"RESTITUTIO IN INTEGRUM" IN EQUITABLE RESCISSION*

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Introduction

This essay deals with the meaning given the term "*restitutio in integrum*" in applying the equitable remedy of rescission[1] in England and Canada. A court of equity can grant rescission on several distinct grounds including fraud, innocent misrepresentation, mistake, substantial misdescription or nondisclosure in contracts *uberrimae fidei*[2]. This paper is generally restricted to misrepresentation, fraudulent or innocent. Discussion will be divided into two parts: (1) the law in England and (2) the law in Canada.

The Law in England

Fraudulent Misrepresentation

A contract induced by a fraudulent misrepresentation is, in general, voidable.[3] This broad statement is, of course, subject to reservations. If the contract has been affirmed after the misrepresentation has been discovered, the defrauded party will have no right to rescind.[4] Since we are here concerned with equitable rescission, all equitable defences (such as laches[5] or the acquiring by an innocent purchaser for value of rights that would be adversely affected by rescission)[6] are available to the defendant. Even if such

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1 It has been said that this is not really a remedy at all. The reason is that a party defrauded has a right to avoid the contract on the basis of fraud and the court merely declares that the case provides a situation that gives him that right: McDonnell and Munroe, *Kerr on the Law of Fraud and Mistake* (7th ed., 1952), p. 570. This view seems to be supported by the House of Lords in *Reese River Silver Mining Co. v. Smith* (1869), L.R. 4 H.L. 64. The proposition is definitely supported by Lord Atkinson in *Abram Steamship Company v. Westville Shipping Company*, [1923] A.C. 773, at p. 781. However, rescission is normally spoken of as a remedy and that usage will be adopted in this paper.

2 G. W. Keeton, *An Introduction to Equity* (4th ed., 1956), p. 342.

3 See *Clarke v. Dickson* (1858), El. Bl. & El. 148, at p. 154; 120 E.R. 463 at p. 466 (K.B.) and *Houldsworth v. City of Glasgow Bank* (1880), 5 App. Cas. 317, at p. 338 for particular examples of the acceptance of this doctrine.

4 See, for example, *Senanayake v. Cheng*, [1966] A.C. 63, at p. 79 (P.C.).

5 Discussed as a valid defence, but rejected on the facts in *Erlanger v. The New Sombrere Phosphate Co.* (1878), 3 App. Cas. 1218 (H.L.), and in *Lindsay Petroleum v. Hurd* (1874), L.R. 5 P.C. 221.

6 See *Clough v. The London and Northwestern Railway Company* (1871), L.R., 7 Ex. 26, at p. 35 (Ex. Ch.), *per* Mellor, J. Bankruptcy of the frauludent party is probably not a bar: *Re Eastgate, Ex Parte Ward*, [1905] 1 K.B. 465; *Tilley v. Bowman*, [1910] 1 K.B. 745 (both judgments of single judges).

normal equitable defences are not available, the requirement of *restitutio in integrum* remains. This was authoritatively[7] set out in *Clarke v. Dickson*, a case at common law, by Crompton J.:[8]

> When once it is settled that a contract induced by fraud is not void, but voidable at the option of the party defrauded, . . . when that party exercises his option to rescind the contract, he must be in a state to rescind; that is, he must be in such a situation as to be able to put the parties into their original state before the contract.

This requirement of restoring the parties to their original position has since been "explained" as meaning restoration in regard to rights and obligations that are some part of what was "contracted for".[9] Thus where a man bought a car, drove it to his place of business and then resold it by way of trade, he was able to rescind without any problems of restitution when it turned out that the car had been stolen and, as a result, was taken back by its true owner.[10] The court held that he had contracted to get *title*, so the benefit he had received by possession and resale did not have to be returned in order to restore the *statu quo ante*.[11]

The requirement of *restitutio in integrum*, as a prerequisite to rescission, was accepted as applying to a court of equity, as well as one of common law, by Lord Blackburn in *Erlanger v. The New Sombrero Phosphate Company*.[12] It was a doctrine, he said, that had been "acted upon both at law and in equity",[13] but that a difference was apparent between those courts in its application—a difference arising out of the different machinery available to the courts. He went on to say:

> . . . a Court of Equity could not give damages, and, unless it can rescind the contract, can give no relief. And, on the other hand, it can take accounts of profits and make allowances for *deterioration*.

