

Recent Developments in European Contract Law
Winter term 2007/08
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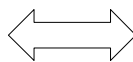
Fraud, Mistake and Misrepresentation

1

Introduction: Fraud, mistake, misrepresentation

When should a party be held to the contract, if he/she has been under a misapprehension?

Freedom of contract
Intention theory



pacta sunt servanda,
Interests of other
party in the contract

2

Germany

Fraud/Threat

§ 123 (1) BGB

(1) "Whoever has been induced to make a declaration of will by fraud of unlawfully by threats may rescind the declaration."

Rescission if party has entered into contract because of fraudulent deception or illegal threat by the other party

Kind of mistake is irrelevant, no liability of damages for reliance loss

France

Fraud/Threat

Art. 1116 Code Civil

"Fraud is a ground for nullity of an agreement when the conduct (manoeuvres) of one of the parties is such that it is evident that, without this conduct, the other party would not have contracted. Fraud will not be presumed and must be proved."

Similar: Art. 1439 Codice civile, Art. 1269 Spanish civil code

Art. 1112 Code Civil

- (1) "Threat exists where it is such as to make an impression on a reasonable person and may instil in him the fear of exposing his person or his material possessions to substantial and imminent harm."
- (2) "Regard shall be had in that connection to the age, sex and condition of the persons concerned."

English law: fraudulent misrepresentation

The classic definition of fraud is found in the judgement of Lord Herschell in ***Derry v Peek*** (1889) 14 App. Cas 337, 374 (HL)
“...First, in order to sustain an action of deceit, there must be proof of fraud, and nothing short of that will suffice. Secondly, fraud is proved when it is shown that a false representation has been made (1) knowingly, or (2) without belief in its truth, or (3) recklessly, careless whether it be true or false....Third, if fraud be proved, the motive of the person guilty of it is immaterial. It matters not that there was no intention to cheat or injure the person to whom the statement was made.”

Measure of damages: remoteness rule (damage must have been foreseeable), does not apply, *Doyle v Olby* [1969] 2 QB 158, CA

Scotland: fraudulent misrepresentation

Brash & Anor v. Boyce [2004] ScotCS 210 (26 August 2004)
A horse called Rosco Inchwood Sirocco, was purchased by the pursuers from the defender in October 2000. A proof took place, the principal issue being whether the pursuers were entitled to reduction of the contract of sale entered into with the defender. The essential issue of fact was Rosco's age, which was said to be 12 at the time of the contract. However, it turned out to be 15 rather than 12. The pursuers sought reduction of the contract. Therefore, the pursuers needed to prove that firstly, there was a false representation, secondly, there was the necessary *mens rea*, and thirdly, the fraudulent misrepresentation induced the contract (according to *Derry v Peek*).

In particular, it was emphasized that an honest belief in the truth of the statement, which had been found to be held by the seller, will negative any finding of fraud on the part of the maker of the statement. Thus, the claimant`s claim was dismissed.

Damages for fraud

§ 823 (1) BGB

- (1) "A person who willfully or negligently, unlawfully injures the life, body, health, freedom, property or other right of another is bound to compensate him for any damage arising therefrom."
- (2) "The same obligation is placed upon a person who infringes a statute intended for the protection of others. If according to the provisions of the statute, an infringement of this is possible even without fault, the duty to make compensation arises only in the event of fault."

§ 826 BGB

"A person who willfully causes damage to another in a manner contrary to public policy is bound to compensate the other for damage arising therefrom."

Art. 1382 Code Civil

"Any human act which causes damage to another obliges the person through whose fault it occurred to make reparation."

England

Measure of damages for fraud

Collins MR in *McConnel v Wright* [1903] 1 Ch. 546, 554:

"It is not an action for breach of contract, and therefore, no damages in respect of prospective gains which the person contracting was entitled to expect to come in, but it is an action of tort – it is an action for a wrong done whereby the plaintiff was tricked out of certain money in his pocket; and therefore, prima facie, the highest limit of his damages is the whole extent of his loss and that loss is measured by the money which was in his pocket."

