. 616 at p.623.

The Master of the Rolls (Lord Denning) has on several occasions invoked a doctrine of unconscionability. Thus in D & C Builders Ltd. v. Rees¹ - a case of discharge of obligation - he held that there was

"no true accord. The debtor's wife held the creditor to ransom. The creditor was in need of money to meet his own commitments, and she knew it."

Again in Lloyd's Bank Ltd. v. Bundy,² after referring to several lines of cases including those on duress, unconscionable transactions and undue influence, he observed, 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 on terms which are very unfair or transfers property for a consideration which is grossly inadequate when his bargaining power is grievously impaired by his own needs or desires, or by his own ignorance or infirmity, coupled with undue influences or pressures brought to bear on him for the benefit of the other."

In Mountford v. Scott³ Brightman J. commented that the Courts would not permit an "educated person to take advantage of the illiteracy of the other". These are the views of individual judges rather than the shared ratio of an appellate court, but may be regarded as plots on a graph of the development in English law of a doctrine of economic duress comparable to that already accepted in the United States. The editor of the most recent edition of Cheshire and Fifoot on Contract⁴ seemingly accepts this view.

¹[1966] 2 Q.B. 617 at p.625.

²[1975] Q.B. 326 at p.339.

³[1974] 1 All E.R. 248 at p.252.

⁴See p.288.

3.123. Uniform Commercial Code. The solution of the Uniform Commercial Code - most probably inspired by the German Civil Code article 138 - is widely accepted in the United States, and is not found inconsistent with commercial competition. Section 2.302 provides:

"(1) If the court as a matter of law finds the contract or any clause of the contract to have been unconscionable at the time it was made the court may refuse to enforce the contract, or it may enforce the remainder of the contract without the unconscionable clause, or it may so limit the application of any unconscionable clause as to avoid any unconscionable result.

(2) When it is claimed or appears to the court that the contract or any clause thereof may be unconscionable the parties shall be afforded a reasonable opportunity to present evidence as to its commercial setting, purpose and effect to aid the court in making the determination."

The Comment to the section explains that

"the principle is one of the prevention of oppression and unfair surprise ... and not of disturbance of allocation of risks because of superior bargaining power".

This section has a double utility, namely that of protecting merchants from grossly unfair dealings with each other and also in consumer protection. Moreover, by allowing the defendant to show that a clause which might prima facie appear unconscionable was in fact reasonable in content, balance between the parties is maintained by the section. It is related, moreover, to s. 1.203 which provides that every contract or duty within the Code imposes an obligation of good faith in its performance or enforcement. Llewellyn, the main force behind these provisions, had concluded¹ that the means

¹See Commentary to Section; also K.Llewellyn, Book Review (1939) 52 Harv. L.R. 700, 702-3.

hitherto resorted to by American courts to check unconscionable transactions were in themselves unsatisfactory, in that (1) by not declaring unconscionable clauses inherently objectionable, the courts encouraged draftsmen to attempt to evade court sanctions; (2) by evading the real issue, the courts failed to set forth minimum deficiencies of commercial transactions; and (3) confusion of the rules of interpretation resulted from the lack of direction.

3.124. It may be remarked that some of the "toughest" American lawyers have supported this system of control. J.P. Dawson, one of the leading American contract lawyers of the century, had written in 1937 before the appearance of the U.C.C.¹:

"The system of 'free' contract described by nineteenth century theory is now coming to be recognised as a world of fantasy, too orderly, too neatly contrived, and too harmonious to correspond with reality. As welcome fiction is slowly disciplined by sober fact, the regime of 'freedom' can be visualised as merely another system, more elaborate and more highly organised, for the exercise of economic pressure. With new vision has come a more conscious and sustained effort to select the forms of permissible pressure and to control the manner of its exercise."

Writing after the Code came into force in the various States of the Union except Louisiana, later authors have commented²:

"Section 2.302 must be evaluated in the context of the contemporary market place which differs markedly from that of the 19th century when the bulk of commercial transactions were conducted on an individualistic basis. Today the market place has become the center of a pluralistic

¹"Economic Duress and Fair Exchange in French and German Law" (1937) 11 Tul. L.R. 345; See also 45 Michigan L.R. 253.

²Cellini and Wertz "Unconscionable Contract Provisions" (1967) 42 Tul. L.R. 193 at p.203.

society composed of large and powerful business interests as well as legions of individual participants. Section 2.302 represents an awareness on the part of the drafters of the U.C.C. that certain limitations upon freedom of contract are desirable and necessary and that courts must be properly equipped to impose these limitations. The drafters have not, however, invested the courts with unlimited powers, since the exercise of their power is dependent upon a finding of unconscionability which must be supported by the underlying policies of the U.C.C. and the body of doctrine which has developed on unconscionability. Furthermore, section 2.302(2) provides an affirmative check on the court's exercise of power by requiring the parties to the contract to be afforded an opportunity to present evidence relative to the commercial setting, purpose and effect of the contract to aid the court in its determination."

3.125. Scots law in a comparative context. Our present Memorandum is concerned with vice of consent and related matters, which means that propositions related to the "unconscionability" approach to contract provisions in general within the context of the closely interrelated provisions of the U.C.C. is, for the present at all events, beyond our enquiry. Dr. McBryde observes¹ with truth in the context of Scots law that there is a danger that "statutory control will grow in an untidy and illogical fashion". We have good reason to appreciate this comment. He also reproaches Scots law with its inept handling of extortionate transactions:²

"In this area Scots law is in a primitive state by comparison with some other legal systems. The French Code did reject a principle of lesion, preferring specific rules, but the French Commission for the Reform of the Civil Code

¹"Extortionate Contracts" (1976) J.L.S.S. 322 at p.323.

²Op. cit., p.323.

proposed the introduction of a general control of lesion. A general theory of lesion is to be found in the Italian Civil Code, the Swiss Code Des Obligations and the German Civil Code. In the United States the Uniform Commercial Code has a provision on unconscionability which has been the subject of much discussion and it is understood that all the Canadian Provinces have enacted legislation relating to unconscionable transactions. English law does not have an established principle of oppression but recent case law has indicated that such a principle may emerge."

It is certainly true that the Scottish judges today seem less astute to control unconscionable transactions than were their predecessors before the era of laissez faire - which is itself a century out of date. We are also concerned that, if other legal systems provide appropriate controls for such transactions, contracting parties may select one of these systems to govern their contracts. We have mentioned briefly modern developments in England and the United States, and Dr. McBryde has directed attention to the position in Western Europe. We must take account of current proposals for reform elsewhere.

3.126. Quebec proposals. The Committee recommending reform of the law of obligations in the Quebec Civil Code has noted¹ that it had become common in modern society for certain contracts to be used as a means of actually exploiting one of the parties, taking advantage of his unfavourable position (poor economic condition, inexperience, senility and so on). They therefore decided that it would be desirable to revive a limited concept of lesion in relation to the obligations of persons of full age, but only in certain circumstances, so as to avoid impairing unduly contractual

¹Report on Obligations, p.77.

stability. Moreover, they rejected the solution of a mathematical formula of proportion of money value. The proposed new Article 38 is as follows:

"Lesion vitiates consent when there is a serious disproportion between the **prestations** of the contract, resulting from the exploitation of one of the parties. Serious disproportion creates a presumption of exploitation."

The Committee comments¹:

"This article is thus limited in scope, since lesion results not only from disproportion between the prestations (an objective concept), but also from one party's exploitation of the other (a subjective concept). To invoke lesion, a contracting party must in fact show that there is a serious disproportion between the prestations under the agreement. Once that is established, in order to avoid placing an impossible burden of proof on the plaintiff, a presumption will arise to the effect that such disproportion results from exploitation by the other contracting party of the plaintiff's condition or of circumstances. Proof to the contrary can be made, of course, as the other party may show that no exploitation exists. Thus only in these precise circumstances, to be assessed by the courts, can lesion vitiate consent."

3.127. The Netherlands formulation. In the draft proposals for a new Netherlands Civil Code a new category vitiating consent has been introduced, partly after consideration of English remedies for undue influence. It is there provided that a juristic act is annulable if brought about by threat, fraud or "abuse of circumstances". Very approximately translated, Article 3.2.10.4. reads:

"Abuse of circumstances exists where some person who knows or ought to know that another is being caused to oblige himself because of special circumstances - such as a situation of emergency,

¹Loc. cit.

dependence, lack of care, abnormality of mind or inexperience - furthers the undertaking of that obligation, although the facts of which he is aware should preclude him from so doing."

3.128. The Quebec and Netherlands formulations taken together seem to focus those various loosely classified or unclassified elements in Scots law which might be grouped within a category of "lesion", and which could be regarded as an additional ground for vitiating consent. Such a category could supersede "facility and circumvention", "undue influence", "extortion" in its secondary sense of exploiting a situation of necessity and other various aspects of exploitation. It may well be that the courts could already to some extent develop the law judicially in this direction, but precedent creates obstacles. They would be impeded by such 19th century judicial pronouncements as those of Lord Justice-Clerk Hope in A B v. Joel¹ and Lord Blackburn in Caledonian Ry. Co. v. N B Ry. Co.² Provisionally it seems to us desirable to create a new platform for judicial development. That is to say, legislation would set the framework within which judicial evaluation could operate freely.

Our proposed new category.

3.129. Accordingly we suggest tentatively for comment and consideration a new nominate category of annulment of obligations which we call, provisionally, "lesion". Annulment for lesion should, we think, be at the discretion of the court, which should have the power to grant it, where

¹(1849) 12 D. 188.

²(1881) 8 R. (H.L.) 23 at p.31.

appropriate, on terms (see paragraphs 3.65 and 3.66, supra). We propose that lesion should be defined along the following lines:

"1. Annulment of an obligation on the ground of lesion shall be competent when a party can show that unfair advantage has been taken of his weak personal or economic position.

It will be presumed that unfair advantage has been taken:

- (1) In mutual obligations, when there is a gross disproportion between the prestations of the parties; or
- (2) when it is proved that serious prejudice has been sustained, or will be sustained, as a consequence of the obligation by a party who was in a situation of dependence upon the other party; or
- (3) when it is proved that serious prejudice has been sustained, or will be sustained, as a consequence of the obligation by a party who, as the other party knew or ought to have known, was suffering from impairment of mental capacity or was weakened by illness, age or addiction to alcohol or drugs; or
- (4) when it is proved that serious prejudice has been sustained, or will be sustained, as a consequence of the obligation by a party who, as the other party knew or ought to have known, lacked the normal ability to protect his own interests when undertaking obligations, through ignorance, inexperience, lack of education or understanding of language.

2. When it is claimed (or appears to the court) that the consent of a party to an obligation has been given because unfair advantage has been taken of his weak personal or economic position, the party maintaining the obligation shall be entitled to present evidence regarding its commercial setting, its purpose and effect to rebut this allegation."

The overriding test would therefore be whether unfair advantage had been taken of a party's weak personal or economic position. It would be for the court to say whether the advantage alleged to have been taken of him by the other party was unfair; and the latter would be entitled to lead evidence of the purpose, effect and general commercial setting of the obligation to counter the pursuer's allegation of unfairness. A rebuttable presumption that unfair advantage has been taken would arise on the pursuer's proving (and the onus would be on him) that his case falls within one or other of the four sets of circumstances set out above.

