

Limits of rescission for misrepresentation

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Key Points:

- Rescission is the primary remedy for misrepresentation.
- Where a defendant relies upon misrepresentation as a defence, it may be required to make an interim payment if it would have to pay that sum of money even if its argument that the contract should be rescinded for misrepresentation were successful.
- Contractual estoppel has been given a wide ambit by the courts.
- The wider the scope of contractual estoppel, the more likely that it will produce a chilling effect upon a party's willingness to exercise its right to rescind a transaction.

Abstract:

Rescission is the primary remedy for misrepresentation. The Court of Appeal has recently emphasised this important point, and has also held that an interim payment can be made where a defendant pleads misrepresentation as a defence and that sum of money would be payable were rescission to be ordered at trial. Yet such a robust approach towards rescission may be undermined by the courts' continuing reliance upon the controversial doctrine of "contractual estoppel".

The importance of rescission

In *Salt v Stratstone Specialist Ltd (t/a Stratstone Cadillac Newcastle)* [2015] EWCA Civ 745; [2015] C.T.L.C. 206 at [24] Longmore LJ made it clear that the "normal remedy for misrepresentation is rescission". This is important: if the defendant's misrepresentation was relied upon by the claimant and had some influence upon the claimant's entering into the agreement, then the claimant should be entitled to rescind the transaction and be put back into the position he or she was in before the contract was made. In a short but significant judgment the Court of Appeal clarified that damages should only be awarded in lieu of rescission under section 2(2) of the Misrepresentation Act 1967 where the right to rescind still exists, and that lapse of time should only bar rescission where laches is established (doubting the notorious reasoning of Denning LJ in *Leaf v International Galleries* [1950] 2 K.B. 86).

In *Salt v Stratstone*, the claimant was induced to purchase a car by the defendant's misrepresentations. The car had been sold unregistered but had since been registered by the claimant. The defendant argued that it was therefore impossible to effect *restitutio in integrum* and that the claimant could not rescind the contract. The Court of Appeal emphatically disagreed, insisting that rescission should be awarded "if possible" and that the court should "do what is practically just" in situations where it cannot precisely restore the parties to the position they were in before the contract was made (see *Erlanger v New Sombrero Phosphate Company* (1878) 3 App. Cas. 1218). The mere fact of registration was a purely legal concept which did not alter the physical nature of the car, which could be returned to the defendant. Moreover, the fact that the claimant gained some benefit from using the car did not bar rescission as he could account for any benefits

gained, and in principle it seems right that the drop in value of the car should be borne by the wrongdoing misrepresenter rather than the innocent misrepresentee.

Salt v Stratstone was a case concerning relatively straightforward and simple facts. But its impact will be felt in much more complicated commercial arrangements, and it is important to remember that the primary remedy for misrepresentation is rescission. In some situations, determining what has to be returned in order to effect *restitutio in integrum* may involve difficult questions of fact, but courts should not shrink from robust findings of what in essence should be transferred in order to achieve the “practical justice” required of rescission (see eg *UBS AG (London Branch) v Kommunale Wasserwerke Leipzig GmbH* [2014] EWHC 3615 (Comm) [717]-[731] (Males J)).

Rescission and interim payments

It appears that rescission cannot be a secondary, alternative claim at trial. For example, in *Re Goldcorp Exchange Ltd* [1995] 1 A.C. 74, the purchasers of gold bullion primarily argued that they had a proprietary interest in the bullion under a contract of sale. This claim failed, and as an alternative the purchasers sought to rescind the contract on the basis of misrepresentation. This also failed. Claimants have to elect to rescind promptly, and should not be able to wait and see how things pan out and then, after an unreasonably long period, only rescind at trial.

Significantly, in *Re Goldcorp* the claimants sought rescission as an alternative remedy. The situation is very different where the claimant seeks primarily to rely upon rescission. This was the issue in the recent decision of the Court of Appeal in *Deutsche Bank AG v Unitech Global Ltd* [2016] EWCA Civ 119. The case concerned a LIBOR rigging claim brought by the borrower UGL against Deutsche Bank in relation to a US\$150m facility agreement and interest rate swap where the interest rates under both the loan and the swap were tied to LIBOR. In an earlier decision ([2013] EWCA Civ 1372) the Court of Appeal held that the borrower was entitled to argue that it had only entered into the agreements because of implied misrepresentations by Deutsche Bank that LIBOR was genuine. This then raised, *inter alia*, the question of interim relief.