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7 This case was accepted, as stating the common law position, by *Urquhart v. MacPherson* (1873), 3 App. Cas. 831, at p. 838 (P.C.), and by Lord Blackburn in the House of Lords in *Erlanger v. The New Sombrero Phosphate Co.* (1878), 3 App. Cas. 1218, at p. 1278.

8 *Clarke v. Dickson* (1858), El. Bl. & El. 148, at p. 154; 120 E.R. 463, at p. 466 (K.B.).

9 *Rowland v. Divall*, [1923] 2 K.B. 500 (C.A.). One of the judges here based his reasoning on total failure of consideration, but the other two (Bankes and Atkin L.JJ.) used this reasoning. This case may have been restricted by *Linz v. Electric Wire Company of Palestine Ltd.*, [1948] A.C. 371, at p. 377 (P.C.).

10 *Rowland v. Divall*, [1923] 2 K.B. 500 (C.A.).

11 In fact, in this case, the benefits of the resale had been reclaimed from the plaintiff by the man who purchased the car from him.

12 (1878), 3 App. Cas. 1218, at p. 1278.

13 *Ibid.*, at p. 1278.

> And I think the practice has always been for a Court of Equity to give this relief whenever, by the exercise of its powers, it can do what is *practically just*, though it cannot restore the parties precisely to the state they were in before the contract.[14]

This is still the accepted doctrine in equity, but it is now necessary to look at how liberally it has been applied.

Although a court of equity cannot give damages, it forces the party making the misrepresentation to give back all benefits he has received under the contract. These benefits can be direct benefits granted to the party or indirect benefits, in the form of obligations undertaken by the innocent party. Thus, while not giving damages for losses arising out of the contract, the court can force the party making the misrepresentation to indemnify the innocent party against any obligations arising directly *from* the contract (although they can do nothing about losses or obligations arising merely *as a result* of the contract).[15]

Lord Blackburn (as quoted above) said a court of equity could "make allowances for deterioration". This phrase was applied in *Lagunas Nitrate Company v. Lagunas Syndicate*[16] by the dissenting judge (Rigby L.J.), who said that deterioration could be accounted for by compensation,[17] and who would have allowed rescission. In that case the syndicate had sold a mining property to a company they had promoted, overvaluing the property. The property had been worked for over two years by the company, taking out large quantities of nitrate and paying large dividends. The two judges giving the majority opinion, not allowing rescission, placed emphasis on the fact that there had been no fraud and both indicated they would have granted rescission had there been fraud.[18] Thus, strong *dicta* supports the view that, where fraud is involved, almost any amount of "deterioration" can be compensated. *Adam v. Newbigging*,[19] in the House of Lords, involved an innocent misrepresentation in the sale of two-thirds shares in a partnership, where the partnership had become insolvent by the time the action was

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14 *Ibid.*, at pp. 1278-1279 (italics mine).

15 *Adam v. Newbigging* (1886), 34 Ch. D. 582 (C.A.); affirmed (1888), 13 App. Cas. 308 (H.L.): *Senanyake v. Cheng* [1966] A.C. 63, at p. 79 (P.C.). Both these cases involved innocent misrepresentations so would certainly apply in the case of fraud.

16 [1899] 2 Ch. 392 (C.A.).

17 *Lagunas Nitrate Company v. Lagunas Syndicate*, [1899] 2 Ch. 392, at pp. 456-458 (C.A.).

18 *Ibid.*, at pp. 433-434, *per* Lindley M.R. and at pp. 463-464, *per* Collins L.J.

19 (1888), 13 App. Cas. 308 (H.L.).

commenced. In that case Lord Watson said:[20] "Such deterioration, for it is nothing more, cannot stand in the way of the respondent's claim for mutual restitution." Thus the concept of deterioration has been useful in expanding the court's discretion to make mutual restitution, allowing rescission.