3.130. Some may take the view that a ground of annulment such as we have just described would introduce an undesirable degree of uncertainty and instability into contractual relationships: any contract would be challengeable if it could be shown that one party had taken unfair advantage of the other's weak position, and a presumption that unfair advantage had been taken would arise whenever, looked at objectively, the contract was much more favourable to one party than to the other. Particularly in relation to business and commercial contracts, it might be argued, such a ground of annulment would be unacceptable since success in business is, to some extent at least, based upon taking full advantage of prevailing circumstances (including the economic weakness of those with whom one contracts) in order to extract

the best possible terms from the other party. This line of argument would point to the conclusion that our proposed new ground of annulment, if introduced at all, should be confined to consumer, or at least to non-commercial, transactions.

3.131. We regard the maintenance of faith in the enforceability of commercial contracts as an important objective of the law, and would not wish to encourage any doctrine which would undermine the stability of contracts fairly concluded. However, we think that a reasonable balance ought to be maintained between the principle that contracts, once entered into, must be enforced according to their terms, and observance of acceptable standards of fair dealing in mercantile transactions as well as in non-mercantile agreements. We would stress that our proposed ground of annulment permits the presentation of evidence regarding the commercial setting, purpose and effect of the obligation in rebuttal of any allegation of the taking of unfair advantage. We would also observe that (as is shown in paragraphs 3.121 to 3.127, supra) a number of highly successful commercial nations have introduced or are about to introduce provisions permitting the annulment of contracts secured by unconscionable or unfair dealing which exploits unduly the relative personal or economic weakness of a co-contractant. We invite comments on our proposed new category of annulment, and on whether, if introduced into Scots law, its operation should be excluded in the case of mercantile or business transactions.

3.132. We have already pointed out (see paragraph 3.85, supra) that our proposals relating to error as a ground of annulment of obligations could be applied by analogy to other inter vivos legal acts. As far as threats and our new ground of lesion are concerned, it would again be possible for them to be applied by analogy and without restriction to other inter vivos acts resulting from consent or other declaration of will. We have reached no concluded view on the matter. But, as in the case of error, we do not at present propose that our suggested new categories of threats and lesion as grounds of annulment should be extended to mortis causa deeds, though it may, at some future date, be desirable for the grounds of annulment of mortis causa deeds to be brought into alignment with those operative in the case of inter vivos acts. Comments are invited.

J. BONA FIDES.

3.133. Apart from nominate categories of factors vitiating consent we recognise that there is a substratum of the doctrine of bona fides in the Scots law of obligations. The institutional writers recognised its relevance in most contracts, except for "transaction" (compromise) which was stricti iuris, and possibly also mutuum.¹ Mr. A.J. Mackenzie Stuart (as he then was) has expressed the view² that Kames's concept of equity in contract dissolved under the analytic scrutiny of the 19th century, but he does not document this conclusion, which he stated in the restricted context of a short article (of prescribed length) on a large topic. It may be that he had principally in mind the doctrine of lesion

¹Kames, Equity, 4th ed., p.246; Stair, I.11.6., Bankton, I.11.65.

²Introduction to Scottish Legal History, Stair Society, vol. 20, p.255.

and justum pretium. Certainly it is true that a doctrine of good faith in Scots law is not easy to harmonise with some of the "sanctity of contract" dicta pronounced, especially in the House of Lords, during the 19th century.¹ "Good faith" is not even to be found in the index of Gloag's treatise on Contract, though he does refer to its relevance in connection with interpretation and substituted performance.² As Llewellyn has pointed out³, if the doctrine of good faith is confined to interpretation of contract in an attempt to do justice, it may distort substantive law. Some may see developments in the English law of fundamental breach as illustrating the danger of distorting substantive law by strict interpretation to avoid injustice. We know of no statute or authoritative decision by which the doctrine of good faith (bona fides) has been abolished in the Scots law of obligations, and views have been expressed in the House of Lords that remedies cannot be lost merely by desuetude.⁴ At least two modern writers on Scots law are prepared to assert the survival of the general doctrine in contract law.⁵ We wish to express no opinion on the matter except that we have no ground for

¹ See e.g. Caledonian Ry. Co. v. N.B.Ry. Co. (1881) 8 R. (H.L.) 23 at p.31.

² Contract, 2nd ed., p.400.

³ See para. 3.123, supra.

⁴ McKendrick v. Sinclair 1972 S.C.(H.L.)25.

⁵ Gow, Mercantile and Industrial Law of Scotland p.179 et seq.; Smith, Short Commentary p.297, 756, 830, 838 et seq.

believing that the doctrine has been abolished. What its scope may be is another matter. Further, in modern legal systems the doctrine of bona fides is not restricted to the time of constitution of obligations but is equally relevant in relation to performance and use of remedies on breach. Accordingly, we consider that the appropriate way to deal with the doctrine of bona fides in Scots law is in a separate study. We cannot commit ourselves to a view on when our priorities and resources will enable us to undertake such a study.

K. DEFECTIVE OR VITIATED CONSENT AND THIRD PARTY RIGHTS

3.134. There can be no doubt that it is currently the law that, where the consent of a party to an obligation has been vitiated by error, fraud, facility and circumvention, etc., that party is entitled to annul the obligation even where the right of credit under it has been assigned for value to a third party who was unaware that any such grounds for annulment existed. This must be contrasted with the protection from such challenge that the law accords to onerous bona fide acquirers of rights in immoveable property, rights in corporeal moveable property and negotiable instruments. So far as the latter three categories are concerned, rules of property law interrupt the normal consequences of annulment summarised in the two Latin maxims resoluto iure dantis resolvitur ius accipientis (when the cedent's right is annulled, the transferee's right is also annulled) and assignatus utitur iure auctoris (the assignee can only assert as good a right as his cedent). We have already sought to counter the view that, because in continental systems the bona fide acquirer of moveables is given greater protection than (say) in English law, this is because these systems do not distinguish between "void" and "voidable" contracts. The distinction between

absolute and relative nullity is, in fact, well known. Matters are well expressed by Holstein:¹

"(A)ll dispositive acts emanating from the contract are extinguished by its annulment. Therefore, the way is open for the principle that nobody can transfer a greater right than he himself has. However, in France, this result is forestalled by the intervention of the celebrated principle 'en fait de meubles, la possession vaut titre' [in questions concerning moveables possession equals title]. The bona fide acquirer of a corporeal moveable is thereby protected although the transaction upon the strength of which his predecessors took title is subject to being annulled on account of consensual vice."

The officious bystander might well ask: if onerous acquirers of heritable rights and rights in corporeal moveables and negotiable instruments are protected, why should not be transferees of obligations and all incorporeal property rights?

3.135. Stair took the view that²

"the fraud of authors is relevant against singular successors, though not partaking nor conscious of the fraud, when they purchased; because assignees are but procurators, albeit in rem suam."

According to Dr. McBryde's research³, this view was probably first judicially approved in Burden v. Whitefoord in 1742.⁴

¹(1939) 13 Tul.L.R. 560 at 583.

²IV.40.21; see also I.9.10, IV.35.19, I.9.15; Bankton, I.257, 59; I.259, 65..

³Op. cit., pp.86-92.

⁴1742 Elch. Dec. Fraud 11.

The matter was fully discussed in Irvine v. Osterbye in 1755.¹ In that case the dispute was between insurers and an onerous assignee, against whom the insurers asserted the cedent's fraud. The assignee pleaded:

"Dolus auctoris non nocet successori ex titulo oneroso" prevails with us, in the case of one purchasing a real estate from a person infert, or moveables which the seller neither stole nor got by robbery, or of one purchasing bills of exchange for value; the same rule must obtain, by parity of reason, in the case of a fair purchaser of personal rights."

The insurers per contra argued that acquirers of bonds were to be treated differently from purchasers of heritage, corporeal moveables and bills - and to bonds the rule assignatus utitur iure auctoris should apply. They relied moreover on Stair and Burden v. Whitefoord, and the court preferred the insurers to the bond. The matter was reargued in 1772² when it was contended unsuccessfully that Stair and Bankton were wrong. Kames, in his Elucidations³, thought that the distinction made with regard to personal rights was due to a misunderstanding regarding the nature of assignation in Stair's time, but the law has been decided in accordance with that view. The argument based on the transferee being procurator in rem suam dates from a period when modern doctrines of assignation were just beginning to emerge. It was somewhat of a novelty that an obligation between A and B could be transferred to C at all. By constituting him as B's agent to enforce the obligation but authorising him to retain the proceeds, B and C could seem to be in a sense identified,

¹(1755).Mor. 1715.

²McDonnells v. Carmichael & Ors. (1772).Mor. 4974.

³pp.13-14.

but this appearance vanished as assignation came clearly to be recognised as a transference of a claim - an incorporeal right of property. It is still competent to constitute a transferee as mandatary but the modern practice is to use assignation. Prior to 1862 two forms of assignation were in use - in one the cedent directly assigned the debt as well as the bond itself; in the other the cedent constituted the assignee the assignee to both sum and deed, and subrogated the assignee in place of the cedent. The Transmission of Moveable Property (Scotland) Act 1862 now provides forms appropriate generally to moveable rights which may be written on the deed assigned or form a separate deed.

3.136. In short, Stair's reason for distinguishing between the effects of vitiated consent on transferees of personal rights and transferees of other rights has ceased even to have ostensible justification. Nevertheless, there is no doubt that the law is settled to that effect. In Scottish Widows' Fund v. Buist¹ Lord President Inglis states:

"It appears to me to be long ago settled in the law of Scotland - and I have never heard of any attempt to disturb the doctrine - that in a personal obligation, whether contained in a unilateral deed or in a mutual contract, if the creditor's right is sold to an assignee for value, and the assignee purchases in good faith, he is nevertheless subject to all the exceptions and pleas pleadable against the original creditor. That is the doctrine laid down in all our institutional writers, and it has been affirmed in many cases The doctrine does not apply to the transmission of

¹(1876) 3 R. 1078.at p.1082.

heritable estate; the doctrine does not apply in the sale of corporeal moveables. But within the class of cases to which the doctrine is applicable - I mean the transmission to assignees of a creditor's right in a personal obligation - I know of no exception to the application of the doctrine."

3.137. Incorporeal property may take very many forms - some of recent origin and not connected with corporeal property at all, such as "intellectual property", and difficult therefore to conceptualise in terms of property rights against the background of the Roman law division between real and personal rights which lies behind the development of the law. A right of credit may be viewed either as a claim or as an asset (property right). There is a sound historical explanation of why onerous transferees of some classes of incorporeal property or obligations - by contrast with transferees of other property - should be liable to all exceptions and pleas competent against the cedent. However, it is possible to argue that apart from settled practice there are today no convincing reasons for making an exception to the general rule.

3.138. The New Zealand Contracts and Commercial Law Committee, in their Report on Misrepresentation and Breach of Contract (1967), examined the problem of "avoidance" against the background of the English doctrine of "cutting off of equities"¹ and noted that there is a dearth of settled judicial authority on this "important problem". They therefore approached it on general grounds. On the one hand it could be said that the party who had signed a document should not be heard to resile from that writing, because by signing he had aided the assignor (who

¹19.1.8.

obtained the document by misrepresentation) to mislead the assignee. On the other hand it could be said that the rights of the party granting the writing should not be abridged by the introduction of an assignee, and that the latter should ascertain from the assignor the exact position. In the last resort, as between the original grantor and the assignee, who should bear the risk of the insolvency or disappearance of the misrepresenting assignor? On balance the Committee concluded that the assignee (who would have a right of relief against an assignor if he himself had been sued) should bear the risk of the insolvency or disappearance of the assignor. However, the third party (the assignee) should not be exposed to claims for damages for an unlimited amount in a situation of which he might have been unaware. Accordingly, they recommended that, unless he had otherwise agreed, the assignee should not be liable to the original grantor beyond the value of the performance of the assigned contract. This approach is understandable, but the same arguments could be said to apply by parity of reasoning to transfers of immoveable or corporeal moveable rights or negotiable instruments which had been secured by misrepresentation and had subsequently been transferred to an onerous third party taking in good faith.

