

Rescission: A Case for Rejecting the Classical Model?



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When is a person 'barred' from rescinding his or her contract? Lawyers have given much consideration to this question, but have rarely asked whether it is necessary to have the bars at all. In this essay, the author examines the fundamentals of rescission, and the bars to it, and concludes that the present rules are outmoded and should be replaced. A new scheme of 'pecuniary rescission', which would operate between the original parties to the contract, is suggested as an alternative to the existing law.

THE question in the title of this paper emerged from an attempt to understand the fundamentals of rescission. If the question seems audacious, it may be because it is often difficult to persuade ourselves to look at established principles afresh. Rescission is undoubtedly well established; it is the principal remedy for the recovery of property transferred under 'non-voluntary transactions'.¹ In the traditional language of equity and contract law, these are transactions which may be avoided on the ground that they were affected in their making by 'vitiating factors'.

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1. The group of non-voluntary transactions includes those in which intention is absent or qualified. Failure of consideration belongs to this group because the consideration, namely the basis contemplated for the payment, fails: see P Birks *An Introduction to the Law of Restitution* (Oxford: Clarendon Press, 1989) 219-249.

My paper follows a line of enquiry that almost sets its own course and leads me to ask if there is a better response. A natural and useful starting point is to re-examine the role of rescission in our jurisprudence. This is called the classical model of rescission (or 'classical rescission') for easier reference and a clearer contrast with variations to it. Next, it is necessary to settle a much-neglected preliminary point — namely, is there only one principle of rescission? For reasons largely of jurisdictional divides and the sensible management of material, rescission is discussed in books on contract, equity, restitution and remedies. It remains unclear if one can say that, conceptually, there is only *one* principle of rescission applicable in all these areas. Academic indulgence is one of the lesser reasons for asking the question. More importantly, if the principle of rescission, whether in its common law or equitable manifestations, is fundamentally a single principle, then we must also address any irrational tendencies that do not respect its integrity.² This paper argues that there is only one principle of rescission and that it is best explained as the operation of the law of unjust enrichment bearing on different kinds of benefit. Turning then to its *modus operandi*, the rest of the discussion exposes the bars to classical rescission as largely illusory and dispensable. Indeed it will be seen that the fabric of classical rescission is already seriously weakened by judicial manipulation of the principle. This makes us confront the matter of a remedy *inter partes*, which classical rescission denies. In conclusion, the paper urges that we reject the classical model of rescission and substitute pecuniary rescission between the original parties to the transaction.³ The paper anticipates that personal liability to restitute may be strict, but subject to the defence of change of position which will assume greater prominence.

A SKETCH OF THE CLASSICAL MODEL OF RESCISSION

By and large the use of the term 'rescission' in the law is well settled. Occasionally it is still used loosely to mean the right to treat the other party's breach as terminating the contract.⁴ Courts in England and Australia have disapproved of

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2. There are many examples, mostly in the historical divide between common law and equity: see the engaging discussion in P Birks 'Equity in the Modern Law: An Exercise in Taxonomy' (1996) 26 UWAL Rev 1.
 3. P Birks is quicker off the mark. In 'Unjust Factors and Wrongs: Pecuniary Rescission for Undue Influence' [1997] Restitution L Rev 72, he begins by asking, 'How far is it possible to translate rescission into money?'.
 4. As recently as *Mahoney v Purnell* [1996] 3 All ER 61, 87; *Shevill v Builders Licensing Board* (1982) 149 CLR 620, Gibbs CJ 625-626. RP Meagher, WMC Gummow & JRF Lehane *Equity Doctrines and Remedies* 3rd edn (Sydney: Butterworths, 1992) 651 identify five uses of the term. Its more limited use is explained in, for example, *Johnson v Agnew*

this extended use for some time and we should no longer tolerate it. We invite confusion by using the same term to describe two fundamentally different remedies, one turning on compensation and the other on the surrender of a benefit received. In the case of breach, the remedy aims to put the aggrieved party in the same position as if the contract had been performed.⁵ In vitiated contracts, rescission renders them void ab initio and restores the parties to their status quo ante. Consequently, property that has been transferred can be recovered specifically or in money's equivalent. This difference explains why one cannot resort to rescission simultaneously with damages for breach unless, of course, there is a separate ground for the recovery of damages.⁶

The right to rescind is subject to two pre-conditions, namely, that there must be no intervening bona fide purchase of the asset without notice, and secondly, that restitutio in integrum must be possible. These are the traditional 'bars' to rescission.⁷ The first protects the security of third party interests from being disturbed. It does so by depriving the aggrieved party (who we will simply call 'the plaintiff') of even a remedy inter partes against the immediate or first recipient. The second bar is intended to ensure that the parties are restored to their status quo ante through the mutual restitution of assets. At common law full counter-restitution must be possible; only minor accommodations are permitted. This inevitably means a simple handing back of the assets or no restitution at all.

Equity takes a more liberal view of the pre-condition: only substantial counter-restitution, which allows for considerations of 'practical justice', is necessary. This lesser requirement of 'substantial' counter-restitution is apparently the result of judicial determination not to be defeated by jurisdictional constraints.⁸ However, equity did not go so far as to substitute (personal) counter-restitution in money for (proprietary) counter-restitution of the specific asset by the plaintiff. The asset must be returnable in substantially its original condition. As a rule, if the plaintiff no longer has the asset he is not allowed to rescind, because equity's concessions have not dispensed with the bar. *Spence v Crawford*⁹ is clear on this: the plaintiff must be in a position to '*offer back the subject-matter of the contract*'. But this rule

[1980] AC 367, 396-8; *McDonald v Dennys Lascelles* (1933) 48 CLR 457; and *Cooper v Ungar* (1958) 100 CLR 510, which disapprove of the extended use of the term.

5. Although termination releases both parties from future obligations under the contract, it preserves rights that have accrued at the time of the breach. The party in breach is liable to pay damages for the breach and the loss or damage flowing from it.