The idea in Lord Blackburn's judgment that has permitted the greatest discretion, however, is his reference to doing what is "practically just". Rigby L.J. seized on this phrase in the *Lagunas*[21] case in arriving at his judgment, and his statement of the law (quoting Lord Blackburn in the *Erlanger* case) was approved by the House of Lords in *Spence v. Crawford*.[22] In this case, the pursuer (Spence) and the defender (Crawford) had been co-owners of a company. In collusion with Richardson, an employee of the company, Crawford had arranged for the balance sheet of the company to show a loss in 1930. Using this as a lever, Crawford convinced Spence to sell his interest at about half value to Crawford. (In addition Spence gave up claims he had against the company for salary and director's fees). In fact the company had shown a profit in 1930 and continued to be a profitable enterprise. The court held that the sale was induced by the fraud of Crawford and Richardson working together. The case was complicated by subsequent developments. At the time of the sale there had been 5850, £1 shares issued in the company, Spence and Crawford each holding half. By the time the action originated, some four years after the sale, the issued capital of the company had been increased to £10,000 of which Crawford and his wife held £7,500 and Richardson held £2,500. Richardson had fallen out with Crawford and told Spence about the fraud. The court assumed that, if rescission were granted, Spence and Richardson would work together, thus depriving Crawford of any effective voice in the operation of the company. However, this was treated as being irrelevant. The last pertinent fact is that, under the contract, Crawford was to assume the responsibility for a guarantee Spence had given a bank in support of the company's debt. In fact, Craw-

20 *Adam v. Newbigging* (1888), 13 App. Cas. 308, at p. 323 (H.L.). In arriving at this conclusion, Lord Watson pointed out that the management of the partnership had not changed and that, therefore, the insolvency must have been due to some inherent defect.

21 *Lagunas Nitrate Company v. Lagunas Syndicate*, [1899] 2 Ch. 392, at p. 456 (C.A.).

22 [1939] 3 All E.R. 271, at pp. 279-280, *per* Lord Thankerton. In this case Lord Thankerton's statements were concurred in by all members of the court (five in all). Lord Wright made statements in addition to those of Lord Thankerton, but only Lord Russel of Killowen concurred with him. This is a case from Scotland, but it states the law in England is identical to that of Scotland in this area.

ford had never been called upon to pay under the guarantee, as the company had always succeeded in meeting its debts.

First the court pointed out that "no stress is placed on whether the pursuer is . . . restored",[23] so the fact that he would get back less than the half-interest in the company that he sold was no bar to Spence obtaining rescission (actually his shares only constituted 29.5% of the issued stock of the company). The next problem dealt with by the court is the fact that the circumstances had greatly changed, with the business being much less speculative and showing a steady and growing profit. This was said to make it impossible to return Crawford to his *statu quo* but the court said that the purchaser "is not entitled, in bar of restitution to found on dealings with the subject purchased, which he has been enabled by his fraud to carry out."[24] The court dismissed the problem of Crawford losing control of the company by saying he could hardly rely on his falling out with his *particeps criminis*[25] as a bar. It disposed of the guarantee transaction on the basis that it cost Crawford nothing, indicating that a benefit received by a plaintiff, at no cost to the fraudulent party, will not be a bar to restitution. This appears to be the extreme position in England today in this area of the law.

In summary, a fraudulent misrepresentation gives rise to a right of rescission in the innocent party, subject to normal equitable defences, the possibility of affirmation of the contract, and the need for *restitutio in integrum*. In the case of fraud, the doctrine of *restitutio in integrum* will not be applied too literally, and liberal allowances can be made for "deterioration". The court will try to do what is "practically just" and, in the words of Lord Wright.[26] "will exercise its jurisdiction to the full in order, if possible, to prevent the defendant from enjoying the benefit of his fraud". However, if "from his own act, or from misfortune, it is impossible to make such restitution",[27] it is too late for the innocent party to rescind.

The exact limits, within which the courts will be bound, cannot yet be accurately defined. Lord Wright has suggested that the courts

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23 *Spence v. Crawford*, [1939] 3 All E.R. 271, at p. 279 (H.L.Sc.), but note that he is entitled to full restitution (see Adam v. Newbigging (1888), 13 App. Cas. 308 (H.L.) which he has agreed to waive in this case.

24 *Spence v. Crawford*, [1939] 3 All E.R. 271, at p. 288 (H.L.Sc.).

25 *Ibid.*, at p. 281. The court went on to say that, if this had been a case of innocent misrepresentation and the holdings in the company had been changed, it might have provided a bar.

26 *Spence v. Crawford*, [1939] 3 All E.R. 271, at p. 288 (H.L.Sc.).

27 *Houldsworth v. City of Glasgow Bank* (1880), 5 App. Cas. 317, at p. 388, (H.L.Sc.) *per* Lord Blackburn.

can order restitution as long as "the substantial identity of the subject matter of the contract remains."[28] In the light of the decided cases, such as *Adam v. Newbigging*,[29] he would appear to contemplate a liberal interpretation of the words "substantial identity".[30] If Lord Wright's dictum is accepted as law, there should be no further attempt at restrictive definition of the limits within which the courts can exercise their discretion in cases of fraud. Leaving the courts with a flexible doctrine will enable them to do justice on the facts of an individual case, without distorting any rules of law too far. It is admitted that this is not very satisfactory for lawyers who place great value on predictability, or for judges, like Lord Sumner, who do not wish to be faced with the problem of justice "between man and man". However, this would be a suitable solution for the plaintiff who seeks the aid of the law because he has been unjustly treated.

