3-2004

Proprietary relief without rescission

Hang Wu TANG
Singapore Management University, hwtang@smu.edu.sg

Citation
TANG, Hang Wu. Proprietary relief without rescission. (2004). *Cambridge Law Journal*. 63, (1), 30-35.
Available at: https://ink.library.smu.edu.sg/sol_research/2390

Published in Cambridge Law Journal, 2004 March, Volume 63, Issue 1, Pages 30-35
http://www.jstor.org/stable/4509067?seq=1#page_scan_tab_contents

PROPRIETARY RELIEF WITHOUT RESCISSION

THE decision of the Court of Appeal in *Halley* v. *The Law Society* [2003] EWCA Civ 97 has the potential to muddy the waters of the law of rescission. It is a fundamental principle that a fraudulent misrepresentation renders a contract voidable at the instance of the representee (*Bristol and West Building Society* v. *Mothew* [1998] Ch. 1, 22). Modern authorities suggest that the representee does not have any proprietary interest in property transferred by him pursuant to the contract before rescission (see *Bristol and West Building Society* v. *Mothew* [1998] Ch. 1, 22–23; *Twinsectra Ltd.* v. *Yardley* [1999] Lloyd's Rep. Bank. 438, 461–462). It is only after rescission that the representee regains title in the property.

Halley adds a twist to the analysis described above in that it suggests that the representee may retain an equitable interest in money transferred without the need for rescission, if the contract is an instrument of fraud. The Law Society intervened in the practice of a solicitor, Wilson-Smith, pursuant to the Solicitors Act 1974 ("the Act") on the grounds of his suspected dishonesty. Owing to the intervention, the Law Society held US $114,000 in the solicitor's account pursuant to the Act. Schedule 1, para. 6(1) of the Act provided that the Society held the money "upon trust for the persons beneficially entitled to [it]". Halley applied to court and claimed to be the person entitled to the money. The money was said to represent fees payable for Halley's services in respect of four transactions of a similar nature. The key players in these arrangements were Halley and Gibbins. They ran an elaborate scheme purportedly to raise money for interested members of the public. In return for their services, the applicants to the scheme (hereafter "the applicants") paid money into the solicitor's account for him to hold as an "escrow agent". The funds were to be released to Halley and Gibbins once their services were completed. Although the primary purpose of these arrangements was to raise funds for the applicants, the scheme was structured in such a way that it was impossible for them to access the money. In order to draw down on the funds, the applicants had to procure a bank guarantee for the principal sum plus interest. However, the evidence suggested that any bank would have insisted on the applicants providing cash security before giving such a guarantee. This would defeat the entire purpose of the scheme. It was found that the contract had been induced by an implied fraudulent misrepresentation by Halley and Gibbins to the applicants that it was possible to obtain the necessary bank instrument to access the funds.

Carnwath L.J., who gave the leading judgment, dismissed the claim principally on the ground that Halley did not have an equitable interest in the money; the applicant retained the beneficial ownership because the court was entitled to disregard the apparent effect of the fraudulent contract since the contract was "no more than a vehicle for obtaining money ... by false pretences" (para. [47]). What is novel about this case is that Carnwath L.J. said rescission was unnecessary for the applicant to retain equitable title; there was nothing to rescind since the fraudster parted with nothing of value and incurred no obligations while the applicant was left with worthless documents. He said that where money was paid pursuant to a "contract" which was no more than "a dishonest device to obtain money", it was meaningless to insist on the requirement of rescission (para. [48]). Potter L.J.'s observation in *Twinsectra* that before rescission, the representee had no proprietary interest in the original property was distinguished. *Twinsectra* was said to be a case where the contract was *induced* by fraud, whereas the present contract was nothing more than an "instrument of fraud" (para. [47]). Similarly, *Car and Universal Finance Co. Limited* v. *Caldwell* [1965] 1 Q.B. 525, which suggested that a representee must rescind the contract before gaining a proprietary interest, was differentiated on the ground that the contract in that case had substance. The fraud was merely in the method of payment. In the present case the contract was simply an "instrument of fraud, and nothing else" (para. [47]) and the court was entitled to disregard the contract. This point is significant because the implicit assumption is that the contract was void and not voidable. Therefore, *Halley* is potentially significant because it hints at a general principle that a representee retains an equitable interest in property transferred without the need for rescission where the "agreement" may be characterised as an instrument of fraud as opposed to a contract *induced* by a fraudulent misrepresentation. It is foreseeable that counsel for victims of fraudulent contracts in future will argue that their case should be characterised as the former since rescission is unnecessary for their clients to obtain an equitable interest in the original property.