6. *Robinson v Harman* (1848) 1 Ex 850, Parke J 855; (1848) 154 ER 363, 365.

7. *Hunt v Silk* (1804) 5 East 449; (1804) 102 ER 1142.

8. *Spence v Crawford* [1939] 3 All ER 271, 290.

9. *Ibid.*

has no application to the case of the subject-matter having been reduced by the mere fault of the vendors themselves; and the rule itself is, in equity, modified by another rule, that where compensation can be made for any deterioration of the property, such deterioration shall be no bar to rescission, but only a ground for compensation'.¹⁰

The courts are cryptic in explaining how rescission operates to restore property transferred by the plaintiff. A frequently cited statement explains it as follows: 'The moment that the instrument by which they had so parted was swept away the original title was then in all its force'.¹¹ Both the High Court of Australia and the House of Lords have confirmed that the force of the 'original title' is brought about by the plaintiff's initiative in sweeping away the contract, not by the intervention of the court.

Treatises on rescission commonly use the images of 'undoing', 'unravelling' or 'cutting away' the transaction, which was valid and binding until cut away, whereupon the concomitant restitution occurred.¹² The restitution of title is automatic, even though the actual recall of the asset may require further action. If we suppose the plaintiff is induced by the defendant's misrepresentation to sell an asset to him, the legal status of that asset is altered by the plaintiff 'cutting away' the contract. The voidable contract becomes void *ab initio* and the plaintiff's title (which passed to the defendant under the contract) automatically re-vests in him, empowering him to recall the asset or recover its equivalent in money. It would seem that the same applies to any asset that passes from the defendant to the plaintiff under their contract. For if the contract is cut away, it must follow that what the defendant has conceded to the plaintiff under the contract re-vests in him for the same reason. The technique of classical rescission thus operates for their mutual benefit. Accordingly, it is unnecessary to justify the restitution to the defendant of his asset on a separate ground even though consideration may fail.

The nature of the right to rescind is more perplexing. Views on it are conflicting. Perhaps it is not even a right. Birks suggests that it may be more correct to call it a

10. Ibid, 279 (emphasis added), quoting Rigby LJ in *Legunas Nitrate Co* infra n 47.

11. *Abram Steamship Co Ltd v Westville Shipping Co Ltd* [1923] AC 773, Lord Dunedin 780-781. See also *Alati v Kruger* (1955) 94 CLR 216, 224.

12. See, for example, the standard textbooks on contract law and RM Goode *Commercial Law* (London: Penguin, 1986) 113: 'A necessary concomitant of rescission is restitution, the restoration by both parties ... of benefits received under the contract. Property transferred under the contract automatically reverts in the transferor'. Birks focuses our attention on the fine and important distinction between the restitution of title and the actual physical recall of an asset, a distinction which is not always apparent in these works: see Birks *supra* n 1, 66-67.

power (in rem) 'qualified in [its] exercise by being subject to the discretion of the court'. The plaintiff has the power in rem which until it is exercised means that his potential ownership has a 'floating phase' and only crystallises on the asset when the power is exercised.¹³ Goode has called it a typical example of an 'equity', a 'mere personal right', to signify that it is not proprietary.¹⁴ Meagher, Gummow and Lehane think it is 'more than merely personal to the original parties but [not] ... fully proprietary'.¹⁵ A more sustained argument is offered by Chambers. The right to rescind in equity, according to him, corresponds to an equitable proprietary interest in the plaintiff which arises at the time the asset is transferred.¹⁶ A trust thus arises upon the transfer of the asset provided that it is capable of being the subject of a trust. Chambers shows there is respectable authority for this view.¹⁷ It is also a common observation that assets have been routinely recovered specifically from subsequent recipients whenever rescission is not barred. In *Latec Investments v Hotel Terrigal*¹⁸ the High Court of Australia unanimously found that the mortgagor of a hotel under a Torrens title had an equitable interest in it where the mortgagee fraudulently sold the hotel to a subsidiary, which then gave a floating charge over it to a trustee who then sold its beneficial interest in the trust property to a bona fide purchaser for value.¹⁹ Menzies J called that equitable interest a trust. According to Chambers,²⁰ the trust is a resulting one arising by operation of law and based on the competing theory that the plaintiff did not intend the defendant to have the asset in this case, in circumstances that vitiated his intention.

Chamber's theory of resulting trusts is compelling even though resulting trusts are still presently institutional and limited in their incidence.²¹ However, his analysis of the right to rescind neither fits in with nor rejects the traditional learning that a

13. Birks *ibid*, 93.

14. Goode *supra* n 12, 72.

15. Meagher et al *supra* n 4, 121.

16. R Chambers *Resulting Trusts* (Oxford: Clarendon Press, 1997) ch 7.

17. Eg *Latec Investments v Hotel Terrigal* (1965) 113 CLR 265. See generally the cases discussed in Chambers *ibid*, throughout chapter 7.

18. *Ibid*.

19. *Latec Investments* *supra* n 17, 291.

20. Chambers *supra* n 16, particularly chs 5, 7 and 9.

21. P Birks is a leading proponent of the competing theory: see Birks *supra* n 12. In England the House of Lords has kept to the conservative and traditional view of resulting trusts: *Westdeutsche Landesbank Girozentrale v Islington London BC* [1996] 2 All ER 961, in which it overturned the Court of Appeal's finding that there was a resulting trust: see the commentaries by G Jones in 'Ultra Vires Swaps: The Common Law and Equitable Fall-Out' (1996) 55 Cambridge L Journ 432; and R Chambers in '*Westdeutsche Landesbank Girozentrale v Islington LBC*: Restitution, Trusts and Compound Interest' (1996) 20 Melb Uni L Rev 1192.

