

RESCISSION¹

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1 RESCISSION - AT LAW AND IN EQUITY

The term rescission is used in various senses, but in its narrow sense the term is concerned with the avoidance *ab initio* of agreements or other dispositions.

There is a common law remedy of rescission and an equitable remedy of rescission.

The common law remedy of rescission is “self help”. A person entitled to rescind – for example, on the ground of fraud or duress – communicates his or her election to the other party and the agreement is thereby avoided.

The equitable remedy of rescission is not self help: it requires a court order, and the court has a discretion whether to grant it.

¹ The contents of this paper are in part derived from the book: Finnane, Newton and Wood, *Equity Practice and Precedents*, Thomson Lawbook Co, Sydney, 2008, of which Edmund Finnane is co-author. The contribution of his co-authors Nicholas Newton and Christopher Wood is hereby acknowledged.

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1.1 Common Law Rescission with the Aid of Equitable Relief

To rescind at common law, it is not enough that a party has a recognized common law ground to do so – such as duress. In addition, that party needs to be in a position to restore the parties to their original state before the contract. Money must be repaid and property returned. If that cannot be done precisely, the contract cannot be rescinded at common law. This requirement is referred to as *restitutio in integrum*, and is applied quite strictly at common law.

Where precise *restitutio in integrum* is not possible, a party may still be able to rescind at law with the aid of equitable remedies.

Equity does not relieve a party from the requirement of *restitutio in integrum* – equity follows the law in that regard. Moreover, equity requires a party to do equity and in the context of rescission – whether at law or in equity – this means that benefits obtained under the contract or other disposition have to be returned.

However, equity has a broader array of remedies available to it than the common law, which it can use to achieve substantive restitution. Essentially, if practical justice between the parties can be achieved through, for example, orders for accounts and inquiries, then orders can be made which will place a person in a position where they can validly rescind on a common law ground. The equitable remedy in this situation consists of orders for accounts, payment of money, specific restitution and so on, together with a declaration that the plaintiff has validly rescinded the contract.

Rescission is still the act of the plaintiff: the court makes orders which adjust the rights of the parties and declares that the rescission was valid.

This is best illustrated by an example. In *Alati v Kruger*,³ a case of rescission of a sale of a business, there was no prospect of the business being returned to the vendor as it had been closed down and the premises vacated. The substantive orders, after variation by the High Court, were to the following effect:

³ (1955) 94 CLR 216

1. A declaration that the contract was lawfully rescinded by the respondent.
2. An order that all executed copies of it be cancelled.
3. An order (described as a declaration) requiring the plaintiff to deliver up to the defendant such chattels which were the subject of the contract as the plaintiff retained.
4. An order that an inquiry be held to ascertain the value of chattels not in the plaintiff's possession or control, the value of stock in trade received by the plaintiff from the defendant, and whether any amount should be allowed in favour of the defendant for use by the plaintiff of the defendant's property.
5. An order requiring the defendant to repay the purchase price, adjusted by reference to the value of the chattels not returned and certain other amounts, plus interest.

1.2 Rescission on Equitable Grounds

Rescission in equity arises in various circumstances where, on some equitable ground, an agreement or other disposition is voidable. For example, a guarantee may be voidable because it was procured by the exercise of undue influence, or by unconscionable conduct, or because of a misrepresentation.

Where benefits have been obtained by the plaintiff the court requires restitution, because a plaintiff is required to do equity. Again, the court can employ a variety of remedies in aid of rescission so that proper restitution is given. The requirement to restore the parties to their original positions means, for example, that a mortgagor who borrows money under a voidable contract will need to repay the principal with interest in order to rescind.⁴

Unlike common law rescission, rescission in equity is not an act of the party concerned. It is a remedy which the court grants – it orders that the transaction be set aside.

It should be clear from this brief description of rescission in equity that in any rescission case – whether at law or in equity – there are two key questions

⁴ *Mayfair Trading Co Pty Ltd v Dreyer* (1958) 101 CLR 428; *Maguire v Makaronis* (1996) 188 CLR 449

which need to be addressed at the outset: First, is the relevant ground for rescission made out? Second, what, if anything would be required by way of restitution in this case?