3.138. Under the Transmission of Moveable Property (Scotland) Act 1862 delivery of the assignation to the assignee is sufficient to confer on the latter the ius crediti against the cedent, but to perfect the transmission against the debtor and third parties there must be intimation of the assignation to the debtor. If the cedent intimates an undelivered assignation to the debtor, the intimation dispenses with the need for delivery to the assignee. It might be thought that, on analogy with the registration of a right in heritage or acquisition of possession of corporeal

moveables, if the assignatus utitur iure auctoris doctrine were to be limited in relation to personal rights, it should only be in favour of an assignee after he had received delivery of an assignation and after notification to the debtor. The assignee would, of course, be protected from annulment only if he was in good faith and, at the time of acquisition of his right, ignorant that the obligation was under challenge on account of the other party's defective consent. Furthermore, he would be protected only from annulment for defective consent (error, threats, lesion). If the other party had grounds for rescission or cancellation of the contract because of the cedent's breach (e.g., in the case of an insurance contract, his breach of the warranty that the information supplied by him in the proposal form was accurate) then the assignee would be as vulnerable as the cedent himself would have been. It is only annulment for defective consent that would be barred by the intervention of a bona fide onerous assignee.

3.139. It is, then, possible to take the view that there is no logical reason for discriminating against onerous bona fide transferees of personal rights as contrasted with the protected position of onerous bona fide acquirers of corporeal moveable property. On the other hand, some may think that there is a very real difference between the transfer of corporeal moveable property to onerous bona fide third parties and the transfer of personal rights. By allowing a physical object out of his possession, the owner enables the present possessor to hold himself out as owner and to induce bona fide third parties to transact with him on that basis. The owner has chosen to trust the person to whom he has confided possession of the thing. If his trust turns out to have been misplaced, then it is he rather than the onerous third party

acquirer in good faith who should bear the loss. In the case of the transfer of personal rights, on the other hand, it could be argued that the equities are not so clearly in favour of the bona fide assignee. He knows that what he is acquiring is a legal claim against another person for payment of money or performance of an act; and he knows, or ought to know, that there can exist defences or legal grounds on which such claims can be defeated. If the claim in question turns out to be defeasible (e.g. because the debtor was induced to contract by the original creditor's misrepresentation) then the assignee's remedy should be against the cedent on whose express or implied representation that the right assigned was valid and unchallengeable the assignee chose to rely.

3.140. Furthermore, it could be argued that since, under our scheme, annulment in most cases is at the discretion of the court, and may be granted on terms compensating the other party for loss sustained in consequence of the annulment, a bona fide onerous assignee is already sufficiently protected. A court, in the exercise of its discretion, might well decide to refuse annulment, or to grant it only on particularly generous terms, where the interests of an innocent and onerous third party were at stake. It could also be argued that to protect the position of the onerous bona fide assignee as against the debtor in an obligation affected by vitiated consent could in certain situations open the door to undesirable trade practices. For example, a retailer (or a mail order trader or a home-improvements contractor) might induce members of the public to enter into contracts with him under which credit was extended by misrepresenting the quality of the goods sold or of the services provided. If the retailer then assigned his rights under these contracts for value to

e.g. a debt-collecting or debt-factoring agency which acted in good faith and without knowledge of the misrepresentations, then the customers would be unable to annul their contracts or to rely upon the retailer's representations as a defence in any action for payment brought against them by the debt-collecting agency. They would be obliged to pay the agency and thereafter to claim whatever recourse was available to them (e.g. a delictual action for negligent or fraudulent misrepresentation) against the retailer, who might in the interim have disappeared or become insolvent. It would be possible to avoid this result, if thought necessary or desirable, by providing that the onerous bona fide assignee should not be affected by his author's misrepresentation, etc, to the debtor in the case of obligations ad factum praestandum, but should be so affected in the case of obligations to pay money. Such a restriction would prevent the increased protection accorded to transferees redounding to the benefit of debt-collection agencies.

3.141. At this stage, before consultation, we do not ourselves wish to put forward even tentative proposals to alter the existing law governing the position of bona fide assignees for value. We should, however, welcome comments, in particular based on problems experienced in practice, on the desirability or otherwise of retaining or modifying the status quo and on the weight which should be accorded to the various arguments in favour of or against extending to onerous transferees in good faith of personal rights the same protection as is accorded to onerous bona fide acquirers of corporeal moveable property. If such protection were to be extended to assignees, should it apply only in the case of obligations ad factum praestandum and not in the case of obligations to pay money?

PART IV

RESTITUTION IN INTEGRUM

Introduction

4.1. Linked with the question of acquisition of rights by third parties and their possible vulnerability to annulment by reason of vitiated consent pleaded against their cedents, is the rule that a contracting party seeking to annul a transaction because of vitiated consent may be barred because restitutio in integrum has become impossible, e.g. because of transfer to a third party whose right is protected or because restitution in any literal sense has become impossible. If a large scale and costly excavation has been carried out in implement of a contract entered into through misrepresentation, restitutio in integrum is in a literal sense impossible. Boyd & Forrest v. Glasgow & S.W.Ry. Co.¹ has been interpreted to the effect that impossibility of restitutio in integrum bars annulment of contract on grounds of vitiated consent. This rule may operate particularly harshly in cases where a party who could otherwise have reduced the obligation has no alternative remedy for damages based on culpa. When the law regarding restitutio in integrum was first developed in Roman law it is unlikely that more than restoration of property was contemplated. The possibility that the promised prestation might have been abstention from action or might have been the carrying out of engineering work or the selling of shares as a result of fraud was probably absent from the minds of the praetors.

4.2. Already some exceptions have been recognised in the law of Scotland to the strict and literal application of the rule that annulment must be refused if specific restitution has become impossible. Especially in cases of fraud, the doctrine of restitutio in integrum is not applied too literally, and money may be awarded as a supplementary

¹1915 S.C. (H.L.)20.

element in restitution to maintain equality.¹ Moreover, a mala fide former possessor of corporeal moveables is obliged to make restitution of value as a surrogatum,² when he cannot restore the property itself. The officious bystander might enquire why this principle should not be extended when a party to an obligation could have had it annulled for vice of consent but is met with the answer that restitutio in integrum is literally impossible. Five years' abstention from competition cannot be restored specifically, nor can the work of boring through solid rock instead of clay be literally restored to a contractor who has been misled, however innocently, by the representation of a beneficiary who will profit from work undertaken in implement of the contract. Having gone some distance in regarding money as a surrogatum for specific restitution - not as damages - it may be thought that matters should be taken to the logical conclusion of annulling obligations for vice of consent when money can be rendered as a surrogatum. Money is the only possible solvent of many legal problems - from solatium for suffering to damages for harm to property or breach of contract, or recompense for unjustified enrichment. Recompense, repetition and restitution are all aspects of unjustified enrichment, and it is not self-evident that, because two of these aspects are assessed in terms of money, the third cannot. As the Preacher discerned,³ "Wine maketh merry; but money answereth all things". This in general has been the law's approach, but hitherto restitutio in integrum has presented obstacles.

Comparative Considerations

4.3. Modern formulations of law confronted by the same problems of restitutio in integrum have not found them unsurmountable and have used money as a surrogatum if necessary. Thus draft Article 57 of the Report on Obligations for the revised Quebec Civil Code provides:

¹Spence v. Crawford 1939 S.C. (H.L.) 52.

²See discussion in Memorandum No. 31, para. 9 et seq.

³Ecclesiastes, ch.10, v.19.

"Restoration in the original position is effected in kind. If this is impossible or cannot be done without serious inconvenience, such restoration is effected by equivalence."

The Israeli formulation in the Contracts (General Part) Law 1973, s.21, reads:

"Where a contract has been rescinded, each party shall restore to the other party what he has received under the contract or, if restitution is impossible or unreasonable, pay him the value of what he has received."

Similarly the draft for the new Netherlands Civil Code provides in art. 6.4.2.1:

"1. Anyone who has given property to another sine causa is entitled to reclaim it as a prestation not owed.

2. If the solutio indebiti relates to a sum of money, then the claim is for repetition of an identical amount."

Article 6.4.2.8. goes on to provide:

"Prestations effected sine causa which differ in nature from those specified in article [6.4.2.] 1 must be undone by applying mutatis mutandis the provisions of this section."

Our provisional solutions

4.4. We see no good reason why, even if it is impossible or impracticable to make specific restitution, a court should not annul an obligation on the ground that consent was vitiated. If restitutio in integrum is impossible or impracticable, the court should have power to evaluate the prestation to be restored in terms of money. This sum would not represent damages but would be a surrogatum for performance. Indeed all questions of damages would be reserved to be dealt with by the appropriate rules of contract or delict. As a basis for comment we suggest a variant of the Quebec formulation: namely that restitutio in integrum should, if practicable, be effected in kind. If this is impossible, or cannot be effected without serious inconvenience or can be effected only partially, the court should be empowered to decree payment of money as a surrogatum for all or part of what is due. We invite comment.

4.5. In certain highly exceptional cases, such a provision could, as it stands, create problems. Suppose a painting were sold which both parties believed to be a modern copy of a Rubens. Some time later, and only after the painting had been accidentally destroyed or disposed of by the buyer, it is discovered that it was a genuine Rubens. The seller, whether because of the misattribution itself or for some entirely separate reason, e.g. deception by the buyer, has grounds for annulment and, under our proposal, the inability of the buyer to restore the painting in forma specifica is no longer a bar to annulment since restitution can be made by means of a monetary surrogatum. It seems wrong to us that the monetary payment due from the buyer should be the value of a genuine Rubens. We therefore suggest for consideration that when restitution of property to a party seeking annulment is no longer physically possible (e.g. because the other party has consumed or transferred it) the other party, on the analogy of the law of recompense, should not be obliged to restore to the party annulling more than the profit which he has made on the transaction. (We do not, of course, seek to exclude any delictual action for damages which the party annulling may have against the other). We invite comments.

PART V
DAMAGES FOR CULPABLE MISREPRESENTATION

Introduction

5.1. We have examined the effect of vice of consent on obligations constituted by the will or consent of a declarant, primarily in the context of annulment of contract or voluntary obligation. Subsequently we considered the effect of such annulment in the context of restitution and repetition which are aspects of obediencial obligation. It may be, however, that the same acts of a contracting party which would justify his co-contractant in rescinding or annulling the contract would also justify a claim for damages in delict. The delictual remedy is independent of annulment or restitution, and indeed a defrauded party, for example, may claim damages for loss without seeking to annul the obligation.¹ English lawyers have long been involved in what the late Professor Winfield described as the "tort-contract catena" and have found it difficult to distinguish clearly between remedies in tort and contract when the facts might justify a remedy in tort or in contract or in both types of obligation. Obvious examples are the background in English law to the House of Lords decision in Donoghue v. Stevenson² and certain aspects of occupiers' liability. The field which we are about to examine seems to be yet another example of the same "tort-contract catena", as is apparent in the treatment of culpable misrepresentation in English treatises on contract law, especially when discussing the Misrepresentation Act 1967. We mention this at the outset of our discussion for the avoidance of misunderstanding. We are in this Part of our Memorandum concerned exclusively with delict and delictual remedies, though the facts which justify them might also be relied on, as discussed in the earlier parts of this Memorandum, in connection with contractual situations.

¹See e.g. Smith v. Sim 1954 S.C. 357.

