RESCISSION[1]

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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.

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[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 Rescission in Equity on Common Law Grounds

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 If that cannot be done precisely, the contract cannot be rescinded at common law.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 on common law grounds, with the aid of equity.

Whilst equity does not insist on precise restitutio in integrum, it is said that equity requires "substantial restitutio in integrum",[3] or that, by the exercise of its powers, it can do what is "practically just between the parties, and by so doing restore them substantially to the status quo."[4]

Equity has a broader array of remedies available to it than the common law, which it can use to achieve substantive restitution. For example, relief can be granted on conditions, or accounts and inquiries can be ordered so as to work out what adjustments need to be made between the parties.

The form in which rescission is effected is that orders for accounts, payment of money, specific restitution and so on are made, together with a declaration that the plaintiff has validly rescinded the contract.

That is to say, 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.

1.2 Rescission on Equitable Grounds

Rescission in equity arises in various circumstances where, on some equitable ground, a transaction is voidable. For example, a guarantee may be

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[3] D Wright, Fiduciaries, Rescission and the Recent Changes to the High Court's Equity Jurisprudence (1998) 13 JCL 166.

[4] *Alati v Kruger* (1955) 94 CLR 216 at 224.

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.[5]

1.3 Working out the appropriate remedy

Alati v Kruger

Alati v Kruger,[6] was a case of rescission on common law grounds. The transaction was a sale of a business, which the purchaser was entitled to rescind on the ground of fraudulent misrepresentations as to the takings of the business. The purchaser had completed the purchase and gone into possession, before realising the fraud and taking proceedings for rescission. The purchaser succeeded but by the time of final orders, there was no prospect of the business being returned to the vendor as it had been closed down and the premises vacated. The court still permitted rescission. The substantive orders, after variation by the High Court, were to the following effect:

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.

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

[6] (1955) 94 CLR 216.

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.

It is useful, with the above example in mind, to explore the basis on which such equitable relief is shaped.

I have said that the court needs to do what is "practically just". It should be noted that in the above example the court considered this requirement met even in circumstances where

- the lease was at an end and therefore the vendor could not be restored to his pre-contract position; yet
- the vendor was not to be given any compensation for this as part of the court's relief.

So, how could rescission be allowed in such circumstances without any requirement of compensation?

At common law the purchaser's entry into possession, alone, was enough to preclude rescission [7] - let alone the fact that there was no longer a lease to be retransferred. (It should be pointed out that it was recognised in *Alati v Kruger* that there are exceptions at common law to the requirement of precise restitutio in integrum, but they would not have assisted the purchaser.)

But equitable remedies are discretionary and flexible, and appropriate relief can be moulded so as to do practical justice. The court could decide on whether to grant relief, but also, on what terms, in the light of the fact that the business had closed down and the circumstances in which that had occurred.

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[7] *Blackburn v Smith* (1848) 2 Ex. 783 at 792.

This was discussed in the joint judgment of Dixon CJ, Webb, Kitto and Taylor JJ, as well as in the judgment of Fullagar J (where his Honour agreed with the orders proposed).

One possibility would be for the court to conclude that the purchaser had acted unconscientiously during the dispute by abandoning the premises, and on that basis, decline relief.

Another possibility, referred to by Fullager J, was for the court to require the purchaser to compensate the vendor as a condition of relief.

But in the present case it could not be said that the purchaser acted unconscientiously. The purchaser had continued in the business for a considerable period (indeed, up to the end of the trial, when the trial judge had announced his findings and had reserved on the question of restitutio in integrum). The purchaser could not be expected to go on indefinitely, incurring losses. On the view of Dixon CJ, Webb, Kitto and Taylor JJ, the vendor was able to protect his interest, whether by appointing a receiver or by offering to take the property back or by proposing an interim arrangement.

Fullagar J considered that the purchaser should give reasonable notice before parting with possession, although the absence of reasonable notice in the immediate case did not matter because the defendant failed to show that he suffered loss by the closure of the business.

If one considers the effect of the orders in *Alati v Kruger* it is clear that the vendor was not restored to his prior position, even in a substantive sense. The vendor did not get his business back, nor any compensation for the loss of the lease or the goodwill. It might be said that the expression “substantive restitutio in integrum”, used in the joint judgment, did not describe the result of the case. The answer to such a charge is that, in the way the High Court viewed the matter, any such losses were attributable entirely to the vendor’s failure to take care of his own interests.