2 GROUNDS FOR RESCISSION IN EQUITY

The following some of the grounds on which rescission may be sought in equity. The basis on which equity intervenes in each instance is equitable fraud. Equitable fraud is concerned with conduct which offends the conscience, rather than deliberate dishonesty.

2.1 Undue Influence

Actual undue influence in relation to a particular transaction, is proved where:

- the other party to the transaction (or someone who induced the transaction for his own benefit) had the capacity to influence the complainant;
- the influence was exercised;
- its exercise was undue; and
- its exercise brought about the transaction.⁵

But this doctrine is particularly useful to parties wishing to avoid a contract where they can raise one of the presumptions and thus reverse the onus of proof.

First, there is the presumption of undue influence. Where a transaction takes place between persons in certain categories of relationship, there is a presumption that it was procured by undue influence – so that the stronger party is left with the burden of negating undue influence.

The relationships are:

- (i) religious adviser and believer;
- (ii) doctor and patient;
- (iii) solicitor and client; and
- (iv) parent and child or guardian and ward (until the child is regarded as emancipated).

⁵ *Bank of Credit & Commerce International SA v Aboody* [1900] 1 QB 923

Second, a party may establish that there was, in fact, a relationship between the parties to the transaction in which the complainant generally reposed trust and confidence in the other party. If such a relationship is proved, this again creates a presumption that the transaction was procured by undue influence.

2.2 Yerkey v Jones / National Australia Bank v Garcia

There is distinct basis on which transactions for the benefit of a third party, in which a wife participates at the request of her husband, can be set aside. This was confirmed in *Garcia v National Australia Bank*:⁶ The basic notion is that a wife may well sign a document (usually a guarantee) at the request of her husband without seeking or obtaining a full appreciation of what she is signing, and a third party, taking the benefit of the transaction, is taken to be on notice of such a possibility because of the nature of the relationship.

According to the majority in *Garcia* it is unconscionable for the lender to enforce the guarantee against the wife in the following circumstances:

(a) in fact the surety did not understand the purport and effect of the transaction; (b) the transaction was voluntary (in the sense that the surety obtained no gain from the contract the performance of which was guaranteed); (c) the lender is to be taken to have understood that, as a wife, the surety may repose trust and confidence in her husband in matters of business and therefore to have understood that the husband may not fully and accurately explain the purport and effect of the transaction to his wife; and yet (d) the lender did not itself take steps to explain the transaction to the wife or find out that a stranger had explained it to her.⁷

Importantly, the only matter of which the lender need positively be aware, for the principle to operate, is the fact that the parties are married.

Garcia left open the possibility that the principle is also available to husbands and/or “de facto” spouses.⁸

⁶ (1998) 194 CLR 395

⁷ (1998) 194 CLR 395 at 409

⁸ *Garcia v National Australia Bank* (1998) 194 CLR 395 at 404

2.3 Catching / Unconscientious Bargains

This category of equitable fraud is sometimes referred to as unconscionable conduct in the narrow sense and sometimes, colloquially, as the *Amadio* defence.

The complainant needs to establish:

- (a) that the complainant was under “a special disability in dealing with the other party with the consequence that there was an absence of any reasonable degree of equality between them”; and
- (b) “that disability was sufficiently evident to the stronger party to make it prima facie unfair or ‘unconscientious’ that he/she procure, or accept, the weaker party’s assent to the impugned transaction in the circumstances in which he/she procured or accepted it”,

at which point that onus is cast upon the stronger party to show that the transaction was fair, just and reasonable.⁹

2.4 Innocent Misrepresentation

At common law misrepresentation will be a ground for rescission only if it is fraudulent.

In equity a person’s entitlement to rescind for misrepresentation does not depend on any intention to deceive. It is regarded as fraudulent (in the equitable sense) for a defendant to hold a plaintiff to a bargain which has been induced by representations of the defendant which were untrue.¹⁰

There must be:

- a misrepresentation;
- which produced a misapprehension on the part of the representee;
- which misapprehension was one of the reasons which induced the representee to enter into the contract;

⁹ *Commercial Bank of Australia v Amadio* (1983) 151 CLR 447 at 474

¹⁰ *Mair v Rio Grande Rubber Estates Ltd* [1913] AC 853 at 870

- an intention on the part of the representor that the representee act in the way he/she in fact did.¹¹

2.5 Mistake

A contract may, in limited circumstances, be rescinded in equity on the ground of mistake. This is a difficult area of law, and it is unsettled in some important respects.