voidable transaction becomes void ab initio. It also leaves some important questions unanswered. They relate mainly to the implications of the resulting trust, possible alternatives and/or additional remedies and the responsibilities of subsequent recipients against whom recovery is sought by the plaintiff. For example, in a straightforward action between the plaintiff and the immediate recipient, what are the duties of the immediate recipient qua trustee? We can safely assume that he must hold the asset for the benefit of the plaintiff and must reconvey it at his behest; but does he have duties for which he is personally liable?²² If we introduce a bona fide purchaser for value of the asset into the example, is the immediate recipient still personally liability to the plaintiff? If he is, the plaintiff will have a choice of remedies where he may have only one at present. Taking subsequent receipts further, if a subsequent recipient takes innocently from the immediate recipient but for no consideration, will he be a trustee as well? If so, what are his duties? Again, the menu of remedies may be enhanced. The questions do not stop there. What is the position if the subsequent acquisition was of the equitable title? Do we rely on the usual rule for settling the priority of conflicting equitable interests (the nub of which is that the interest first in time is preferred at law)? If we do, can we assume that the strengths of the competing interests are equal? If we can, it makes little sense to speak of a bona fide purchase without notice as a bar to rescission because (i) according to Chambers' argument, the equitable interest in the right to rescind will always be earlier in time, and (ii) the bona fide purchase of the *legal* title without notice simply defeats the plaintiff's equitable interest. Or, shall we suggest instead that this is an exceptional case to which that rule does not apply? One is again left with the question of whether the immediate recipient may be personally liable as a trustee. As Chambers rightly points out, the nature and degree of fiduciary obligations cannot be deduced from the mere fact of a resulting trust because they will depend on the circumstances giving rise to the trust. Unfortunately, the cases rarely deal with issues of personal liability and these questions have not been considered comprehensively. They cannot be dealt with satisfactorily in this paper and we must leave them for the time being. However, if the pecuniary rescission proposed later in this paper finds favour there will be no real need to pursue them.

22. The Court of Appeal in *Westdeutsche Landesbank* [1994] 4 All ER 890 held that the resulting trustee was personally liable to pay for the value of the property. The House of Lords rejected the finding of a resulting trust but did not consider the issue of liability. In *Lonrho plc v Fayed (No 2)* [1991] 4 All ER 961, 968, a sale of shares was rescinded for fraudulent misrepresentation. Millet J thought there was a constructive trust and the trustee's obligations were limited to the property actually received and liable to be returned. The trustee's obligations were analogous to those of a vendor of property contracted to be sold.

MORE THAN ONE PRINCIPLE?

Considered opinion on this question is scarce and some academic writings simply assume one view or the other.²³ Burrows seems to offer the only published analysis in which he concludes that rescission is not a unitary principle. According to him, rescission is a restitutionary response to executed but not executory contracts.²⁴

An executory contract, Burrows says, does not confer any benefit and there is nothing to restitute whereas rescission of an executed contract is restitutionary. The rescission of executory contracts thus belongs rightfully to contract. Burrows considers that the importance of rescission in executory contracts is 'simply in allowing the parties to escape from their contractual obligations'. It has, he says, the 'same practical effect as wiping away the contract in futuro by termination for breach or frustration which is similarly not a restitutionary remedy'.²⁵

It is demonstrably untrue that no benefit is conceded under an executory contract. A plaintiff who rescinds an executory contract wants to retrieve the claim against him which was conceded to the defendant under the contract. The benefit is the personal contractual right against the plaintiff — a common variety of personal property which is often assignable, and if assigned, adds to the assignee's wealth. The defendant is clearly enriched and it does not matter whether or not the right is assignable. Assignability serves only to highlight the positive benefit, the realisable gain, the asset, given to the defendant under the contract. Like other benefits, this one is established by showing that the defendant has it and there is no scope for the defendant to argue that it is of no value to him. To make this a little clearer, let us suppose the plaintiff wishes to rescind a contract under which the defendant pays for goods the property in which is still in him. It is clear that the plaintiff 'wants back' the defendant's right to claim against him. For this he must do (counter) restitution.

23. For example, K Mason & JW Carter consider 'unjust enrichment [an] acceptable concept by which the equitable principles may be unified' but do not attempt to resolve the matter: *Restitution Law in Australia* (Sydney: Butterworths, 1995) 52. D Nolan assumes there are two principles: 'The Classical Legacy and Modern English Contract Law' (1996) 59 Mod L Rev 603.

24. In equity there is discretion to order rescission on terms. Thus any argument that rescission is a unitary principle is in a sense not completely true. However, putting the discretion aside it is still useful to determine whether there is more than one principle of rescission.

25. A Burrows *The Law of Restitution* (London: Butterworths, 1993) 33. It would be wrong to allow the 'same practical effect' to obscure the fundamentally different operation of frustration. Frustration concedes that a contractual relationship should cease to bind the parties in futuro, leaving undisturbed rights that have accrued and providing a defence against inability to perform. That is why a seller may incur no liability for the breach of his statutory duty to deliver in the event of frustration under sale of goods legislation, eg the Sale of Goods Act 1895 (WA).

Rescission causes the defendant to give up that contractual claim and reduces his wealth by an amount equal to that received at the plaintiff's expense, even though this is obscured because the right to claim is extinguished instantaneously.²⁶ Indeed, the rescission of executory contracts illustrates the restitutionary relief in its least complicated form. It assumes the most straightforward course without running into difficulties of counter-restitution and actual restoration.

In contrast, only where an executory contract is a nullity is there nothing to restitute. The defendant cannot be said to have been enriched. The contract was never one in the eyes of the law and cannot concede any benefit. An issue of restitution can only arise in respect of an asset which passes physically to the defendant. There may be a restitutionary right conceded by law but this would be separate and distinct. The asset is anyhow recoverable on the strength of the plaintiff's right in rem exigible against the res. This 'pure proprietary' claim/right (Goff and Jones) 'passively anticipates' (Birks) enrichment and effectively prevents it until overridden by operation of law in favour of a subsequent party in the interest of secure receipt.²⁷

According to the foregoing analysis, rescission in all the following situations is the same restitutionary remedy that causes the defendant (D) to give up an enrichment or benefit obtained at the plaintiff's (P's) expense:²⁸

1. P is induced by D's misrepresentation to give D \$100. P wants the \$100 back.
2. P is induced by D's misrepresentation to pay him \$100 in exchange for something. P wants the money back.
3. P is induced by D's misrepresentation to promise to pay \$100 in exchange for something. P has not yet paid.