What the court must do in exercising its discretion, both as to whether to grant or permit rescission, and as to the terms on which relief is granted, is

determine what is required by way of "practical justice". This requirement of practical justice is informed by the maxim that "he who seeks equity must do equity", and more generally, it is informed by equitable principles and discretionary factors.[8]

The precise orders which should be made will always be driven by the circumstances of the case, which circumstances include, not merely the nature of the transaction and the position of the respective parties following the transaction, but also a consideration of what was the wrong which gave rise to the right to rescission and what was its consequence.

Maguire v Makaronis

Maguire v Makaronis[9] was a case of rescission on equitable grounds. A husband and wife, who were clients of solicitors, executed a mortgage in favour of the solicitors to secure bridging finance for the purchase of a poultry farm. The solicitors did not draw the clients' attention to the fact that the solicitors were to be the mortgagees, and nor did they tell them that they should obtain independent legal advice. The clients defaulted on the loan secured by the mortgage and the solicitors claimed possession of the mortgaged property. The clients were held to be entitled to rescission on the ground of breach of fiduciary duty. However, relief was conditional on payment of principal and interest. Failing such payment judgment for possession was to be entered in favour of the mortgagee.

Vadasz v Pioneer Concrete (SA) Pty Ltd

Maguire v Makaronis concerned rescission by borrowers who had use of the money advanced under a voidable transaction. What about guarantors?

An interesting contrast can be made the contrast between two guarantee

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[8] See for example *Vadasz v Pioneer Concrete (SA) Pty Ltd* (1995) 184 CLR 102 at 110 to 116.

[9] (1997) 188 CLR 449

cases - *Commercial Bank of Australia v Amadio*[10] and *Vadasz v Pioneer Concrete (SA) Pty Ltd*[11], as discussed in the latter case at p 115. In *Amadio*, the *Amadios* were led to believe that they were guaranteeing their son's overdraft to a limit of $50,000. In granting relief the court relieved them from the whole of their liability on the ground that they would not have entered into the transaction at all had they known the true position.

In *Vadasz,* in contrast, the plaintiff was prepared to guarantee the future debts of the company, but did not know (as he was misled) that the guarantee he signed also extended to past debts. In those circumstances, the High Court considered that the trial judge was correct to decide that the guarantee could not be enforced in respect of the past indebtedness but could still be enforced in respect of the future indebtedness.

This decision has excited some controversy on the basis that it "invents a doctrine of partial rescission".[12]

<u>The distinction between common law and equitable fraud in shaping the remedy</u>

A further point to be aware of is the distinction between rescission for common law fraud and rescission in equity. There are two important consequences for the framing of remedies. First, common law fraud (unlike innocent misrepresentation in equity) gives rise to an entitlement to damages for deceit. When cases of common law fraud are dealt with in equity the process of restitutio in integrum can include an indemnity in lieu of damages.[13] Secondly, in cases of common law fraud, the courts are traditionally far more prepared to leave a defendant uncompensated than in cases not involving

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[10] (1983) 151 CLR 447.

[11] (1995) 184 CLR 102.

[12] See Meagher RP, Heydon JD and Leeming MJ, *Meagher, Gummow and Lehane's Equity Doctrines and Remedies* (4th ed, Butterworths, 2002) at [24-050].

[13] As discussed in *Belperio v Munchies Management* (1989) ATPR 40-926 at p 50,034 to 50,036.

conscious fraud.[14]

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.[15]

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 negativing undue influence.

The relationships are:

(i) religious adviser and believer;

(ii) doctor and patient;

(iii) solicitor and client; and

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[14] *Berridge v Public Trustee* (1914) 33 NZLR 865 at 872; See Meagher RP, Heydon JD and Leeming MJ, *Meagher, Gummow and Lehane's Equity Doctrines and Remedies* (4th ed, Butterworths, 2002) at [24-080].

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

(iv) parent and child or guardian and ward (until the child is regarded as emancipated).

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*:[16] 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.[17]

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.

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[16] (1998) 194 CLR 395

[17] (1998) 194 CLR 395 at 409

Garcia left open the possibility that the principle is also available to husbands and/or "de facto" spouses.[18]

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.[19]

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.[20]

There must be:

- a misrepresentation;
- which produced a misapprehension on the part of the representee;

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[18] *Garcia v National Australia Bank* (1998) 194 CLR 395 at 404

[19] *Commercial Bank of Australia v Amadio* (1983) 151 CLR 447 at 474

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

- which misapprehension was one of the reasons which induced the representee to enter into the contract;
- an intention on the part of the representor that the representee act in the way he/she in fact did.[21]

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*.[22] 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. [23]

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:

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

[22] 84 CLR 377

[23] 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

- 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.[24]

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,[25] 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

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[24] *Taylor v Johnson* (1983) 151 CLR 422 at 432

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

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.

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 or unfair or unconscientious 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.