Innocent Misrepresentation

Torrance v. Bolton[31] establishes that "There is no general rule that actual fraud is necessary to induce a Court of Equity to rescind a contract of sale". However, in spite of the wide words used there and in *MacKenzie v. The Royal Bank of Canada*,[32] the scope of the equitable remedy of rescission has been extremely restricted in cases involving innocent misrepresentation.[33] At present the accepted statement of the law seems to be that equity will not set aside an

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28 *Spence v. Crawford*, [1939] 3 All E.R. 271, at p. 289 (H.L.Sc.).

29 (1886), 34 Ch. D. 582, affirmed (1888), 13 App. Cas. 308 (H.L.).

30 But he certainly didn't intend the result obtained in *Kupchak v. Dayson Holdings Ltd.* (1965), 53 W.W.R. 65 (B.C.C.A.); see text at footnote 61.

31 (1872), L.R. 8 Ch. App. 118, headnote, supported in the judgment at p. 124.

32 [1934] A.C. 468, at p. 475 (P.C.) *per* Lord Atkin: "A contract of guarantee, like any other contract, is liable to be avoided if induced by material misrepresentation of existing fact, even if made innocently." A recent Privy Council case, *Senanayake v. Cheng*, [1966] A.C. 63, has suggested that this case and *Adam v. Newbigging* (1888), 13 App. Cas. 308 (H.L.), fall into a special class. (The *Senanayake* case has a fact situation very similar to the *Adam* case.) There it is said that the contracts in these cases are neither executed nor executory, but contemplate a continuing relationship. In this type of contract, rescission will be granted if *restitutio in integrum* is possible even if the misrepresentation is innocent. This would explain the fact that neither of the older cases have resulted in a change in the general law, in spite of their wide words and great authority.

33 In this essay, unless otherwise indicated by the context, all references to "innocent misrepresentation" means "material innocent misrepresentation as to an existing fact." To be effective as a cause of action for rescission, the misrepresentation must always be material; and misrepresentations as to law or future fact will not provide grounds for rescission, in the absence of express contractual provisions to the contrary.

executed contract because of innocent misrepresentation.[34] Although this position has been doubted,[35] there has been no decision clearly overruling it. Because of this, when an action has been brought for rescission of a contract on the ground of innocent misrepresentation, the courts have been reluctant to declare a contract executed. Mere execution of the document does not result in the contract being executed.[36] Neither the passing of money under the contract[37] nor entering into possession of property that is the subject matter of the contract[38] necessarily bars the rescission of the contract for innocent misrepresentation. Even assignment of the signed contract to a third party, who then consented to a minor change, was not held to bar rescission.[39] (But the assignment had to be rescinded before judgment could be given granting rescission.) This broad interpretation often given to "executed" has resulted in some anomalies. For example, how can a contract be executed when a truck is held for 5 *days*,[40] but not be executed when shares are held for 5 *months*?[41]

Because the rule has been stated as: "no rescission for an executed contract based on an innocent misrepresentation," and there is no problem of *restitutio in integrum* where the contract is unexecuted, there has been little discussion of the application of the doctrine of *restitutio in integrum* to cases of innocent misrepresentation. As an alternative, it is submitted that the effect of the English decisions is that rescission is, as a rule, allowed for innocent misrepresentation, but that the requirement of *restitutio in integrum* in all cases of equitable rescission is applied more strictly than where fraud is found. While the courts have not used this terminology, all the decisions in England would fit nicely into this doctrine.

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34 *Armstrong v. Jackson*, [1917] 2 K.B. 822, at p. 825 (K.B.D.); *Wilde v. Gibson* (1848), H.L.C. 605, at p. 632; 9 E.R. 897 at p. 909; *Angel v. Jay*, [1911] 1 K.B. 666, at p. 671 (K.B.D.).

35 *Leaf v. International Galleries*, [1950] 1 All E.R. 693 (C.A.) *per* Denning L.J.; *Solle v. Butcher*, [1950] 1 K.B. 671, at p. 692 (C.A.) *per* Denning L.J.; G.C. Cheshire and C.H.S. Fifoot, *The Law of Contract* (6th ed., 1964), pp. 249-253.