However, there are four reasons why *Halley* should be not be extrapolated to stand for any such proposition. First, the distinction introduced by Carnwath L.J. between a contract *induced* by a fraudulent misrepresentation and a contract which is an instrument of fraud may be difficult to make in practice. Second, Carnwath L.J.'s implicit reasoning that a contract that is an instrument of fraud is void is a novel point. Thus far, the courts have only been prepared to hold a contract void for mistake of identity (*Cundy* v. *Lindsay* (1873) 3 App. Cas. 459) or on the grounds of *non est factum* (*Saunders* v. *Anglia Building Society* [1971] A.C. 1004). In cases of fraudulent misrepresentation, the courts have always held that such a contract is voidable and not void. Third, *Halley* should have been decided on agency principles, especially with reference to the authorities on stakeholders. Unfortunately, this point was not pursued at trial and only raised very late on appeal. The Court of Appeal declined to hear arguments on this issue. In the present case, although the solicitor was described as an "escrow agent", he was a stakeholder for Halley and the account holder (see para. [xi] of the Appendix). This point is crucial because a stakeholder does not hold the money on trust (see *Hastingwood Property* v. *Saunders Bearman Anselm* [1991] Ch. 114; *Gribbon* v. *Lutton* [2001] EWCA Civ 1956, [2002] Q.B. 902; cf. Mummery L.J.'s analysis in *Halley* at paras. [91]–[97]). Thus, Halley's assertion of beneficial ownership in the money was misconceived. As Pennycuick V.C. observed in *Potters (A Firm)* v. *Loppert* [1973] Ch. 399, 406, "a contract deposit paid to a stakeholder is not paid to him as a trustee, but upon a contractual or quasi-contractual liability with the consequence that the stakeholder is not accountable for profit upon it". Halley's right to the money was purely contractual. If the contract had been valid and the payment conditions met, then Halley would have been entitled to payment. Otherwise, the applicants had a restitutionary right to recover the money. As Carnwath L.J. found that the contract was an instrument of fraud, it followed that Halley had no right to be paid. Finally, Halley's claim could also have been defeated and in fact was rejected by Mummery L.J. on the grounds of illegality. Since Halley was party to a deliberate deceit committed against the applicant, the contract was unenforceable (see *Brown Jenkinson & Co. Ltd.* v. *Percy Dalton (London) Ltd.* [1957] 2 Q.B. 621). In conclusion, although prima facie *Halley* appears to be an important decision on rescission, it is submitted that the holding of this case should be confined to its peculiar facts.

TANG HANG WU

CORPORATE OPPORTUNITIES: IF IN DOUBT, DISCLOSE (BUT HOW?)

RECENT proposals for codification of directors' duties have been driven by concerns about the complexity of the existing law and informed by debates about the strictness of the standards to which directors should be held. These issues are well-illustrated by the treatment of directors' "secret profits", once again brought into sharp relief by the Court of Appeal's recent decision in *Bhullar* v. *Bhullar* [2003] EWCA Civ 424, [2003] 2 B.C.L.C. 241.

Bhullar Bros Ltd. ("the Company") was owned and managed by brothers Mohan and Sohan Bhullar and their families. Its business was a chain of supermarkets, although it also owned an investment property, seemingly as an afterthought. Relations between the brothers broke down in 1998, and they began negotiating a division of the business. At this time, the Company's board resolved not to acquire any further investment properties.

Shortly afterwards, Inderjit, one of Sohan's sons and a director of the Company, took a brief holiday. During his time off he went bowling at an alley situated on the Company's investment property and operated by its tenant. Whilst there, Inderjit realised that a piece of adjacent land ("the Property") was for sale. He acted swiftly to acquire the Property for himself. Following advice from his solicitor, he did not disclose the matter to the Company.

Mohan's family subsequently brought a petition under section 459 of the Companies Act 1985 claiming that the Company's affairs were being conducted in a manner unfairly prejudicial to their interests, and amongst other things alleging that Inderjit's purchase had constituted a breach of fiduciary duty. At first instance, Judge