INTERVENING THIRD PARTY INTERESTS DO NOT ALWAYS BAR RESCISSION

It is axiomatic in classical rescission that intervening third party interests constitute a bar that leaves the plaintiff without a remedy even against the immediate

26. It may seem odd to speak of a benefit revesting in the plaintiff when the defendant's claim cannot continue as property in the plaintiff's hands. This oddity, however, is not analytical and does not matter. Perhaps 'reclaiming' the right against himself sounds marginally better.

27. That is why the lapse of time should not make a difference to the plaintiff's rights. If lapse of time bars the plaintiff's claim, a new right is being created in the defendant which may extinguish the other's interest for all practical purposes.

28. Even though, strictly speaking, the restitutionary remedy for non-contractual payments is presently still the traditional action for money had and received.

recipient. However, it is wrong to think that rescission is always barred by the intervention of third party rights. Whenever a party rescinds and wants to recover money paid, the intervention of a third party's right to the money is never an issue. The third party's interest in the money is never an obstacle to the plaintiff's recovery from the immediate recipient cum defendant. So a plaintiff who bought because of the defendant's misrepresentation is never troubled in his rescission by the fact that a third party has acquired the money paid by him. The classical model of rescission does not explain this and never draws attention to it.

There is an explanation and it lies in the rules that govern title to money. Money is uniquely acquired under the law each time value is given in good faith for it — and not by force of contract. As the third party's title to the money is not dependant on the validity of the contract sought to be rescinded, his interest is not disturbed by the rescission of the contract between the plaintiff and the immediate recipient cum defendant. This is eminently sensible. The obvious point is this — if it is possible to rescind when third party interests happen to be protected by the rules relating to title to money, it ought to be no less possible to preserve the plaintiff's remedy if the interests of third parties can be protected in other ways. It is undoubtedly important to protect third party interests that are acquired bona fide from being disturbed, but there is no need to bar rescission.

One way in which third party interests can be protected without depriving the plaintiff of a remedy is by abandoning classical rescission and allowing a purely pecuniary remedy against the immediate recipient. In other words, rescission can be turned into money and limited between the original parties to the transaction. The case of *Mahoney v Purnell*²⁹ can be understood to permit it. Mahoney and his son-in-law, Purnell, each held half the shares in a company which owned a hotel. Mahoney eventually agreed to a scheme proposed by Purnell whereby his shares were relinquished, at a serious under-value, namely an annuity for ten years which included the accelerated repayment of money lent by him to the company. Mahoney commenced proceedings to rescind the sale for undue influence (which was presumed and not rebutted). At the time of the action the parties could no longer be 'restored to their former positions', the hotel having been sold for £3.3 million which was later lost in another venture. The annuity had ceased and the company had been wound-up. Mahoney 'plainly [could] not have his shares back'.³⁰ The court did not think that was a problem as '[t]he basic principle is that the defendants must account for the profits obtained by them from the improper agreements'. The court was able to do what was 'practically just'. Specifically, it could order 'equitable

29. *Supra* n 4.

30. *Ibid*, 86.

compensation' as an adjunct to setting aside the agreement. Mahoney was accordingly compensated to the tune of £202 131 for what he had given up under the contract, with credit given to Purnell for what he had received.³¹

The precise basis for Mahoney's compensation is not clear. May J referred to undue influence as a wrong and shifted to the breach of a fiduciary obligation to justify it. It cannot be assumed, of course, that every case of undue influence entails a breach of fiduciary obligation or that every breach of fiduciary obligation gives rise to undue influence. Moreover, wrongs must be distinguished from non-wrongs. Non-wrongs ground (autonomous) restitution, but wrongs give rise to damages as well. Undue influence is arguably a non-wrong.³² It may be that a case for undue influence includes facts that also constitute a wrong, such as deceit, but that would be separate and distinct. Nevertheless, it is possible to read *Mahoney v Purnell*³³ to permit rescission of the contract for undue influence (independently of the breach of fiduciary duty) and recovery of the value of the shares which were no longer extant less the value already received. This implicitly rejects the classical model of rescission which, in the circumstances, dictates that Mahoney's right in rem cannot survive the loss of the res. The decision effectively turned rescission into money, thus substituting pecuniary rescission for proprietary restitution.

From the plaintiff's point of view his difficulty is the same whether the res has ceased to exist or third party rights have intervened. There is no justification for treating the two situations differently. The substitution of pecuniary rescission in *Mahoney v Purnell*³⁴ must be equally applicable whenever third party interests intervene. Indeed, so long as third parties are protected, say, by a defence of bona fide purchase without notice, the bar is superfluous. We can safely dispense with it to allow a remedy inter partes. As Treitel³⁵ points out, even as a matter of policy there is no reason why a defendant should not have a personal duty to return the value of the asset. It is in this light that we can explain *McKenzie v McDonald*³⁶ as an exercise in substituting pecuniary rescission for proprietary restitution too. This

31. This is, according to JD Heydon, an impeccable conclusion on equitable compensation for a party who rescinds a transaction for undue influence: see JD Heydon 'Equitable Compensation for Undue Influence' (1997) 113 LQ Rev 8. This writer prefers Birks' view that undue influence is a non-wrong for which restitution for unjust enrichment and not damages is the appropriate remedy: see Birks supra n 3. The distinction between equitable compensation and damages is roundly criticised by Birks supra n 2.

32. PB Birks & NYChin 'On the Nature of Undue Influence' in J Beatson & D Friedmann (eds) *Good Faith and Fault in Contract Law* (Oxford: Clarendon Press, 1995).

33. Supra n 4.

34. Ibid.

35. GH Treitel *The Law of Contract* 9th edn (London: Sweet & Maxwell, 1995) 333.

36. [1927] VLR 134.

was a decision of the Supreme Court of Victoria in which a third party's interest intervened and could not be disturbed.