England

Measure of damages

East v Maurer [1991] 2 All ER 733

Plaintiff agreed to buy one of two hair salons from defendants for £ 20.000 because one had stated that he had no intention of working at the other salon; in fact, the defendant worked there full-time. Business fell rapidly and plaintiff sold ultimately for £ 7.500. The Court found that defendants had committed fraud, the measure: out-of-pocket losses could include the profit which the plaintiffs would have made if they had not bought this exact business but another of a similar kind in the same area. However, they could not claim the profits they would have made if the statement had been true.

Germany

Claim for rescission: §§ 119 ff. BGB

A claim for rescission can be brought if-

- a) the party who intends to break free from the contract makes a declaration to the other party that it does not want to abide by the contract, § 143 (1) BGB
- b) the contract is voidable due to mistake (§§ 119, 122, 123 BGB)
- c) the claim for rescission has been brought without delay (immediately), § 121 BGB

Germany

Grounds for rescission

§ 119 (1) 1. Alt. BGB

Error as to the content of the declaration (*Inhaltsirrtum*)

TEST: would the party have made the declaration if it had reasonably understood the situation?

§ 119 (1) 2. Alt. BGB

Error of statement (*Erklärungsirrtum*)

(e.g. fluffing, someone - forgetting one zero - writes a bill of 50€ although the actual bill is 500€)

Germany

Grounds for rescission

§ 119 (2) BGB

errors relating to any characteristic of the subject matter that business regards as essential (*Eigenschaftsirrtum*)

(e.g. age of a car sold)

§ 120 BGB

incorrect conveyance or transmission

(e.g. by messenger or interpreter, NOT agent)

Austria

Mistake

§ 871 ABGB

- (1) If one party was mistaken as to the content of its statement concerning the principal object or an essential attribute of it to which the intention was principally and expressly directed, it can rescind his promise, if the other party caused the mistake, if the mistake must have been obvious to the other party in all the circumstances, or if the mistake was notified to the other party in good time.

Germany

Consequences of claim for rescission

- 1) **§ 142 (1) BGB:** claim for rescission leads to void contract *ex tunc* (from the time of the conclusion of the contract)
- 2) **§ 122 (1) BGB**
The rescinding party is liable for damages, which occur because the other party relied on the existence of the contract.
Test for type and amount of damages: the other party must financially be put into the position as if he/she had never entered into the contract in the first place (reliance loss)

BUT: § 122 (2) BGB

No damages if injured party knew or ought to have known the ground for rescission

Switzerland

Mistake

Art. 23 OR

The contract is not binding on a person who has made an essential mistake when entering the contract.

Art. 24 OR

(1) The mistake is essential if:

1. If the person wanted to enter into a different contract;
2. If the person made a mistake concerning the subject-matter of the contract or the other party;
3. If the person promised or was promised much more than he intended;
4. If the mistake related to a particular matter which the mistaken party would, consistently with commercial good faith, regard as forming the necessary basis of the transaction.

(2) Mistakes as to the motives are not regarded as essential.

Switzerland

Mistake

Bundesgericht 4 December 2003 (5C.153/2003/sch)

In a case dealing with a compromise between an insurance company and an insured person who had suffered complex bodily injuries in a traffic accident, it was held that the rules on mistake are inapplicable to errors concerning the very issues that were settled by the compromise. A compromise can, however be invalidated if the mistake pertains to undisputed facts that were crucial for one party's agreement, provided the importance attached to these facts was recognisable to the other party. In this case, the compromise was based on a state-of-the-art estimate of the plaintiff's medical impairments. Nevertheless, the plaintiff was allowed partially to invalidate the compromise because a second expert had pointed out a lasting orthopaedic impairment which had not been discovered by the first expert – and which had therefore not been included in the compromise at all – but which led to a significantly higher degree of invalidity.

Switzerland**Mistake****Art. 26 OR**

- (1) If the person who made the mistake does not want to be bound by the contract anymore, he has to compensate the other party if the mistake occurred because of his own negligence, unless the other party knew or ought to have known about the mistake.

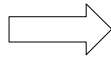
France**Mistake****Art. 1110**

Error is a cause of nullity of an agreement only when it goes to the very substance of the object of the agreement (*la substance même de la chose*). It is not a ground for nullity when it relates only to the person with whom a party intends to contract, unless the consideration of that person was the principal purpose of the agreement.