²1932 S.C. (H.L.) 31.

Fraud

5.2. In Roman law and in systems which have developed their laws on Obligations from Civilian sources, "fraud" or "dolus" is a delict justifying a claim for damages. As we have discussed earlier in this Memorandum, fraud as "a machination or contrivance to deceive" may take many forms apart from misrepresentation and, as in the case of culpa in the narrower sense of negligence, its categories are never closed. We are unaware of any doubts or difficulties in the law of Scotland relating to fraud as a delict either in general or, in particular, when a delictual claim is founded on fraudulent misrepresentation. However, we should be glad to consider the comments of those we consult on difficulties encountered regarding the scope of fraud in its delictual aspect.

Negligent misrepresentation

5.3. The other main source of delictual liability in Scots law, apart from dolus (an aspect of culpa in its wider meaning), is culpa, in its narrower sense of negligence. It is the basis of delictual liability in a very wide variety of situations. If foreseeable harm has been caused to another by a defender's failure to take reasonable care to avoid it, the onus is now usually on the defender to show reason why the general principles of liability should not attach.¹ There are, however, apparent exceptions to the general rule. Thus there has been considerable controversy as to whether and to what extent liability for culpa should be imposed when the harm sustained takes the form of economic loss and this loss has not been caused by physical damage to property of the pursuer. The concept of Aquilian fault, which is the basis of a Scottish reparation action based on negligence, derives from Roman law which ultimately had recognised within limits liability for harm caused nec corpore nec corpori, i.e. caused neither by nor

¹ See e.g. Home Office v. Dorset Yacht Co. [1970] A.C. 1004 per Lord Reid at p.1027.

to a physical thing. Liability for economic loss caused without physical harm to the pursuer's property was formerly often recognised in Scots law when a gaoler negligently had allowed a debtor to escape from prison where he had been subjected to squalor carceris to induce him to pay.¹ Carelessness in witnessing a bond was also held to entail liability to a party prejudiced when the bond was annulled.² Thus the creditor (the pursuer) was prejudiced financially. In the earlier part of the 19th century there are several Scottish decisions which recognised liability for economic loss irrespective of physical harm to the pursuer's property,³ but this line of development was to some extent checked through confusion of delictual claims with the rights of a tertius and the doctrine of jus quaesitum tertio.⁴ Moreover, quite recently in Dynamco v. Holland & Hannan & Cubitts (Scotland)⁵, in which more recent authorities were considered, the Court of Session has refused to admit a claim for financial loss resulting from the cutting off of electric current by an excavation which did not physically damage the pursuer's property. The scope of that decision is not altogether clear, since Lord Cameron, with whom the Lord President agreed, declined expressly to decide whether in the circumstances a duty of care was owed by the defender. It will eventually be the task of this Commission to undertake a comprehensive study of the law of delictual liability for economic loss. Clearly as the law stands at present there are some limits to liability for pure economic loss caused negligently but without physically harming the pursuer's property. Nevertheless the fact that there are some limits does not

¹ Erskine III.1.13 and see the many cases cited sub voce "Prisoner" Mor. 11719 et seq.

² Blair & Allan v. Peddie (1684) Mor. 13942.

³ Lang v. Struthers (1826) 4 S.418, (1827) 2 W. & S. 563; Lillie v. Macdonald Dec. 13, 1816 F.C.; Goldie v. Macdonald (1757) Mor. 3527; Macmillan v. Gray Mar. 2, 1820 F.C.

⁴ e.g. Robertson v. Fleming (1861) 4 Macq. 167; see discussion in Smith, Studies Critical and Comparative pp. 190-191.

⁵ 1971 S.C. 257.

necessarily mean that the law does not already recognise certain areas of liability. In our view it already recognises liability for negligent misrepresentation at very least where a relationship can be established between the maker of the misrepresentation and the person deceived such that the latter could reasonably rely on the statements of the former.

5.4. An ostensible obstacle to the view that there can be delictual liability for negligent misstatement in Scots law are certain dicta in the House of Lords in Robinson v. National Bank of Scotland,¹ a case which was not fully argued after intervention by Lord Loreburn. The course of pleading and argument in that case were not apt to focus the issue of liability for negligent misstatement, and Lord Reid's dissection of the case and his exposition of its curious treatment during the hearing by the House of Lords² seems to justify disregarding dicta in Robinson as an obstacle to recognition of such liability today, even beyond situations where negligent misstatement has induced contract.

5.5. Even before the important decision of the House of Lords in the English case of Hedley Byrne & Co. Ltd. v. Heller and Partners Ltd³ in 1963, views had been expressed by text writers and extra-judicially by at least one Scottish judge that Scots law was free to award damages for negligent representation in certain circumstances. Thus, for example, T.B. Smith wrote in 1962⁴:

¹1916 S.C. (H.L.) 154.

²Hedley Byrne & Co. Ltd. v. Heller & Partners Ltd [1964] A.C. 465 at pp. 489-492.

³Sup. cit.

⁴Short Commentary pp. 834-5; see also p.674.

"As has been discussed already in the context of delict, there may be liability in Scots law for harm caused by negligent statements ... The doctrine of Candler v. Crane, Christmas & Co.¹ which was regretted by the English Court of Appeal as illogical, is not binding in Scotland. It is submitted that when a false representation causes loss, an action in delict should be competent in Scotland (as an alternative to reduction and restitution) provided that culpa can be established."

At about the same time, and again before the House of Lords had examined the law in Hedley Byrne, Lord Hunter had commented extra-judicially²:

"With all³ respect to the memory of Bowen L.J. this statement³ seems to me as a lawyer unsound and as a layman lacking in common sense and even absurd ... Professor T.B. Smith ... has recently dismissed Candler v. Crane, Christmas & Co. in the following sentence⁴ - 'To describe, as the English do, a non-fraudulent statement as "innocent misrepresentation" seems to me as unjustifiable as to describe running down a pedestrian on the highway as "innocent bad driving"' - and he adds that both should surely found an action in delict. On this matter I confess myself on the side of Lord Denning and Professor T.B. Smith, and I dare say we may all be on the side of the angels. At any rate I should be sorry to see a Scottish court reach upon English authority a decision so grossly inequitable as that to which the majority in Candler v. Crane, Christmas & Co. felt themselves compelled."

5.6. In Hedley Byrne the House of Lords were concerned with liability for negligent misstatement in a context where the relationship between plaintiff and defendant was in fact less close than is that of parties negotiating the terms of a contract which, self-evidently, they must appreciate is going to affect the parties thereto. In that case, the plaintiffs had entered into contracts on behalf of Easipower on terms under which they would themselves be liable if Easipower defaulted.

¹[1951] 2 K.B. 164.

²"Recent Legal Cases of Interest to Chartered Accountants" (1961) 65 The Accountants Magazine esp. p.240 et seq.

³"But the law of England ... does not consider that what a man writes on paper is like a gun or other dangerous instrument, and, unless he intended to deceive, the law does not, in the absence of contract, hold him responsible ..."
Le Lievre v. Gould [1893] 1 Q.B. 491 at p.502.

⁴Studies Critical and Comparative, p.82.

Wishing to check on Easipower's credit, they asked their bank to make inquiries regarding this matter of the defendants, who were Easipower's bankers. Relying on the bankers' reply they placed orders and suffered substantial financial loss when Easipower went into liquidation. The House of Lords expressed the clear view that, but for the defendant's express disclaimer of liability for their reply, they would have been liable for economic loss caused by their negligent statements. The House of Lords were not prepared to deal with such liability on the basis of general liability for negligent conduct, but considered that liability for negligent misstatement depends upon the existence of a "special relationship" between plaintiff and defendant. In the subsequent Privy Council Case of Mutual Life Assurance Co. v. Evatt¹ (which is not a binding authority as far as United Kingdom courts are concerned) the majority sought to limit the somewhat wider formulation of the law in the earlier case by Lords Reid and Morris. But in the recent case of Esso Petroleum v. Mardon² the Court of Appeal in England has preferred their wider statement of the law. We are not for present purposes concerned with the limits of liability for negligent misstatement. We are concerned only with negligent misstatements made by or on behalf of contracting parties which have influenced one party to enter into a contract or ostensible contract with the other in circumstances which have caused financial loss to the party deceived. We do not think that it is stateable that there is not a "special relationship" between the contracting parties within the meaning of the House of Lords in Hedley Byrne. In the Esso Petroleum case in England, which was decided at common law and not under the provisions of the Misrepresentation Act 1967, the courts had no difficulty in holding a contracting party liable in tort for negligent misstatements to his co-contractant. In short the House of Lords and the English courts have made it clear that a contracting party can be liable for loss caused by negligent misstatement inducing a party to contract. As we observed, views which

¹[1971] A.C. 793.

²[1976] Q.B. 801.

went beyond these limits had been expressed in Scotland even before these developments, and we cannot envisage that the House of Lords would decline to recognise a Scottish claim in delict for damages in these circumstances.

5.7. Although we are satisfied that today the law of Scotland would grant a delictual remedy for negligent misstatement causing loss if such statement were made in negotiating an obligation, we think that this may be a case in which confirmation of the position by legislation would be desirable. Matters have been obscured by irrelevant discussion in a Scottish context of the English doctrine of so-called "innocent misrepresentation". This expression was, and to a lesser sense still is, used in England to denote non-fraudulent misrepresentation generally, i.e. including negligent misrepresentation and misstatements which were made entirely without fault. The latter category must be very rare indeed, and it is unfortunate that so misleading an expression should ever have gained circulation in a Scottish context. We do not think that Scots law would hold a defender liable in delict for an inaccurate statement for which he could not be blamed at all. However, we find it difficult to envisage such cases. If a person in negotiating a contract has made a false statement which has caused loss to the other, the inference of negligence would, we think, be strong and not easy to displace. Nevertheless, we think that, in view of the absence of modern Scottish judicial authority on negligent misstatements in the law of delict and in the light of the doubt which exists over the general question of the extent of liability for pure economic loss, it would be beneficial if it were confirmed by legislation that a contracting party be liable in delict for loss caused by a negligent statement inducing the other party to contract. Comments are invited.

5.8. It seems to us that where one party had induced another to contract with him on certain terms by negligent misstatement and consequently caused loss to that other,

it would be impossible to establish that there was no such "special relationship" between the parties as to found liability on the principle recognised in Hedley Byrne. We are not in this Memorandum concerned with the limits of liability for negligent misstatement generally, but consider that the same basis of liability as would apply in contractual situations must, by analogous reasoning, apply in other situations in which a person has suffered loss because he was induced to declare his will to a certain effect as a result of the negligent misstatement of a beneficiary of that declaration. Thus transfers of property, discharges of obligations, pollicitations, cautionary for another induced by negligent misstatement by the beneficiary should also be recognised as potential grounds for delictual liability if loss is incurred in consequence. Comments are invited.