Mrs McKenzie exchanged her farm for McDonald's shop and dwelling at his suggestion. McDonald dishonestly persuaded her that the farm was worth less than what she expected and also inflated the value of the shop/dwelling. The farm was resold soon afterwards to a third party who went into possession. McDonald, 'a land and estate agent and property salesman' who had assumed the role of advising McKenzie, was aware of her difficult personal circumstances and her pressing need to acquire a city dwelling. In the circumstances he had become a fiduciary agent who owed her a duty of full disclosure and a duty to deal with her at arm's length. These duties were breached, to say the least, by his withholding information on the true value of the farm and the prospect of a ready buyer. McKenzie was accordingly entitled to have the contract set aside, but in view of the third party's interest in the farm McDonald was ordered to pay £145 'by reason of the under-valuation of the farm and £450 by reason of the over-valuation of the shop and dwelling'.³⁷ He was also given the option to take over the shop and dwelling for the same sum paid by McKenzie under the contract of which the amount of the over-valuation was to be satisfied by the aforesaid payment. These orders are capable of suggesting the substitution of pecuniary restitution for proprietary restitution. This is especially true of the second order, even though it was left to McDonald's option.

THE REMNANTS OF RESTITUTIO IN INTEGRUM

Restitutio in integrum restates as a pre-condition a seemingly logical outcome of classical rescission. That is, if a contract is 'cut away' mutual restitution must run its course. If that is not possible the plaintiff cannot rescind. Hence restitutio in integrum has to be a pre-condition. The upshot of the pre-condition is that failure of consideration is another but superfluous string to the defendant's bow.³⁸ As the plaintiff cannot rescind unless he is able and willing to restore any benefit conceded by the defendant, it will be a rare case where he needs to rely on failure of consideration.³⁹

In its strict form, restitutio in integrum dictates that the plaintiff must provide specific counter-restitution of the benefit received. When specific restitution cannot

37. Ibid, Dixon J 148.

38. The sense of Burrows supports this: see Burrows *supra* n 5, 313.

39. Sometimes restitutio in integrum is treated as an illustration of the maxim that 'those who seek equity must do equity' even though the same pre-condition exists at common law.

occur, *restitutio in integrum* is said to be impossible. It is implicit that intervening third party interests will also prevent specific counter-restitution. In *Spence v Crawford*⁴⁰ the House of Lords said this of *restitutio in integrum*: 'The condition of the relief [rescission] is the restoration of the *defender* to his pre-contractual position, and that no stress is placed on whether the pursuer is so restored'.⁴¹ Strict *restitutio in integrum* is sterile logic for two reasons. The first is that it is never truly impossible if we consider that it can always be done in money. Even more importantly, there is no interest worth protecting in the notion of impossibility of *restitutio in integrum* that cannot be protected by allowing pecuniary counter-restitution. In other words, failure of consideration adequately protects the defendant's interest. Once counter-restitution is turned into money, the plaintiff's duty to make counter-restitution will simply correspond to the defendant's right to recover for failure of consideration.

In the cause of action traditionally known at common law as total failure of consideration, there is already a significant shift of orientation to counter-restitution in money. In *David Securities Pty Ltd v Commonwealth Bank of Australia*,⁴² the High Court of Australia explained that if the consideration can be 'apportioned' or where 'counter-restitution is relatively simple' it would be misleading and inappropriate to insist on total failure. Although the common law has not yet renounced total failure, thus following equity's lead in giving counter-restitution in money, one cannot doubt the importance of a shift of approach which accepts that total failure is unduly restrictive. At the same time there is weighty judicial support for a more liberal interpretation of failure of consideration from both the Privy Council and the House of Lords. This may well hasten the retreat from total failure.⁴³

40. Supra n 8.

41. Ibid, 279 (emphasis added). Cases on rescission are overwhelmingly concerned with the issue of counter-restitution.

42. (1992) 175 CLR 353.

43. In *Goss v Chilcott* [1996] AC 788 (an appeal from New Zealand) the Privy Council approved the approach in *David Securities Pty Ltd v Cth Bank* *ibid*. In *Westdeutsche Landesbank* supra no 22, Dillon LJ in the Court of Appeal was of the view that total failure of consideration should be interpreted more liberally. In the House of Lords, Lord Goff expressed a similar view even though the matter did not arise directly: *Westdeutsche Landesbank* supra no 21. The High of Australia in the later case of *Baltic Shipping Co v Dillon* (1993) 176 CLR 344 did not resile from its position in *David Securities* even though it refused Mrs Dillon recovery of her fare for a luxury cruise on the ground that there was no total failure of consideration. Mrs Dillon pre-paid her fare for a 14-day cruise which ended in her being injured when the vessel sank after the eighth day. She was awarded damages for breach of contract that included compensation for disappointment and distress and a full refund of the fare. One reading of the case reveals some unease with counter-restitution, which was not a simple matter in the circumstances. That may have influenced the court to take the compensation path since, in its view, full compensation and complete restitution cannot be given for the same breach.

The changeover now advocated will not be completely foreign to us. For a long time, we have turned to valuations and retreated from the strict application of classical rescission. Even at common law, where counter-restitution must be strict, we have approved of an approximate mutual restitution with allowance for 'incidents for which the buyer [P] is not responsible, such as those to which the property [is] liable either from its inherent nature or in the course of the exercise by the buyer of those rights over it which the contract [gives]'.⁴⁴ Equity has of course gone further requiring only substantial counter-restitution. Orders have been used, at times creatively, to achieve 'practical justice'. Thus allowance is made for deterioration, depreciation, permanent improvement and profits by taking accounts.⁴⁵