There are three categories of mistake:

Common mistake: both parties are mistaken as to a matter when they enter into the contract. At common law, common mistake, however serious, gives no right to rescind by operation of law. It is possible, however, that a condition, might be implied into a particular contract, which might bring the mistake into play. See *McRae v Commonwealth Disposals Commission*.¹² In that case it was held that there was an implied promise by one party as to the existence of an oil tanker which was the subject matter of a contract.

In equity, common mistake is not generally a ground for rescission, but there are some particular situations in which equitable relief may be available.¹³

Mutual mistake: one party is mistaken and the other party is not aware of that party's mistake. At common law and in equity mutual mistake gives no right to rescind.

Unilateral mistake: one party is mistaken and the other party is aware of the other party's mistake. Generally, there is no right to rescind at common law on the basis of unilateral mistake. In equity there is a jurisdiction for the court to rescind a contract, but it only arises where there is:

- a serious mistake;
- about a fundamental term;
- conduct of the unmistaken party involving deliberately setting out to ensure that the mistaken party does not become aware of the misapprehension.¹⁴

¹¹ See Meagher RP, Heydon JD and Leeming MJ, *Meagher, Gummow and Lehane's Equity Doctrines and Remedies* (4th ed, Butterworths, 2002) at p 467-8 and the cases cited therein.

¹² 84 CLR 377

¹³ These are summarised in Meagher RP, Heydon JD and Leeming MJ, *Meagher, Gummow and Lehane's Equity Doctrines and Remedies* (4th ed, Butterworths, 2002) at p 499

This ground of rescission, like the others dealt with above, is an instance of equitable fraud, because it depends upon conduct of the defendant which offends the conscience.

2.6 Statutory Alternatives to Equitable Fraud Grounds

The concepts discussed above have inspired various pieces of legislation.

The field of misrepresentation is now largely regulated by Trade Practices Act s 52 and its many state and Commonwealth equivalents.

The concept of equitable fraud, including the concepts discussed above, has informed several pieces of legislation, such that in any case falling within the above concepts, one should consider whether there is also a statutory remedy.

Trade Practices Act s 51AA prohibits a corporation, in trade and commerce, from engaging in conduct that is unconscionable within the meaning of the unwritten law of the states and territories. The concept directs the court to the doctrines established by the courts of equity,¹⁵ but it opens up a range of remedies including damages under s 82 and various remedies under s 87, including orders declaring a contract void.

In the Trade Practices there is also a prohibition on conduct which is “in all the circumstances unconscionable”: see s 51AB and s 51AC. The former provision is limited to consumer transactions and the latter is for the protection of companies other than public companies. Both provisions require the court to consider a list of factors, and those factors expressly include undue influence as well as matters such as a comparison of bargaining positions and the ability of a person to understand relevant documents. Again these provisions attract the remedies including those in s 82 and s 87.

There is also the *Contracts Review Act* 1980 (NSW), s 7, which enables a court do refuse to enforce a contract, vary it or declare it void, if it was unjust in the circumstances relating to the contract at the time it was made. There is (in s 9) a non-exhaustive list of factors which the court is to consider, and the list has similarities with those in *TPA* ss 51AB and 51AC.

¹⁴ *Taylor v Johnson* (1983) 151 CLR 422 at 432

¹⁵ *ACCC v CG Berbatis Holdings Pty Ltd* [2003] HCA 18

For consumer credit contracts, there is the Uniform Consumer Credit Code, s 70, which is similar to the *Contracts Review Act* provisions.

The *Industrial Relations Act* 1996 (NSW) s 106 gives the Industrial Relations Commission powers in relation to contracts, whereby a person performs work in any industry, if it finds them to be unfair.

In any case falling within the territory of unfair or unconscionable dealings, it is important to consider the full range of relevant statutory provisions and equitable doctrines and remedies and, where appropriate (after a careful analysis of the facts), to consider pleading multiple grounds in the alternative.