The English Misrepresentation Act 1967

5.9. In this Part of our Memorandum we have considered delictual liability for negligent misstatement, and have deliberately avoided a hybrid solution between contractual and delictual liability such as seems to have been favoured by the English Misrepresentation Act 1967.¹ This Act was based on the Tenth Report of the Law Reform Committee in 1962 and apparently takes no account of the development of the law in Hedley Byrne v. Heller. Those who are primarily concerned for consumer interests may observe that the English Act enables a person to claim damages for misrepresentation unless the other party to the contract proves that he has reasonable cause to believe and did believe that the facts represented by him were true. The Act, moreover, confers on a Court a discretion to uphold the contract and award damages in lieu of cancellation even though the misrepresentation was entirely "innocent" in the sense of being neither fraudulent nor negligent. We note that the English Act has seldom been the subject of judicial decision, has been extensively criticised by authors of

¹We discuss defects in this legislation more fully in paras. 5.12 et seq., infra.

books and articles and that its solutions have been expressly rejected by the Contracts and Commercial Law Reform Committee of New Zealand. We consider that if a pursuer can prove that he was induced to contract by a defender's false statement and consequently suffered loss, in Scots law the statement would be regarded as having been uttered negligently unless the defender could establish the contrary - a formidable task. Scots law, in our view, would and should be concerned with what a reasonable man should have foreseen rather than whether the defender had reasonable grounds for believing that the facts represented by him were true. In the rare case where the defender could establish that he had been altogether without fault in securing the contract by misrepresentation - e.g. that he had communicated the unanimous opinion of a highly regarded professional body - he would on the grounds proposed in Part III of the Memorandum still be vulnerable to annulment of the contract because of vitiated consent. We do not consider that he should also be strictly liable in delict. This Commission did not favour the extension of the Misrepresentation Act 1967 to Scotland when the legislation was being considered in Parliament, partly because the legislation seemed confused, and partly because in the Commission's view the law of Scotland already provided adequate remedies for misrepresentation in contract, restitution and delict. We remain of this opinion.

5.10. The Report of the Contracts and Commercial Law Reform Committee of New Zealand on Misrepresentation and Breach of Contract (1967) rejected the solutions of the English Act of 1967 and recommended inter alia that¹:

¹
Recommendation 2.

"It should be enacted that a party to a contract who is induced to enter into it by the 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."

Scots law came to accept during the first decades of the 19th century that liability for breach of contract need not be based on fault, as is required in many other contemporary legal systems, unless there has been an express undertaking to achieve the promised result. Accordingly, if it were desired to accept strict liability for misstatement generally it might be appropriate to go further than the New Zealand solution. Contractual provisions need not necessarily be promissory in the strict sense. Contracts may, for example, include suspensive and resolute conditions and provisions limiting or excluding liability. It would not be altogether inconsistent with principle to recommend that all misstatements inducing contract should become contractual terms. We should, however, reject as unacceptable the fictional approach of the New Zealand Committee and would prefer misstatements to become by law contractual provisions, if (which we do not recommend) such a solution should be desired in addition to our proposals on delict.

5.11. We think, however, that it would be highly artificial to regard all misstatements inducing contract, however collateral their nature, as contractual terms. Further if such misstatements were oral and the contract in writing (or proveable only by writ) they would complicate considerably the rules regarding writing to constitute or prove obligations. Accordingly, we consider that misstatements inducing contract should provide grounds for annulment, as giving rise to "caused error", for restitution and, when culpable, for actions of reparation. The pursuer should, in our view, have the right to invoke any one, or all three, of these types of remedy. As Lord Wheatley pointed out in Smith v. Sim,¹

¹1954 S.C. 357.

it is competent to pursue a delictual remedy for misrepresentation without rescinding or reducing the relevant contract. Such a remedy is not in the nature of an actio quanti minoris. We invite comment.

Comparison of our proposals with the English Misrepresentation Act 1967

5.12. General. In this Part of our Memorandum we have considered delictual liability for negligent misstatement and have rejected a hybrid solution between contractual and delictual liability such as seems to have been favoured by the English Misrepresentation Act 1967. Hitherto in our Memorandum we have deliberately sought to avoid conceptual confusion. We have therefore treated in different Parts problems of annulment of obligation for vitiated consent, restitution and delictual remedies based on facts which would also justify annulment and restitution. In the present section of our study it is impossible or impracticable to consider in isolation from each other the various consequences of misrepresentation.

5.13. The Misrepresentation Bill was first introduced in 1965 shortly after this Commission had been set up by the Law Commissions Act 1965, and the Commission as then constituted considered from the outset that it would be inappropriate to extend the Bill quoad misrepresentation to Scotland. The respective approaches of Scots law and English law to delictual liability for negligent misrepresentation were seemingly different, though the decision of the English Court of Appeal in Esso Petroleum v. Mardon¹ has subsequently recognised tortious liability at common law for negligent misstatement in negotiating contract. It was thought more appropriate for this Commission to study misrepresentation systematically in the general context of the Commission's programme subject of Obligations rather than to spatchcock Scottish provisions into a measure which was obscurely drafted and essentially designed to deal with

¹[1976] Q.B. 801.

interlocking problems of English law and equity jurisprudence. We have continued to be of that opinion and have noted criticisms of the operation in England of the Misrepresentation Act 1967 made by eminent English lawyers such as Atiyah and Treitel,¹ and the editor of Cheshire and Fifoot.² The main criticism of the legislation must probably be that it sought to implement the recommendations of the Tenth Report of the Law Reform Committee on Innocent Misrepresentation in 1962 without taking account of the House of Lords' views on negligent misstatement as pronounced in Hedley Byrne & Co v. Heller³ in 1964.

5.14. We are concerned only with the provisions of the Misrepresentation Act 1967 which regulate remedies for misrepresentation. Sections 1 and 2 of the Act are as follows:

"1. 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.-(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.

¹Misrepresentation Act 1967" (1967) 30 M.L.R. 369; also Treitel Law of Contract 4th ed., pp. 226-8.

²Law of Contract, 9th ed., (by Furmston) at pp. 247, 266-7, 276.

³[1964] A.C. 465.

(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.

(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)."

5.15. Subsection 1(a) was seemingly enacted because, as noted by the Law Reform Committee,¹ there had been some authority in England for saying that the remedy for a misrepresentation which has attained the status of a contractual term is "not the equitable one of rescission but the common law one of damages". We are unaware of Scottish authority to that effect. Reduction or rescission on grounds of error, whether or not caused by a co-contractant's misrepresentation, has been granted even though the false statement had been incorporated in the contract itself.² This seems sound under the present law. A misrepresentation inducing contract does not cease to have that effect merely because it is later incorporated as a contractual term. The party misled cannot, of course, both approbate and reprobate. If he wishes the contractual relationship to be annulled in toto and the parties to be restored to their previous positions, he will seek reduction and offer restitution. If on the other hand he wishes to affirm the contract, he can only claim damages, or specific

¹Tenth Report, para. 16.

²Earl of Wemyss v. Campbell (1858) 20 D. 1090; Edgar v. Hector 1912 S.C. 348.

implement, or cancellation for breach of a material term, on the basis of contractual remedies. We see no reason why, under the present law, he should be compelled to sue on a contract into which, ex hypothesi, he would not have entered but for the defender's misrepresentations.

5.16. Section 1(b) was enacted to give effect to the Law Reform Committee's recommendation to abolish by statute the former rule in English law that, after a contract had been executed, the remedy of rescission was excluded.¹ The Act goes beyond the Committee's recommendation which would have retained the rule in the case of sales or other dispositions of land. In Brownlie v. Miller² the Lord Chancellor observed obiter that in Scots law as in English law there could be no reduction for misrepresentation of a completed conveyance except on the ground of fraud or misrepresentation amounting to fraud. However, reduction had not been sought in that case, and in at least three³ subsequent cases, including Menzies v. Menzies decided in the House of Lords, reduction of a completed conveyance because of error caused by misrepresentation has been considered competent even though no fraud could be established. Lord Constable expressly rejected the former English rule as applicable to Scotland.⁴ As Gloag pertinently comments⁵:

"Is there any reason why a man should be entitled to maintain a conveyance resulting from his own misstatement when he could not maintain the contract if challenged at an earlier stage?"

We do not anticipate any need for statutory protection of Scots law today against the possibility of the House of Lords by judicial decision applying to Scots law the former English rule now abolished by the Misrepresentation Act.

¹See Tenth Report, paras. 8-10.

²(1880) 7 R. (H.L.) 66.

³Menzies v. Menzies (1893) 20 R. (H.L.) 108; Hart v. Fraser 1907 S.C. 50; Straker v. Campbell 1926 S.L.T. 262.

⁴Straker v. Campbell sup. cit.

⁵Contract, 2nd ed., p. 474.

5.17. The meaning of s.2(1) is particularly obscure and has already been interpreted in at least three ways by courts and commentators in England. On one view, by referring to the rules relating to fraudulent misrepresentation in relation to liability, the subsection creates a "fiction of fraud", and requires the defendant who has made a non-fraudulent representation to be treated as fraudulent unless he establishes that he had reasonable grounds to believe and did believe that the facts represented were true. Accordingly, liability would be as in the tort of deceit.¹ Another view, favoured by the authors and editor of *Cheshire and Fifoot on Contract*², is that

"the object of this subsection is to impose liability in damages for negligent misrepresentation and to reverse the normal burden of proof by requiring the representor to disprove his negligence, but a singularly oblique technique was adopted for this purpose since the draftsman elected to proceed by reference to the common law rules on fraud."

However, these learned authors consider that though the action created by statute "looks more like an action in tort than one in contract"³ and though this approach is correct in principle, such authority as exists is against it. This authority seems to accept a third view, namely a contractual basis for damages. Thus in *Jarvis v. Swans Tours Ltd*⁴ Lord Denning M.R. considered it unnecessary to decide whether the statements were representations or warranties, and in *Watts v. Spence*⁵ Graham J., albeit considering that the measure of damages for deceit should apply, gave damages for loss of bargain under section 2(1). The Contract and Commercial Law Reform Committee of New Zealand⁶ have construed the subsection as importing a contractual remedy and criticise the introduction of "the concept of negligence

¹Treitel (1969) 32 M.L.R. 556, Law of Contract, 4th ed., pp. 227-8; but see also p.237.

²At p.261.

³At p.276.

⁴[1973] 1 Q.B. 233 at p.237.

⁵[1975] 2 All E.R. 528; cf. Baker, 91 L.Q.R. 307; see also Davis & Co. (Wines) Ltd. v. Afa-Minerva (EMI) Ltd [1974] 2 Lloyd's Rep. 27; Gosling v. Anderson (1972) E.G. 709, The Times February 8, 1972.

⁶Report on Misrepresentation and Breach of Contract (1967) para. 9.41.

which in our view has no place in the law of contract". It has been suggested by an Australian writer¹ that since the 1967 Act purports, especially in section 1, to deal only with contractual situations, and since the Law Reform Committee were concerned to remove anomalies and uncertainties resulting from "the distinction between the legal consequences of a misrepresentation and of a breach of a term in contract", a contractual basis of liability is intended. He hopes that the courts will deal in reasoned and detailed manner with the basis of liability under section 2(1). Otherwise "the seeds of doubt and confusion sown by Parliament and nurtured by the courts may flower into the very kind of uncertainty and anomaly that the Act was intended to remedy". Inasmuch as the measure of damages is estimated on different principles in contract and tort and since a different measure may apply to the tort of deceit than to that of negligence, there would seem to be convincing objections both of principle and of interpretation to extending this provision of the English Act to Scotland.

5.18. Subsections (2) and (3) of section 2 also present difficulties. The latter subsection provides that an award of damages under subsection (2) shall be taken into account in assessing liability under subsection (1) - a calculation which must depend on how damages under these subsections should be calculated. With regard to subsection (2) again the commentators are neither confident nor in agreement. Cheshire and Fifoot stress² that damages under section 2(2) are given in lieu of the remedy of rescission which was developed in Equity:

"It seems probable, therefore, that in the case of innocent misrepresentation, the Act does not disturb the rule that financial relief for consequential loss should be limited to an indemnity. It is suggested therefore that in assessing damages under section 2(2), the guiding rule is to produce, as nearly as maybe, the same effect as could be obtained by rescission plus indemnity and not to recoup consequential loss ..."