Deutsche Bank sought around \$177m under the loan agreement. UGL would be liable to pay this amount if its defence of misrepresentation failed. But if the defence of misrepresentation succeeded, then rescission would involve UGL’s returning to Deutsche Bank the outstanding amount of the principal sum that it had received, which was agreed to be about \$120m. On this basis, it seemed clear that UGL would have to pay Deutsche Bank around \$120m in any event, and Deutsche Bank sought this amount as an interim payment. The Court of Appeal (Longmore, Christopher Clarke and Sales LJ) overturned the decision of Teare J and emphatically agreed that such a payment should be ordered. The Court held that the language of section 32(5) of the Senior Courts Act 1981, concerning orders for interim payment, was sufficiently wide to cover this situation (since “other sum” could cover an obligation to pay money by way of restitution) and CPR Part 25.1(1)(k) uses similar language in making provision for orders of interim payment. The overriding objective under the Civil Procedure Rules clearly supports the conclusion of the Court of Appeal. As Longmore LJ put it (at [66]):

Since it is obvious now, in advance of trial, that UGL must pay the Lenders a minimum of \$120m, it is not just that the Lenders should be kept out of their money to that extent until after a trial. Putting it positively, dealing with the case justly requires that an interim

payment should be made, since otherwise the substantive result is that UGL benefits from an uncovenanted and unmerited forced loan of \$120m by the Lenders, where the absence of UGL's entitlement to retain and have the benefit of that sum is already clear. We know that if there were a trial tomorrow, the court would require UGL (i.e. hold UGL liable) to pay that amount, as a minimum, to the Lenders. Further, the expeditious and fair disposal of the case in relation to the \$120m which is known at this stage to be the minimum due to the Lenders, is that UGL should be required to make an interim payment in that amount.

The Court of Appeal further held that the trial judge was wrong to hold that no payment into court should be required for UGL to defend the claims of Deutsche Bank. CPR Part 3.1(3) governed conditional orders in the context of applications for summary judgment, and this was not disapplied by any special rules. In accordance with the overriding objective, it was only just for UGL to pay \$120m in order to resist the claims of Deutsche Bank at trial: UGL had no good arguable basis for saying that it should be entitled to keep the benefit of that money for itself, and it was appropriate to be required to pay that sum at the interim stage in order to provide security for Deutsche Bank's claim against UGL, and to assure Deutsche Bank that it was not litigating in vain.

Chilling effect of contractual estoppel

The role of rescission as the primary remedy for misrepresentation may be undermined in banking and financial disputes by the evolving doctrine of contractual estoppel. According to Aikens LJ in *Springwell Navigation Corporation v JP Morgan Chase Bank* [2010] EWCA Civ 1221, [144]:

“[I]n principle and always depending on the precise construction of the contractual wording ... A and B can agree that A has made no precontract representation to B about the quality or nature of a financial instrument that A is selling to B ... even if both know that is not so. Like Moore-Bick LJ in [*Peekay Intermark Ltd v Australia and New Zealand Banking Group Ltd* [2006] EWCA Civ 386, [56]–[57]], I see commercial utility in such clauses being enforceable, so that parties know precisely the basis on which they are entering into their contractual relationship.”

Clearly, in the context of sophisticated parties entering into complex financial products (such as the rouble-denominated “GKO” notes in *Peekay* and *Springwell*) the desire for contractual and commercial certainty provides a strong justification for giving an estoppel effect to clauses which prevent the parties from invoking pre-contractual or extra-contractual statements. Nevertheless, there exist well-rehearsed doctrinal concerns regarding whether contractual estoppel might be viewed as an illegitimate species of estoppel (see McMeel, “Documentary Fundamentalism in the Senior Courts: The Myth of Contractual Estoppel” [2011] LMCLQ 185), and, in practice, the English courts have struggled to articulate any clear controls upon that doctrine's application to misrepresentation and mis-selling claims in the financial context and more generally. Whilst the Court of Appeal in *Wood v Capital Bridging Financing Ltd* [2015] EWCA Civ 451, [30]–[31] prevented a lender from invoking the doctrine to estop a borrower, who had signed a declaration that the loan was “wholly or predominantly for the purposes of [her] business”, from claiming that the loan was in reality a regulated consumer credit agreement, this result was clearly mandated by anti-avoidance provisions in the Consumer Credit Act 1974 (“CCA 1974”), s 173(1). Similarly, in *NRAM plc v McAdam* [2015] EWCA Civ 751, [53]–[56], a lender was not estopped by statements in the loan agreement

from denying certain benefits arising from the CCA 1974 to a borrower under an unregulated agreement, but once again any other conclusion would have operated to set the gateway requirements for the CCA 1974 at naught.

Beyond the specific context of the CCA 1974, there exists (according to Trukhtanov, “The Limits of Contractual Estoppel” [2012] LMCLQ 359) a panoply of doctrinal tools that might be deployed to check the advance of contractual estoppel, such as rectification of the agreement, the implication of terms (on which see *Compass Group UK and Ireland Ltd (t/a Medirest) v Mid Essex Hospital Services NHS Trust* [2013] EWCA Civ 200, [83]) and estoppel by convention. To date, however, such deployment as there is has been rather half-hearted and *ad hoc*, such that, without coherent or stable limits to the doctrine, contractual estoppel has largely been given free range. In particular, it is not clear why a doctrine, developed in the context of sophisticated financial counterparties, should have the same justificatory force when applied to the less sophisticated end of the market. Whilst this issue has received some recognition in Singapore (see *Als Memasa v UBS AG* [2012] SGCA 43), the English courts have paid little attention to this concern (with the possible exception of Clarke J in *Raiffeisen Zentral Bank v Royal Bank of Scotland plc* [2010] EWHC 1392 (Comm), [304]–[312], who recognised that contractual estoppel applied to “the car dealer as well as the bond dealer”).