There is, however, a misunderstanding in the cases which needs to be corrected before there can be a complete change over to pecuniary counter-restitution. It is the belief that the retreat from strict restitutio in integrum must be justified on the ground of the defendant's fraud even if only in the wider sense of the word. This is wrong.⁴⁶ A comparison of *Lagunas Nitrate Co v Lagunas Syndicate*⁴⁷ and *New Sombrero Phosphate Co v Erlanger*⁴⁸ helps to explain why it is wrong.⁴⁹ The material facts in the two cases were very similar. In the first case, the purchasers of property consisting of nitrate works attempted to rescind the purchase, for our purposes, on the ground of misrepresentation by the vendors. The mines had been worked vigorously and profitably for some years with the vendors making large outlays under the agreement when called upon to do so. It was not until the market price of nitrate and the value of the purchasers' shares had fallen permanently that they attempt to rescind. The vendors had themselves sold the shares received in part-payment of the purchase price while the purchasers declared large dividends before the suit. The court held that counter-restitution was 'impossible', the mines having been so worked and altered that the parties could not be restored to their original

44. *Head v Tattersall* (1871) 7 LR Ex 7, 12. Eg *Adam v Newbigging* (1886) 34 Ch D 582 (failure of a partnership business due to inherent vice).

45. *O'Sullivan v Management Agency & Music Ltd* [1985] QB 428 is a particularly interesting example.

46. In *Laundering and Tracing* (Oxford: Clarendon Press, 1995) 337 the editor, P Birks, commented that 'nobody [at the seminar] defended the distinction between greater willingness as against bad defendants and less willingness as against innocent defendants ... [and] there was essentially universal support for a liberal regime of counter-restitution in money.' This writer confesses to not having read E McKendrick's paper which considered and/or generated discussion on this point, at the time of writing.

47. [1899] 2 Ch 392.

48. [1872] 5 Ch D 73.

49. See also *Spence v Crawford* supra n 8; *O'Sullivan v Management Agency & Music* supra n 45.

positions. The absence of fraud in *Lagunas Nitrate Co* was crucial to its outcome. The Court of Appeal said that fraud would have justified rescission and the kind of orders needed to adjust the positions of the parties in *New Sombrero Phosphate Co*.⁵⁰

In the earlier case of *New Sombrero Phosphate Co* the plaintiff could rescind on the ground of the sellers' fraudulent non-disclosure of material information. They recovered the purchase price of the mining lease on a phosphate island even though the lease had been worked extensively for a time at a loss. The purchase price comprised £80 000 in cash and £30 000 in fully paid up shares. The plaintiff had to restore the island and account for profits derived from them while the defendant sellers were ordered to repay the purchase price with an account to be taken of those shares they had parted with, together with interest from the time of the receipt of the moneys.

It is clear from *Lagunas Nitrate Co*⁵¹ that when counter-restitution is 'impossible', the insurmountable difficulty is not always one of feasibility. Indeed counter-restitution is always feasible in money, in which case rescission will rarely be impeded by difficulties in making counter-restitution. It is only impossible in the sense that the court will not adjust the positions of the parties unless the defendant would otherwise benefit from his own fraud. As Goff and Jones have observed, where there is 'moral obliquity' the court is more easily satisfied that substantial counter-restitution is possible.⁵² Clearly, there is already significant judicial discretion in the elastic requirement of restitutio in integrum. The courts' restraint when there is no fraud on the part of the defendant is quite unnecessary. We must go back to the distinction between wrongs and non-wrongs to make this point. A non-wrong is sufficient for autonomous restitution. If a non-wrong gives a right to rescind in the classical sense then it ought to take no more than a non-wrong to rescind in the substituted pecuniary sense. There is no reason to introduce another element of bad conscience. Turning proprietary restitution and counter-restitution into money meets the need to protect third party interests without sacrificing the plaintiff's remedy against the immediate recipient. Fraud has a larger repertoire of remedies and will support an action in damages for the tort of deceit.⁵³

50. Supra n 48, per Lord Lindley MR 434.

51. Supra n 47.

52. R Goff & G Jones *The Law of Restitution* 4th edn (London: Sweet & Maxwell, 1993) 200.

53. *Smith New Court Securities v Scrimgeour Vickers (Asset Management) Ltd* [1997] 3 All ER 796, (namely) ... 'full compensation for the wrong', actual and consequential loss directly flowing from the transaction induced by the fraud.

MANIPULATING CLASSICAL RESCISSION

The notion of 'partial rescission' is very troublesome for classical rescission because it is fiendishly difficult, and perhaps impossible, to explain it. Going back to the imagery of 'cutting away' a contract, we need to know how much of the contract gets cut away. How do we determine the size of the excision to be made? When and how do we correlate counter-restitution with that part which is rescinded? It is hard to be persuaded that the 'logic' of classical rescission allows random mixing and matching between the obligations of the parties or the selective excision of a contract to remove the so-called original infection.⁵⁴ In *O'Brien v Barclays Bank plc*,⁵⁵ Lord Browne-Wilkinson rejected partial rescission as an 'elusive concept' and confirmed that rescission is an 'all or nothing process'.⁵⁶ Recently, in *Vadasz v Pioneer Concrete (SA) Pty Ltd*⁵⁷ the High Court of Australia ordered partial rescission of a guarantee but did not answer any of these questions. There was instead a barely disguised manipulation of classical rescission which suggests that the High Court implicitly or at least unwittingly rejected the logic of that concept.

In that case Vadasz gave a personal guarantee to secure the continued supply of cement to a company of which he was one of two directors and two shareholders. The company having fallen behind in its payments for cement supplied was in financial trouble and the suppliers would not continue supplies unless a guarantee was given. Vadasz was induced by the suppliers' misrepresentation that the guarantee secured only *future* indebtedness, to sign — without reading — a guarantee for past indebtedness as well. The company failed. Vadasz sought to resist the suppliers' action by having the guarantee rescinded. The High Court affirmed Vadasz's liability for the future indebtedness of the company. It suggested that the appropriate order may, 'in the absence of an offer to do equity, be an order partially setting aside the guarantee rather than such an order for partial rescission'.⁵⁸ As the parties did not

54. Eg L Proksch states categorically that rescission may be denied if 'partial rescission would suffice to remove the unconscionability that originally infected the transaction' in P Parkinson (ed) *The Principles of Equity* (Sydney: Law Book Co, 1996) 868.