¹C.L. Zelestis "Misrepresentation - Doubts on Damages" 1975 New L.J. 1158.

²At p.276.

On the other hand Treitel¹ considers that the damages are neither tortious nor contractual: "They are really sui generis, and the subsection gives no clue as to the basis of assessment." He states:

"It can be inferred from this that damages under subsection (2) are meant to be less than damages under subsection (1). One possible explanation for this may be that remoteness is governed by the deceit rule under subsection (1) and by the negligence rule under subsection (2). But if (as has been submitted above) remoteness under subsection (1) is in fact governed by the negligence rule, an alternative explanation must be found for the inference based on subsection (3); and it may be that consequential loss is not covered by subsection (2) at all. The result would be that a wholly innocent misrepresenter would only be liable for the amount by which the actual value was less than the price; while a negligent misrepresenter could be made liable for this amount under subsection (1) or (2), and, in addition, for foreseeable consequential loss under subsection (1)."

Though the Report of the Law Reform Committee would seem to be suggesting assimilation of such damages with those given for breach of a non-material term of contract, as Treitel points out an amendment to apply the contractual basis of liability was withdrawn at the Bill stage. Again we see no advantage in complicating the law of Scotland by adopting doubts and controversies from another system of law.

5.19. However, the other provision of importance in section 2(2) confers a discretion on a court or arbitrator (in cases of non-fraudulent misrepresentation) to award, if it would be equitable to do so, damages in lieu of rescission to a person who would be entitled to rescission. The court in exercising this discretion is to have regard to the nature of the misrepresentation as well as to the loss which rescission would cause to the other party. This discretion to award damages instead of rescission gives effect to Recommendation 3 of the Law Reform Committee's Report, in para. 11 of which they had commented:

¹At pp. 237-8.

"Unless the court's power to grant rescission is made more elastic than it is at present, the court will not be able to take account of the relative importance or unimportance of the facts which have been misrepresented. A car might be returned to the vendor because of a misrepresentation about the mileage done since the engine was last overhauled, or a transfer of shares rescinded on account of an incorrect statement about the right to receive the current dividend. In some cases the result could be as harsh on the representor as the absence of a right to rescind under the present law can be on the representee. Moreover, the conflict between the remedies for misrepresentation and those for breach of contract would be aggravated. There is already the anomaly that a statement embodied in the contract and constituting a minor term of it is treated as a warranty, the breach of which gives only a right to damages, whereas the same statement as a representation inducing the contract enables the latter to be rescinded. Before the contract is executed and at a time when the parties can be relatively easily restored to their original positions, this anomaly may not matter very much, but the position would be very different if the court had no option but to order rescission after the contract had been executed."

5.20. The New Zealand reaction to the English solutions. Commenting on Recommendation 3 and the Misrepresentation Act 1967 section 2(2), the New Zealand Committee's Report¹ objects that

"they will compound complexity by adding to the problems of classification the difficulties inherent in any discretionary remedy ... as far as possible, the decision of disputes under contracts should not be a matter of discretion. There should be known rules so that the parties may be encouraged and enabled to settle their differences out of Court."

In the Committee's view a party aggrieved by misrepresentation should have the right² to choose between available remedies. Further it should be affirmed that the parties to a contract may expressly designate remedies for misrepresentation or breach,³ and where they do not do so the principle governing the choice between cancellation and damages should be prescribed by law.⁴ Though the Committee was divided on several important questions it was unanimous in its Recommendation set forth in para. 13.3 of the Report:

¹ Referred to in para. 5.17 supra. See Report, para. 9.41-2.

² Para. 16.3.

³ Para. 17.2.

⁴ Para. 18.1.

"Accordingly we recommend that 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."

5.21. General comment on English solutions and New Zealand reactions. By way of general criticism of the effects of the Misrepresentation Act we do not think that we could improve on the comments of Cheshire and Fifoot on Contract¹:

"Although there can be little doubt that the general effect of the Act will be to improve the lot of representees as a class, this has been achieved at the cost of making an already complex branch of the law still more complicated. At least three factors have contributed to this. The first was the general policy decision to proceed by a limited number of statutory amendments to the common law. This means that the Act can only be understood if the previous law has been mastered and since the previous law was often far from clear the Act has been erected on an uncertain base. Secondly, 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. Thirdly, these defects in approach were compounded by drafting which is frequently obscure and sometimes defective."

5.22. We have, however, fundamental difficulties regarding the whole conceptual approach of the legislation - at least as a possible model for a system such as Scots law which is not primarily "remedy-based" and which, in this branch of the law, did not develop through the interaction of Law and Equity. The English, and to a lesser extent the New Zealand, solutions operate within a different conceptual framework and, in particular, seem by civil law standards to confuse the different categories of obligation - contract, delict and restitution. Scots law, broadly speaking, shares a conceptual framework with the Civil law systems of the world. In none of these, so far as we are aware, would it be conceivable to regard misrepresentation inducing contract and breach of contract as aspects of a single problem, unless, as we shall consider presently, it were possible to incorporate

¹At p.276-7.

all representations inducing contract into the contract itself as contractual terms, so that the law was concerned only with remedies for breach. Though it may often be difficult to distinguish between statements made in negotiation and statements of obligation, there is, and should be in our view, a fundamental difference between their legal effects. If consent is vitiated - that is, in the present context, if a party would not have entered into the contract in question had he not been induced to do so by misrepresentation - it seems only reasonable that the party misled should have the right to demand that the contract should be annulled ab initio and that the parties should be restored to their former respective positions by restitutio in integrum. In situations of breach of contract, however, ex hypothesi the parties have agreed to be bound and may themselves regulate the consequences of breach. Moreover, the remedies of specific implement and retention would not seem appropriate to deal with misrepresentation situations. It may well be that the remedy for a minor breach of contract should in many cases be an award of damages and also that the remedy of annulment may in some cases bear heavily on a misrepresenter who had acted in good faith, but to treat the two situations alike seems to create rather than to remove anomalies. Better solutions can, we think, be devised. The logic of treating minor breaches and minor misrepresentations alike should result in abolishing reduction or annulment for major misrepresentations and substituting the remedy of cancellation for a fictitious repudiation by breach by a misrepresenter.

5.23. Attempts to assimilate misrepresentation inducing contract with breach of contract neglect the factor that a party may have been induced to enter a contract by considerations which do not necessarily involve patrimonial loss, either actual or capable of proof. Thus a merchant may be induced to buy stock on the representations that the products were made by disabled ex-servicemen or in a country whose economy was discriminated against on political grounds by neighbouring states. If in fact the products delivered had been produced by forced labour in a totalitarian state

and had been sold cheaply by a state monopoly, the quality and price may be unquestionable, but the whole transaction should, in our view, be capable of annulment. Again a scientific instrument may be acquired on the faith of representations that it had been tested by a named expert of repute and had been in use in a famous laboratory for the past year. Even if these statements were false and induced the contract, it might be impossible to fault the instrument itself. Similarly, no economic prejudice may result if trucks capable of military use are sold to buyers claiming to represent a specific friendly government, whereas they are agents of terrorists in a neighbouring state planning the overthrow of that government. Nevertheless, if the seller would not have contracted but for the false representations, it may be thought that he should be entitled to annul.

5.24. The New Zealand Committee's recommendation in paragraph 13.3 was that it should be enacted that a party to a contract who is induced to enter into it as the result of a 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. This solution on first impression has a clarity and simplicity which is lacking in the 1967 Act. However, the view which we have at an earlier point expressed¹ is that a person who has been induced by misrepresentation to make a contract which he would not otherwise have made should have the right to have it annulled ab initio, even if the representation has been incorporated into the contract as a term, unless the term is one which allocates the risk of an error such as that caused by the misrepresentation to one or other of the parties. Further, on the New Zealand approach, it is not clear what the tempus inspiciendum should be for estimating damages based on misrepresentation treated as breach. The misrepresentation may have been made a substantial time before the contract

¹Para. 3.51, supra.

was concluded. The relevant time for considering what damages should have been in the contemplation of the contracting parties is the time of contract. As Gloag put it¹:

"[A] party who breaks his contract is liable for those consequences which a reasonable man, possessing the knowledge which the party had at the time of contracting, would have anticipated."

Unless on the theory that the misrepresentation only becomes fictionally a term when the contract is complete, the date of the actual misrepresentation would seem more appropriate, so that it would cover, for example, expenditure incurred in reliance on the representation but before the contract was concluded. If misrepresentations relate to profits or performance expected to result from the contract, it would be easier to construe them as contractual terms than if they were of a collateral nature. Not all contractual provisions are promissory. Some stipulate conditions upon which the validity of the contract is made to depend, others limit or exclude liability; but it is not clear how one could classify misrepresentations as terms if they were not capable of being construed as promises, a construction which would be artificial unless they related to performance. If treated as conditions they would suspend or resolve the whole obligation. There are other objections to the "fiction of contractual term" approach favoured by the New Zealand Report. However, it is logical in rejecting the introduction of the question of negligence in connection with contractual remedies, and we think that it is also well justified in rejecting the idea of conferring a judicial discretion in determining between rescission and a claim for damages.

5.25. The effect of our own proposals. Our own provisional proposals set forth earlier in this Memorandum would, in our view, achieve much simpler and more satisfactory

¹Contract, 2nd. ed., p.697.

results in cases of misrepresentation than the rival solutions considered. The conceptual framework of the law of obligations would be maintained - a matter of some importance if a coherent legal system is desired rather than haphazard rules. Moreover, existing remedies incidental to recognised rights could be invoked, and to some extent made more efficient. Our scheme would be as follows.

5.26. Contract. So far as the law of contract itself is concerned the nominate categories of fraudulent, negligent and innocent misrepresentation would cease to be relevant. The legal question would simply be: "Has the defender caused the pursuer's error, thereby inducing him to enter a contract the terms of which he would not otherwise have agreed to?" This we have discussed at length in Part III.

5.27. Annulment and restitution. If a party's consent was thus vitiated, he should in our view be entitled to affirm or to have the court annul the contract. If a misrepresentation has been incorporated as a contractual term and was not implemented, then, if the party had chosen not to ask the court to annul he should on breach be entitled to the normal remedies of specific implement, retention or damages. Moreover, if the breach was material, whether so regarded by virtue of the terms of the contract or by reference to all the circumstances, the aggrieved party would be entitled to cancel (or "rescind") the contract. If he elected to seek annulment this would be conditional on the parties being restored to their pre-contract position so far as possible by restitutio in integrum. However, if restitution had ceased to be possible or practicable in forma specifica then, as previously recommended in Part V, a money surrogatum could be decreed by the court. Thus annulment and restitution would not be excluded as at present by the impossibility of restitution in forma specifica.

5.28. Delict. We see no merit in stretching contractual remedies to cover situations where obligation was not intended. Moreover, as the law stands regarding proof by writ and the parole evidence rule, application of contractual solutions might exclude liability for misrepresentations because they were not open to proof prout de jure. Fraud is a ground of delictual and not of contractual liability. As Gloag states¹:

"[I]t has to be kept in mind that fraud has two aspects - it is a ground for the reduction of a contract; it is also a civil wrong, for which the party aggrieved may recover damages. With the latter aspect the law of contract is not directly concerned."

The same results flow, and in our view should flow, from culpable misstatement in the sense of negligent misrepresentation; that is, it may cause error justifying reduction or annulment of contract and also justifying an action in delict for damages. These damages would be assessed by the test of foreseeability at the time when the duty of care was breached. Generally speaking the object of awarding damages in a delictual action is to put the pursuer in as good a position - as far as a money payment can achieve it - as he would have been if the wrong had not been committed, but this does not include loss of profit.