- includes *qualités substantielles de la chose*
- mistake must have been *motif principal ou déterminant*
- error must be *excusable*

Art. 1117

An agreement entered into as the result of error, violence or fraud is not absolutely void. There is merely an action for nullity or for rescission in accordance with Sc. VII of chapter V of the present title.

Common Law**Misrepresentation**

untrue statement of existing fact made by one party which reasonably induced the representee to enter into the contract

Kinds of misrepresentations:

- fraudulent misrepresentation
Derry v Peek (1889) 14 App. Cas 337
- negligent misstatement
Hedley Byrne v Heller [1964] AC 465
- innocent misrepresentation
- negligent misrepresentation
S. 2(1) Misrepresentation Act

EFFECT: A contract entered into as a result of a misrepresentation may be rescinded.

Common Law**Misrepresentation Act 1967**

(1) Where a person has entered into a contract after a misrepresentation has been made to him, and –
 (a) the misrepresentation has become a term of the contract, or
 (b) the contract has been performed;
 Or both, then, if otherwise he would be entitled to rescind the contract without alleging fraud, he shall be so entitled,...

(2) Where a person has entered into a contract after a misrepresentation has been made to him by another party thereto and as a result thereof has suffered loss, then, if the person making the misrepresentation *would be liable* to damages in respect thereof *had the misrepresentation been made fraudulently*, that person *shall be so liable* notwithstanding that the misrepresentation was not made fraudulently, unless he proves that he had reasonable ground to believe and did believe up to the time the contract was made that the fact represented were true.

Common Law: misrepresentation

Peekay Intermark Ltd. v Australia v New Zealand Banking Group Ltd,
(2005) EWHC 830

One of Peekay's directors had been invited by the defendant, ANZ, to invest in a bond issued by the Russian Treasury. During telephone conversations about the investment, a representative of ANZ represented that the claimant would have a beneficial interest in the underlying bond. In fact, the product was structured synthetically, and the investor would acquire no direct interest in the underlying bond. The director then signed, without reading them, the final terms and conditions which gave the company no such interest. The claimant claimed damages under S.2(1) Misrepresentation Act 1967 for alleged misrepresentations as to the nature of the product.

The High Court awarded the claim to the company, holding that the investment product had been misrepresented in a fundamental respect and that the signing of the final terms did not nullify or supersede the prior oral misrepresentation concerning the nature of the product.

21

Common law: Common mistake

Bell v Lever Bros. [1932] AC 161

A common mistake which makes the subject-matter of a contract essentially different from what the parties supposed renders the contract void.

On the takeover of an oil company one of its managers, *Bell*, agreed to accept a golden handshake of £ 30.000. The company then discovered that he had previously been guilty of misconduct which would have justified them in dismissing him instantly without pay, and sought to be released from its agreement. Although the claim was rejected, *Lord Warrington* asked whether there had been a "mistake as to some facts which by the common intention of the parties, whether expressed or more generally implied, constitute the underlying assumption without which the parties would not have made the contract they did." (at 206)

22

Common law**Fraudulent misrepresentation/mistake as to identity**

Shogun Finance Ltd. v. Hudson [2003] UKHL 62, [2004] 1 All ER 215

In order to obtain possession of a car under a hire-purchase agreement with the claimant firm, a fraudster availed himself of a false identity, i.e. that of Mr. Patel. The firm, *Shogun Finance*, performed all necessary credit/ identity checks. After delivery, the fraudster sold the car to *Mr. Hudson*. Having found out about the fraud, *Shogun Finance* demanded that the vehicle be returned to them. Under S. 27 of the Hire Purchase Act 1964, *Mr. Hudson* could only the car if the agreement between the fraudster and *Shogun* was merely voidable and not void ab initio.

23

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Shogun Finance Ltd. v. Hudson [2003] UKHL 62, [2004] 1 All ER 215

The House of Lords awarded (3:2) the action to *Shogun*, because pre-contractual negotiations on a face-to-face basis had not taken place and because the identity of the purchaser (Patel) was fundamental to *Shogun*. Thus, no agreement had been reached.

In the dissention opinion, Lords Millet and Nicholls of Birkenhead argued that in today's world of customer identification and credit checks, it was impossible to make a distinction between negotiations conducted face-to-face and those which took place by telephone, fax or video link.

24

Thank you for your attention!