55. [1994] 1 AC 180.

56. *Ibid*, 199, followed in *TSB Bank plc v Camfield* [1995] 1 WLR 430 in which a wife was able to set aside a mortgage given over her home on the ground of her husband's misrepresentation to her that it was to secure only £15 000. See also D O'Sullivan's discussion of its departure from established principles in 'Partial Rescission for Misrepresentation in Australia' (1997) 113 LQ Rev 16; and L Proksch's suggestion that the decision is best understood as an instance of equity allowing rescission on terms which may be guided by the principles of unjust enrichment: 'Rescission on Terms' [1996] 4 Restitution L Rev 71.

57. [1995] 184 CLR 102.

58. *Ibid*, 116. As assumed by the parties to be the appropriate remedy. Unfortunately the court did not elaborate on the differences between the two remedies.

raise the matter and the amount of the final monetary judgment would in any event be the same, the distinction was not pursued and the guarantee was partially rescinded, as requested.

Analytically, the decision in *Vadasz* is terribly unsatisfactory. It can be and is better justified on the ground of the wider powers bestowed by, for instance, section 87(2)(b) of the Trade Practices Act 1974 (Cth). Arguably, the guarantee could also have been rectified. *Vadasz* intended to guarantee future indebtedness in return for continued supplies as originally agreed between him and the suppliers. The contract was justifiably trimmed to reflect just that. Rectification, however, is traditionally given for common and mutual mistakes — not for unilateral ones unless the party not mistaken was guilty of fraud (even if only equitable fraud). If the court had determined that the misrepresentation was fraudulent, the guarantee could have been rectified.⁵⁹ Apparently fraud might have been inferred⁶⁰ from the evidence but as the Supreme Court refrained from making a specific finding, the High Court left the matter well alone. Nonetheless, the High Court continued to assume the presence of fraud for its order — and if the assumption can be made for one order, it must also be possible to make it for another.

The Court's dilemma in the case is evident: *Vadasz* personally benefited from his guarantee. Under the corporate veil, *Vadasz* and his wife (who were the sole shareholders of the company) received an undeniable benefit, namely, the supplies which were used up in the business. The Court considered it plainly unconscionable to allow *Vadasz* an 'unwarranted benefit' if the guarantee was rescinded. So the ubiquitous notion of unconscionable was used to manipulate, indeed defy, the classical model by 'cutting away' only so much of the guarantee as would deny the unwarranted benefit. It was undisputed that *Vadasz* intended to give a guarantee for *future* supplies and this intention was used as the reason for the excision — the partial rescission.

The Court's manipulation of classical rescission was not particularly refined in the way it dealt with *restitutio in integrum*. As we have seen, *Vadasz* acting as guarantor received nothing which he could personally retribute, the benefit having been conveyed at his request to the company. In this three-party configuration, there is only one contract at issue, that is, the one between the guarantor and the supplier. This situation is not different from the standard two-party configuration. Classical rescission demands, in the form of a pre-condition, that it must be feasible to return, substantially, the supplies delivered to the company. In this case it was not; the supplies had been used up in the company's business. Somehow it did not

59. Meagher et al *supra* 4, 680 n 19.

60. *Ibid*, 109.

matter in partial rescission that *restitutio in integrum* was not feasible. This suggests that either partial rescission is a password for ignoring the pre-condition or it crudely attributes the impossible counter-restitution to the part of the contract that survives the partial rescission.

THE REACH OF PECUNIARY RESCISSION

One can sensibly argue for the outright substitution of pecuniary rescission between the original parties for proprietary restitution. It would greatly enhance the security of third party interests. Alternatively, we can continue to hold subsequent recipients who are volunteers liable by preserving the present proprietary remedy against them while bona fide purchase without notice is re-established as a defence. In either event, the pre-conditions of classical rescission will simply become otiose. The personal liability to restitute will be strict but subject to the defence of change of position, which will probably assume a more prominent role. There are already intuitive attempts at shaping the defence of change of position in a few cases on classical rescission. These cases are interesting as their outcomes are immensely difficult to explain. We shall look at three of them. In each case, the plaintiff who rescinded was denied full recovery of his payment to the immediate or first recipient. These denials were exceptional. One case offered no explanation because it did not call for any. Another clearly grappled with a restitutionary defence and the last purported to apply classical rescission with a view to practical justice. All three can be understood as applications of the restitutionary defence of change of position.⁶¹

*Allcard v Skinner*⁶² is the oldest of the trio. There a novice nun was defeated by laches and affirmation in her attempt to rescind her gifts many years later on the ground of undue influence. However, the court made it clear that she could not have recovered fully in any event. The money had already been spent on the charitable works for which it was given and which both of them (the novice nun and her mother superior) had been keen to promote.⁶³ The mother superior, who had acted throughout with moral rectitude, would not have been liable to return it. This may be one of the earlier instances in which the restitutionary defence of change of position was contemplated. As the benefits received had been applied according to the

61. M Chen-Wishart makes this point brilliantly about *Allcard v Skinner* (1887) 36 Ch D 145 and *Cheese v Thomas* [1994] 1 WLR 129 in 'Loss Sharing; Undue Influence and Manifest Disadvantage' (1994) 110 LQ Rev 173. P Birks develops it enthusiastically in 'Overview: Tracing, Claiming and Defences' in Birks *supra* n 46, 289, 327.

62. *Ibid.*

63. *Ibid.*, 164, 171, 180, 186.

novice nun's wishes, the loss of benefit was causally linked to the (unjust) enrichment. It is hard to imagine a more direct causal link in the defence of change of position. Even on the narrower view of the defence, which insists that the mother superior changed her position to her detriment, she would have been able to show what Beatson and Bishop call 'out of pocket' reliance.⁶⁴ She had spent the money in ways that could not be recouped and which she would not otherwise have done.