5.29. There would not in our view be any need to introduce a new delictual remedy for negligent misrepresentation inducing contract, since this is one aspect of a more general category of culpa which comprehends negligent misstatement. This is a developing aspect of culpa and, in our view, it would not seem expedient to cut liability for negligent statements in a contractual context from the mainstream of development. We have already noted the view of Cheshire and Fifoot² in the context of English law that the Misrepresentation Act 1967

¹ Contract, 2nd ed., p.479.

² Law of Contract, 9th ed., at p.276.

"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."

This is a consequence which we should wish to avoid.

5.30. Delictual remedies for misrepresentation based on fault would, of course, supplement the remedy of reduction or annulment, but could be asserted even if a contracting party entitled to seek annulment elected to affirm the contract.

5.31. Since in our view culpable misstatement causing loss should develop coherently, we do not consider that special rules regarding burden of proof should be introduced in the limited context of misrepresentations inducing contracts. In our view if a pursuer can prove misstatement inducing contract and consequent loss, the inference of negligence would be difficult to rebut. If a defender could prove that he was altogether without fault in the representation that he made - e.g. that he had taken the collective opinion of all the recognised authorities in the country before making an assertion - then we consider that the sanction of annulment with restitution in forma specifica or by monetary surrogatum should suffice, without imposing a new form of strict liability in damages for such rare cases. This seems to us a more just and a more consistent policy than that enacted in section 2(1) of the Misrepresentation Act, which may in a very few cases enable a party to recover damages from a defendant who, though not culpable, is unable to prove that "he had reasonable ground to believe and did up to the time of contract believe that the facts represented were true."

PART VI

AN ACCELERATED ANNULMENT PROCEDURE

6.1. Under the proposals which we have made in this Memorandum, annulment would no longer be a step which could be taken unilaterally by a contracting party by means of simple notification to the other party of his intention to annul. An obligation having once come into existence, albeit one tainted by error, threats or lesion, it should not, in our view, be capable of being annulled, in the absence of agreement between the parties to bring it to an end, without judicial decree (or decree arbitral where the parties have agreed to refer the dispute, or disputes generally, to arbitration). However, we recognise that it may often be important - as is frequently the case in commercial disputes generally¹ - for the matter to be resolved rapidly; and we are doubtful whether ordinary Court of Session or sheriff court procedure would at present enable a party to obtain annulment sufficiently speedily. We therefore think that, if brevi manu annulment by one party acting unilaterally is to cease to be recognised by the law, an accelerated or abbreviated or summary form of judicial procedure for obtaining decree of annulment should be provided. This could probably be done, without the need for statutory intervention, by appropriate amendments to the Rules of the Court of Session and the Sheriff Court Rules. In the paragraphs that follow we refer particularly to Court of Session procedure; but we think that a similar new accelerated procedure should also be available in the sheriff court for use in such actions of annulment as are competent in that court (i.e. actions which do not amount to actions of reduction of deeds or other writings, these latter actions being, and remaining, within the exclusive jurisdiction of the Court of Session).

¹See e.g. Mr Justice Kerr, "Modern Trends in Commercial Law and Practice" (1978) 41 M.L.R.1, especially at p.3: "In the present economic difficulties ... success in litigation is no longer measured simply by the decision whether or not a party is liable to pay. The problems of liquidity are such that an immediate judgment, or the ability to stave off the day of reckoning, can make the difference between survival and insolvency."

6.2. The need for annulment of an obligation to be obtained speedily may arise from various causes. In the first place, the party seeking annulment may wish to prevent third parties from acquiring unchallengeable rights in the subject-matter of the contract. In the case of transfers of corporeal moveables, heritage, and registered incorporeal rights (e.g. company shares) a transferor who alleges that his consent to the contract under which the disposal took place was defective or vitiated will nevertheless be unable to recover the property if, in the interim, his transferee has disposed of it to an onerous third party acquirer who was unaware that the transferee's right was being challenged. It is therefore important, in circumstances in which it is possible for a third party to acquire rights good against the transferor, for the latter to be able to act swiftly and effectively against his transferee in order to protect his own interests. Clearly, there would be even more cases in which speed in annulment would be vital in order to forestall the acquisition of unchallengeable rights by third parties if effect were accorded to the suggestion that, in all cases, bona fide onerous assignees of personal rights should acquire rights not defeasible by virtue of the defective consent of the obligor (paragraphs 3.134 to 3.141, supra).

6.3. It is true that under the existing law (and under the law as it would remain if no additional protection were accorded to third party acquirers in good faith) an assignee¹ of a creditor's personal rights under a contract (and also the creditor's trustee in bankruptcy² or a person using arrestments³ in the hands of the debtor) takes those rights

¹Scottish Widows' Fund v. Buist (1876) 3R.1078. It may be noted that in this case the insurance contract which was in issue contained a warranty that the information which had been supplied by the insured to the company was accurate. Our earlier suggestion (para. 3.141, supra) that a bona fide onerous assignee should not be affected by, e.g., a misrepresentation made by the cedent to the debtor, would not prevent the application of such a warranty to the assignee, forming as it does a term of the contract to which he has obtained the right of credit.

²E.g. Molleson v. Challis (1873) 11 M.510.

³Graham Stewart, Law of Diligence, pp. 128-9.

subject to any pleas pleadable against the creditor/cedent. Consequently, facts which render a contract annulable as against the original creditor equally have that effect against an assignee. Where the debtor has not already obtained annulment (which, under our proposals, would require judicial decree) prior to the assignation, he is entitled on the same grounds to seek annulment of the contract as against the assignee. Consequently, speed in the process whereby annulment is obtained is not crucial. However, even under the present law, in which brevi manu annulment is generally possible and effective, there are certain types of third parties, other than assignees, trustees in bankruptcy and users of diligence, the intervention of whose interests renders ineffective annulment otherwise than by judicial decree and may make the rapid obtaining of such decree a matter of importance.

6.4. In Westville Shipping Co v. Abram SS Co¹ the defender had concluded a contract for the construction of a steamer with a firm of Dublin shipbuilders. The defender for value assigned the benefit of this contract to the pursuer, to whom the defender had made certain representations concerning the stage which had been reached in the steamer's construction. Shortly thereafter the pursuer for value subassigned the benefit of the shipbuilding contract to another company, making similar, but not identical, representations as to the progress of the work on the steamer. In July the subassignee discovered that these representations were false and intimated to the pursuer his intention to annul the subassignation. In August the subassignee raised in the English courts an action for reduction of the subassignation, and in December decree of reduction was pronounced. Meanwhile, in November, the pursuer had raised in the Court of Session an action for reduction of the assignation made to him by the defender, founding on the false representations concerning the stage of the steamer's construction made to him by the defender. The defender pleaded inter alia that the pursuer had no title to sue, since at the time when the action was raised the benefit of the shipbuilding contract was still

¹1923 S.C. (H.L.) 68; 1922 S.C. 571.

vested in the subassignee and consequently the pursuer at that date was not in a position to offer restitutio in integrum in the form of restoring to the defender the benefit of the shipbuilding contract.

6.5. In the House of Lords, Lord Atkinson took the view that the relevant date, as far as the restoration of the pursuer's title to sue and ability to offer restitutio in integrum was concerned, was not the date of decree of reduction of the subassignment (December), but the date of the notification to the pursuer of the subassignee's election to "rescind" the contract (July). The subsequent decree merely declared or confirmed that the earlier "expression by the plaintiff of his election to rescind was justified, was effective, and put an end to the contract."¹ However, although in both the First Division and the House of Lords there was unanimous agreement that the pursuer was entitled to succeed, only Lord Atkinson appears to have taken the view that, even as regards the position of a third party such as the defender, the mere notification of "rescission" by the subassignee to the pursuer was sufficient. Thus the clear inference to be drawn from Lord President Clyde's opinion² (which Lord Shaw of Dunfermline expressly adopted in the House of Lords³) is that judicial decree of reduction of the subassignment was necessary before the pursuer could be in a position to offer restitution to the defender in the form of restoring to him the benefit of the shipbuilding contract. The possibility that mere intimation by the subassignee to the pursuer of his intention to "rescind", whatever its effect as between the subassignee and the pursuer, might be sufficient in law to require the defender to accept the pursuer as having being reinstated in the benefits of the contract and so as being in a position to restore those benefits to the defender, was not even considered by these judges. Judicial decree of reduction of the subassignment was what was clearly thought by them to be required, though they were prepared to hold in

¹1923 S.C. (H.L.) 68 at p.73.

²1922 S.C. 571 at p. 582.

³1923 S.C. (H.L.) 68 at p.78.

the end of the day that it was not fatal to the pursuer that that decree was not pronounced until after his own action against the defender had been raised. Lord President Clyde stated:¹

"I cannot see that [the pursuers] were bound to postpone raising action in this Court until the rescinding order was actually pronounced. All that actually stood between them and reinstatement in the benefits of the builders' contract was the pronouncement of this order which the sub-assignees were moving the English Court to make, and which ... the pursuers had no means of resisting. I think in these circumstances the pursuers may properly be regarded as having a substantial title to sue, and as being substantially in a position to offer restitution to the defenders. If this be so, the circumstance that the substantial right was not actually completed at the initiation of proceedings is not material."

And in the House of Lords, Lord Dunedin (with whom the Earl of Birkenhead² and Viscount Finlay concurred) said:

"... the [pursuers'] original title to set aside a contract induced by misrepresentation was quite good. It is true that for the moment [i.e. when the Court of Session proceedings were initiated] there seemed a good answer, namely: 'You have parted with the subject of the contract and therefore you have lost your interest', but the moment that the instrument by which they had so parted was swept away the original title was then in all its force."

6.6. Under the present law it would accordingly appear that even in the case of personal contractual rights, simple notification of annulment or "rescission", though effective inter partes, may not be sufficient where certain types of third party interests are involved. In order to defeat the claims of subsequent assignees, trustees in bankruptcy, and arresters, notification of annulment by the debtor to the original creditor is all that is at present required. But before the rights of third parties such as the defender in Westville Shipping Co. v. Abram SS Co.³ can be affected, judicial annulment must have taken place. It also seems clear that the debtor in that case (the Dublin shipbuilding firm) would not have been bound (or entitled) to accept the pursuer

¹1922 S.C. 571 at p.583.

²Lord Birkenhead also expressed his concurrence in the speech delivered by Lord Atkinson.

³1923 S.C. (H.L.) 68 at p.72.

in the place of the subassignee as the person to whom performance under the shipbuilding contract was due, until decree of annulment of the subassignment had been pronounced (and this would certainly be the case under our proposal to the effect that judicial decree of annulment should always be required, even inter partes). It seems obvious that the debtor would not have been entitled to treat a unilateral non-judicial annulment of the subassignment by the pursuer, even though intimated to the debtor, as divesting the subassignee and restoring to the pursuer the benefit of the shipbuilding contract: no unilateral action by a third party can justify a debtor in treating his creditor as having been supplanted by another. And if the debtor is entitled (or bound) to refuse to recognise anything other than judicial decree of annulment in the case of one of the parties to an assignment, it seems reasonable to suppose that the same would hold good in respect of an annulment by the other, his current creditor: as far as the debtor is concerned that creditor would, we think, cease to be ~~the~~ beneficiary under the contract only on intimation to the debtor of a translation to another party or a retrocession to the previous creditor, or on judicial reduction of the assignment. That being the case under the existing law as we understand it, and that certainly being the case under the law as we have proposed it should in future be, the importance in some circumstances of speed in the obtaining of judicial decree seems clear: until annulment of the assignment has taken place the cedent is not revested in his right of credit under the obligation and is not entitled to receive the benefit of the debtor's performance or, where appropriate, to give any instructions which may be necessary as to the manner of performance by the debtor.