Particularly concerning in this regard is *Crestsign Ltd v National Westminster Bank plc* [2014] EWHC 3043 (Ch), [110]–[120], in which Tim Kerr QC, having concluded that the bank had unusually stepped beyond its sales role and had assumed an advisory duty to its client (a small family owned company, described as “a retail client and not a large and sophisticated party”), nevertheless rejected the allegations that the bank had failed to ensure that the swap was suitable for the client’s needs or that the information provided was accurate on the sole basis of the estoppel created by the non-advisory clause in the documentation. A similar approach is discernible in *Thornbridge Ltd v Barclays Bank plc* [2015] EWHC 3430 (QB), [103]–[112], which involved a claim by a private company – essentially an incorporated partnership between Mr Harrison and his wife – alleging that it had been misled an interest rate swap intended to hedge a loan required to purchase a leasehold interest in a Sheffield property. The claimant’s allegations related to the suitability of the hedging product, the inadequacy of the break costs’ presentation and the lack of advice concerning the restrictions on refinancing and the lack of loan portability. Once again, contractual estoppel gutted the claims of any content. Moreover, both *Crestsign* (at [119]) and *Thornbridge* (at [109]–[112]) have now neutered any significant protective role for the Unfair Contract Terms Act 1977 in the context of misrepresentation by endorsing the specious distinction between “basis clauses” and exclusion clauses (although see, to the contrary, *Raiffeisen Zentral Bank v Royal Bank of Scotland plc* [2010] EWHC 1392 (Comm), [314] (asking whether “the clause attempts to rewrite history or parts company with reality”); *Deutsche Bank AG v Chang Tse Wen* [2013] 4 SLR 886). Any hope that there might be a retreat from this position in *Crestsign Ltd v National Westminster Bank plc* [2015] EWCA Civ 986 has now been dashed by that case settling on confidential terms.

It is this expansive approach to contractual estoppel, exemplified by cases like *Crestsign* and *Thornbridge*, that may well produce a chilling effect on rescission and limit its utility in response to misrepresentation claims. The impact of contractual estoppel upon rescission is likely to be subtle, since it is unlikely that a court would allow a party to invoke a contractual estoppel to mount a direct attack on rescission as a remedy. For example, in *Lsref III Wight Ltd v Millvalley Ltd* [2016] EWHC 466 (Comm), [120]–[122], Cooke J recently refused to countenance the possibility that such an estoppel might oust the court’s equitable jurisdiction to rectify contracts; rather, the existence of any contractual estoppel should only be a factor in the exercise of the courts’ discretion, but not

determinative of the matter. Similarly, although rescission is first and foremost a self-help, rather than a judicial, remedy, the court nevertheless retains a supervisory jurisdiction over this form of relief that it is likely to defend equally jealously, with the result that a clause purporting to preclude any exercise of the right to rescind (or any subsequent judicial assessment) is unlikely to be given full effect according to its terms. Nevertheless, contractual estoppel is still likely to have a chilling effect on attempts to rescind financial transactions. At the unsophisticated end of the market, individual investors are almost invariably going to shun misrepresentation or other common law claims altogether in favour of the more favourable regulatory regime set out in the Financial Conduct Authority's conduct of business rules and enforceable pursuant to the Financial Services and Markets Act 2000 ("FSMA 2000"), s 138D. This is the product not only of the regulatory rules being more favourable to individual investors than the common law, but also the fact that the common law route to compensation has now effectively been blocked by the contractual estoppel doctrine. For individual investors, rescission will remain the refuge of the desperate (see *Green v Royal Bank of Scotland* [2013] 2 CLC 634). Further up the food chain, where the regulatory regime has no application, contractual estoppel is still likely to make rescission a problematic remedial option, since it would be a brave or foolhardy investor who would attempt to rescind a financial contract in the face of boiler-plate non-reliance, entire agreement or no representation clauses that (on current authority at least) are likely to be determinative of any misrepresentation claims — an unjustified attempt to rescind might amount to a repudiation justifying the bank in liquidating the client's positions. As long as rescission is a self-help form of relief, contractual estoppel's blanket coverage is likely to stifle its use. Whilst one may have little sympathy for sophisticated investors who find themselves in this position, but who ought to have known better, a real difficulty remains for small, unsophisticated, corporate investors, such as those in *Crestsign* and *Thornbridge*, that are unable to bring a claim under FSMA 2000 and accordingly rely upon their common law rights. It is for such investors that any ability to "sit" on one's ability to rescind is likely to prove most significant.

Conclusion

As long as contractual estoppel operates to dissuade a victim of a misrepresentation not to exercise their rights for fear of itself being liable to the misrepresenter for repudiating the agreement, there will be a temptation to sit on one's right of rescission or to hold it in reserve. The decisions in *Salt* and *Goldcorp* provide a reminder of the potential risks associated with adopting such a delaying tactic, and *Unitech Global* suggests a way of mitigating them.

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