The more recent Australian case of *Quek v Beggs*⁶⁵ was decided before the change of position defence was fully recognised in Australia.⁶⁶ It bears some similarity to *Allcard v Skinner* on the issue of undue influence. Mrs Quek suffered from a severe personality disorder which made her chronically vulnerable to anxiety. She had become dependent on the pastor of her church, Mr Beggs, who knew that she regarded him as God's representative and she treated him accordingly. Mrs Quek made substantial gifts of money to the pastor and his wife, the Beggs, for the construction of a house ('God's house') for them on land belonging to Mrs Beggs' parents, who were not parties to the action. Three residential properties were also gifted to the Beggs at a time when Mrs Quek was ill with cancer. The gifts practically exhausted her assets. The presumption of undue influence was not rebutted because the solicitor who advised Mrs Quek was not fully informed of the relevant facts. McLelland J, citing *Australia & New Zealand Banking Group Ltd v Westpac Banking Corporation*,⁶⁷ held that the Beggs could not be required to return the money spent on the house for the same reason that the defence of ministerial receipt is available in an action for restitution on the ground of fundamental mistake of fact. The difficulty with this reasoning is that Mr Beggs did not in fact receive as an agent. Perhaps the court was groping for the defence of change of position. It is clear from the decision that the expenditure of the money was the critical fact. Mr Beggs had spent it according to her wishes and that was something which he would not have done otherwise. He could not now recoup it. The causal link in the loss of benefit, namely the execution of Mrs Quek's wishes, created an illusion of instrumentality; but Mr Beggs had in fact changed his position.

The last case in the trio is a little different. There was no gift which was committed or spent according to the donor's wishes. In *Cheese v Thomas*,⁶⁸ Cheese

64. J Beatson & W Bishop 'Mistaken Payments in the Law of Restitution' (1986) 36 U Toronto L Journ 149, 151-152. The High Court in *David Securities v Cth Bank* supra n 42, favoured the narrower view.

65. (1990) 5 Butterworths Property Reports 11 761.

66. By the High Court in *David Securities v Cth Bank* supra n 42.

67. (1988) 164 CLR 662, 673-674.

68. Supra n 61.

made a deal with his great nephew, Thomas, that the latter would buy a house and Cheese would contribute towards the purchase price in return for a licence to live in it for the rest of his life. Cheese contributed £43 000 to the purchase price of £83 000. The balance was raised by Thomas by mortgaging the house. After Cheese moved in he discovered that Thomas had stopped payments on the loan. Cheese left and sought to recover his contribution in full. In the meantime, property prices had fallen and the house was resold for only £55 400.

The court held that although Thomas had not been guilty of any improper conduct, Cheese was entitled to relief on the ground of presumed undue influence arising in the circumstances of the case. But Cheese could only recover the proportion of the resale value as represented by the proportion of his contribution to the original purchase price. In other words, he had to share the loss resulting from the depreciation. The Court of Appeal did not consider itself to be departing from established principle. Cheese's contribution, it said, had been made towards the purchase of a house with Thomas over which both were to have defined rights. To undo this transaction, the house had to be sold and the pair restored to their antecedent status from the proceeds of the sale. As the proceeds were insufficient, 'practical justice' dictated that the loss be shared according to the spirit of the 'joint venture'. The solution was somewhat novel; rescission did not lead to restitution and counter-restitution. The loss was shared according to the intention of the parties as gathered from the nature of the deal. In the eyes of the court, the parties contemplated the sharing of losses by structuring the transaction as they did. There is some difficulty with this approach even on its own terms. Suppose property values had appreciated instead. One would predict that this 'joint venture' would require the profits to be shared in the same proportions that their contributions bore to the purchase price. But why should this be so given that Cheese was to have only a licence to live in the house for the rest of his life? The agreement was not to buy a house jointly. It was that Thomas would buy a house which he would own and Cheese would contribute towards the purchase price in return for the right to live in it until he died. It is quite misleading to call the deal a 'joint venture' and to make too much of this.⁶⁹

A better explanation is that the court intuitively applied the change of position defence; Thomas having received the benefit also suffered a causally related loss by the depreciation of the house in which his own money had been invested.⁷⁰ The upshot of this is that if property values had in fact appreciated, Cheese would not be entitled to share in the profits. There is really no reason why he should be

69. See also the doubt expressed by Chen-Wishart *supra* n 61.

70. See Birks & Chin *supra* n 32.

entitled because he was to have only the right to live in the house. Like the defendants in *Allcard v Skinner* and *Quek v Beggs*, Thomas's loss of benefit was caused directly by applying the benefit received as agreed between them. All of them would have been able to establish the defence by showing that the benefits received had been cancelled or reduced by their subsequent loss. What was left to be restituted was complicated in *Cheese v Thomas* by the fall in market value of the house. The issue then is the extent to which Thomas changed his position. Most will consider it acceptable to deal with the change of position losses by using the proportions of the two parties' respective contributions to the purchase price to work out how much restitution Thomas must give.

CONCLUSION

In concluding, it must be said unreservedly that the task of reviewing rescission is not finished. This paper only scratches the surface. It calls for considered points to be confronted and defended thoroughly. Nevertheless it is already apparent that there are compelling reasons to urge the rejection of classical rescission. Its principle has been compromised and manipulated. Its integrity has been challenged by partial rescission. The bars or pre-conditions are demonstrably dispensable. We know that third party interests can be protected by the defence of bona fide purchase without notice while leaving the plaintiff to a remedy *inter partes*. Specific restitution *in integrum*, even in its more liberal form, is superfluous and protects no worthy interest. Much of this difficulty can be overcome by turning proprietary restitution into money. The pecuniary rescission argued for allows practical justice to be achieved within a framework of principle which withstands scrutiny better than classical rescission. Even as a matter of policy, there is no reason to deny pecuniary rescission *inter partes*.⁷¹

71. Birks has argued that even the discretionary jurisdiction to award damages in lieu of rescission for innocent misrepresentation in s 2(2) of the Misrepresentation Act 1967 (UK) must be read as no more than pecuniary valuation of the restitution and counter-restitution otherwise affected: see Birks *supra* n 3.