6.7. However, even where the case is not one in which assignments have complicated the situation or in which third parties might acquire indefeasible rights against the party seeking annulment, it may still be of great importance to him for the obligation to be annulled more quickly than could be done by resorting to ordinary judicial procedure. Thus

although inability to make restitutio in integrum in kind is not, under our proposals, to be a bar to annulment, nevertheless the fact that a contract has been substantially performed might well in some cases be a factor which would influence a court to exercise its discretion to refuse annulment. Therefore the party claiming to have grounds for annulment would often wish to obtain decree before the other party had started to perform or had performed to any appreciable extent. Moreover, even if a party were confident that annulment would be granted of an executed or partially executed contract, he might well still wish to act rapidly in order to minimize the amount of the pecuniary surrogatum for restitution in kind for which, on annulment, he might be found liable to the party who had embarked upon performance of the contract.

6.8. Again, speed in the determination of the question whether a party has grounds for, and should be granted, annulment may be vital in circumstances in which a party wishes to withdraw his resources from performance of the obligation which he claims should be annulled and to deploy them elsewhere. For example, a civil engineering contractor may believe that he was induced to enter into a construction contract by the misrepresentations of the employer. He is offered by a third party an opportunity, which must be accepted without delay, to conclude a contract for another construction project. His ability to perform this second contract is, however, dependent upon his machinery, employees, etc. being freed from performance of the first contract. If, relying upon his supposed grounds of annulment, he simply stops performing that contract, he will be liable in substantial damages for breach of it if a court subsequently decides that his grounds were insufficient. That this danger is a genuine and serious one can be seen from the case of Wade v. Waldon¹ which was concerned, however, not with whether grounds existed for annulment on account of vitiated consent, but with the

¹1909 S.C. 571; see also Lindley Catering Investments Ltd. v. Hibernian F.C. Ltd. 1975 S.L.T. (Notes) 56.

problem of purported cancellation or rescission for material breach by the other party. Although the remedies of annulment of contract for vitiated consent and cancellation of contract for material breach have different consequences when justifiably invoked,¹ it is thought that they present comparable problems in determining whether their use is, in any particular circumstances, justified. In the case under consideration, Wade and Waldon had concluded a contract in terms of which the former was to perform in the latter's theatre. One of the terms of the contract was that Wade should confirm his intention to appear and should supply "bill matter" some 14 days before the date of the performance. He failed to do this, and Waldon purported to rescind the contract on the ground of Wade's material breach and refused to allow him to appear at the theatre. It was eventually held by the First Division that Wade's breach was not material, that Waldon was therefore not justified in refusing to allow Wade to perform, and that Waldon was himself liable in damages for breach of contract for so doing. The outcome would, it is thought, have been the same had the facts been that Waldon had sought, not to prevent Wade's performance because of the latter's supposed material breach, but rather to do so on account of some alleged misrepresentation on the part of Wade which was later held not to warrant annulment. If, however, in order to avoid the possibility of later being held to have been in breach of contract, a party in the position of the civil engineering contractor mentioned earlier in this paragraph continues to perform the first contract and at the same time raises an action for annulment of it, he will lose the chance of concluding the second contract, since judicial decree of annulment cannot be obtained by ordinary court procedure, even at its most expeditious, before the offer of

¹See Walker, Civil Remedies, pp. 48-58. In view of the very different legal consequences of annulment for vitiated consent and cancellation for breach (e.g. the fact that in the case of annulment but not in the case of cancellation restitutio in integrum is required) it is, we think, misleading and inconvenient that the term "rescission" should be used to cover both. Cf. Cheshire & Fifoot, Law of Contract, 9th ed., p. 579.

the new contract expires. In order to cope satisfactorily with such cases an accelerated form of judicial annulment procedure seems called for.

6.9. It is true that the Rules of the Court of Session at present make provision¹ in commercial causes for the speedier determination than by normal procedure of a question in dispute. However, this accelerated procedure is applicable only if both parties agree to it and only to causes "arising out of the ordinary transactions of merchants and traders"². In any event, it can come into operation only on the closing of the record:² prior thereto ordinary procedure applies. If both parties to a dispute are agreed that greater despatch than this is required, resort could be made to the summary trial procedure³ under which the parties themselves (with the consent of the Lord Ordinary to whom they have chosen to submit the cause) may agree upon the procedure to be adopted for the determination of the dispute. However, the summary trial procedure has the disadvantage that, once again, it can be resorted to only where both (or all) parties to the dispute agree. Neither of these procedures, therefore, seems well adapted to enabling speedy judicial intervention to be sought where a party wishes as a matter of urgency to annul an obligation on the ground of his defective or vitiated consent. We therefore propose the introduction of a new procedure whereby judicial decree of annulment of an obligation could be rapidly obtained by a party who, for some sufficient reason, was not prepared, or not in a position, to accept the delay involved in obtaining a judicial decision by means of ordinary procedure.

6.10. Our suggested new procedure is modelled in general terms upon Rules 72(b) and 150 of the present Rules of the Court of Session. What we envisage is that the party who is seeking annulment should prepare, in the usual way, a summons concluding therefor. After the summons had been signeted, but before its service upon the defender, the pursuer would apply in writing to the Deputy Principal Clerk of Session craving

¹R.C. 148-151.

²R.C. 148(a).

³Administration of Justice (Scotland) Act 1933, s.10 and R.C.231.

the Court to direct that special summary or abbreviated procedure be followed in the determination of the cause. The Deputy Principal Clerk would then bring the application forthwith before a Lord Ordinary in chambers (or the Vacation Judge). The Lord Ordinary on being satisfied by the pursuer, or by counsel or solicitor on his behalf, of the urgency of the matter would then appoint the procedure thereafter to be followed in the cause. The Lord Ordinary would be empowered, in his discretion, and depending upon the precise degree of urgency established to exist, to shorten (and, if appropriate, to dispense with completely) the induciae in the summons; to substitute for service of the summons upon the defender informal intimation to him of the proceedings; to dispense with the lodging of defences (and, hence, with the preparation of open and closed records); and to ordain that the merits of the cause be argued (and proof, if necessary, be heard) on such day and at such time (whether in or out of Term) as he may direct.

6.11. Under such a scheme it would be possible for decree of annulment to be obtained very rapidly. The hearing on the merits might even, in cases of great urgency, be fixed for the same day as the making of the original application to the Lord Ordinary to direct that the cause be determined under the special abbreviated procedure. A pursuer seeking such an unusual degree of despatch would, however, generally be required to satisfy the court that he had given notice to the defender, even if only informally, of his intention to seek an immediate hearing of the merits of the cause. At the hearing the Lord Ordinary (or, out of Term, the Vacation Judge) would decide whether grounds for annulment existed and, in those cases where, under our proposals, annulment is to be at the discretion of the court, whether to exercise that discretion in the pursuer's favour. If it were decided that it was appropriate to grant annulment but only on terms that the pursuer compensate the defender, the court, if it had sufficient information before it, would immediately fix the sum payable. If the court did not at that time have sufficient

information, it might nevertheless grant decree of annulment and ordain the pursuer to find caution for the payment to the defender of a sum to be determined by the court at a later date. 6.12. If such a procedure were introduced, we think that an accelerated appeal procedure should also be made available whereby the Lord Ordinary's decision could be speedily reviewed. This procedure might be initiated by a party's making application, in writing, to the Deputy Principal Clerk of Session for the Lord Ordinary's interlocutor to be reviewed by the Inner House. The Deputy Principal Clerk would then bring the application forthwith before a Division in chambers (or, in vacation, before the Vacation Judge). The Division (or the Vacation Judge) on being satisfied by the applicant, or by counsel on his behalf, of the urgency of the matter, would then appoint the procedure to be followed in the disposal of the appeal. This, in circumstances of great urgency, and particularly if the respondent had already been notified of the appellant's application, might take the form of an immediate hearing by the Division of the appeal, or of the assembling of a Division (if necessary, an Extra Division) during vacation to hear the appeal.

6.13. It would be possible for our proposed accelerated procedure to go even further than we have so far suggested. In cases in which annulment is sought on the ground of caused error or of threats where, under our proposals, annulment is a matter of right and is not subject to the discretion of the court, it could be provided that decree of annulment, if the court were satisfied that the matter was sufficiently urgent, might be pronounced without the necessity of intimation of the proceedings to the defender and, consequently, without his being accorded an opportunity to appear. The court would act on the basis of the pursuer's averments alone, as can at present be the case in proceedings for interim interdict. However, again as in cases of interim interdict, we envisage that resort to this ex parte procedure should be periculo petentis: if the pursuer misstated the facts (whether fraudulently, negligently or innocently) such that, had the

court known the true position it would not have granted annulment, the pursuer would be liable to the defender for the loss, injury and damage suffered by the latter in consequence of the annulment of the obligation. We have reached no concluded view on whether this possible extension of our abbreviated annulment procedure should be introduced. We invite comments on the abbreviated procedure which we have outlined, as well as on the possible extension of it mentioned in this paragraph.

6.14. We intend, in due course, to consider, with a view to reform, the existing law governing remedies for breach of contract. Even before the appearance of that study, however, we think it might well be beneficial for the abbreviated or accelerated judicial procedure, which we have just proposed should be introduced in the case of annulment of contract for defective or vitiated consent, to be extended to apply also to cancellation (or rescission) of contract on the ground of material breach by the other party. We have already expressed the view¹ that, although annulment for defective or vitiated consent and cancellation or rescission for material breach have different consequences when justifiably invoked, yet they present comparable problems and dangers to contracting parties in determining whether their use is, in any particular circumstances, justified. We think that application of our proposed summary procedure would go at least some way towards solving those problems in cases of cancellation for material breach, just as it would in cases of annulment for vitiated consent. Comments are invited.

¹See para. 6.8, supra.

APPENDIX

The provisions concerning error in the Draft for a new Dutch Civil Code, Revised Bill (published 1976). Translation by courtesy of Professor Fokkema of Leiden.

(Book 6: General part of the law of obligations.)

(Title 5: Contracts in general.)

(Section 2: Formation of contracts.)

Article 6.5.2.11. 1. A contract which has been formed under the influence of error and which would not have been concluded in case of knowledge of the relevant circumstances may be annulled:

- a. if the error is due to some information given by the co-contractant, unless the latter was entitled to believe that the contract would also be concluded without that information;
- b. if the co-contractant, in connection with what he knew or ought to know about the error, should have informed the party in error;
- c. if the co-contractant, in concluding the contract, has acted on the same erroneous assumption as the erring party, unless he ought not, even in case of knowledge of the relevant circumstances, to have understood that such knowledge would prevent the erring party from concluding the contract.

2. The annulment cannot be based on an error which concerns exclusively future circumstances, or which is to remain at the risk of the erring party, on account of the nature of the contract, the views current in society or the circumstances of the case.

Article 6.5.2.12. A contract which is to build further on the basis of an already existing legal relation between the parties, is annulable if that relation is absent, unless this circumstance ought to remain at the risk of the party who invokes the absence of the relation, on account of the nature of the contract, the views current in society or the circumstances of the case.

Article 6.5.2.12a. 1. The right to annul a contract in virtue of articles 11 and 12 lapses, if the other party in due time proposes a modification of the effects of the contract which effectively makes good the prejudice that the party entitled to annulment would suffer as a result of the contract.

2. Moreover, on demand of one of the parties the court can, instead of declaring the contract annulled, modify its effects so as to make good the prejudice.