36 *Redgrave v. Hurd* (1881), 20 Ch. D. 1 (C.A.); *Wauton v. Coppard*, [1899] 1 Ch. 92 (Romer J.); *Goldrei, Foucard and Sòn v. Sinclair and Russian Chamber of Commerce of London*, [1918] 1 K.B. 180 (Pinckford L.J. and Sargant J., Bankes L.J. dissenting on another ground).

37 *Ibid.*

38 *Redgrave v. Hurd* (1881), 20 Ch. D. 1 (C.A.).

39 *Abrams Steamship Company v. Westville Shipping Company*, [1923] A.C. 773 (H.L.).

40 *Long v. Lloyd*, [1958] 2 All E.R. 402 (C.A.).

41 *In Re Metropolitan Coal Consumers' Association—Karberg's Case*, [1892] 3 Ch. 1 (C.A.).

Besides accounting for the past cases, this would give the courts a much clearer guide for the future.

The Law in Canada

Fraudulent Misrepresentation

Not long after the Privy Council in *Urquhart v. MacPherson*[42] applied the rule enunciated in *Clarke v. Dickson*, the general requirement of *restitutio* in the common law was accepted by the Court of Appeal of Ontario. In adopting the doctrine, Armour J. gave a unique explanation of its meaning:[43]

> It is trite law and plain equity that one cannot elect to rescind a contract for fraud, keep what he has got under it as the consideration for what he has given under it, and sue for what he has given as the consideration for what he has got; he must first give back what he has got as the consideration for what he has given, before he can sue for what he has given as the consideration for what he has got. This is what is meant when it is said that there can be no rescission without restitution.

In spite of this exposition of the law, the doctrine received general acceptance in Canada.[44] Thus, as a general rule, a party induced by fraud to enter into a contract has a right to have it rescinded if he can make restitution of benefits received under the contract.

In 1913, the Ontario Court of Appeal accepted[45] the statements of Lord Blackburn in the *Erlanger*[46] case as establishing the doctrine to be followed in equity to accomplish *restitutio in integrum*. In the case then before the court a woman had bought a car, having been told it was a new 1913 model. In fact, the car had been in an accident and had been rebuilt at the factory. Although the woman had used the car for four months before discovering the fraud (at which time she immediately returned the car), the court adopted[47] the statement from the *Lagunas*[48] case:

> If substantially compensation can be made, rescission with compensation is ex debito justitiae.

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42 (1878), 3 App. Cas. 831 (P.C.), adopting the doctrine of *Clarke v. Dickson* (see text at footnote 7.).

43 *Fraser v. M'Lean* (1881), 46 U.C.Q.B. 302, at p. 329 (C.A.).

44 See, for example, *Waterloo Motors Ltd. v. Flood*, [1931] 1 D.L.R. 762, at p. 771 (N.B.C.A.); *Carter v. Golland*, [1937] 4 D.L.R. 531 (Ont. C.A.).

45 *Addison v. Ottawa Auto and Taxi Co.* (1913), 16 D.L.R. 318, at p. 324 (Ont. C.A.).

46 *Erlanger v. The New Sombrero Phosphate Co.* (1878), 3 App. Cas. 1218, at pp. 1278-1279 (H.L.).

47 *Addison v. Ottawa Auto and Taxi Co.* (1913), 16 D.L.R. 318, at p. 324 (Ont. C.A.).

48 *Lagunas Nitrate Company v. Lagunas Syndicate*, [1899] 2 Ch. 392, at pp. 456-457 (C.A.) *per* Rigby, L.J.

and ordered rescission. Note that here the court was merely compensating for deterioration, and the subject matter of the contract as an entity was returned.

On the other hand, in another case, a man bought a car, being induced by fraudulent representation that the car would be insured against fire by the seller while the car was being paid for. The car was destroyed by fire after he had used it eleven months. Because the car had been used eleven months and had been destroyed by fire, and so could not be returned, the court held that *restitutio in integrum* was impossible and refused to grant rescission.[49]

Finally in another case, the car had been driven some 13,000 miles and the court allowed rescission, with payment of compensation, because it had been fraudulently misrepresented as a new car. (In fact, someone else had owned it for twelve days.)[50]

The only way these three cases can be reconciled is on the basis that in two of them the subject matter was returned in a deteriorated condition, whereas in the other, the subject matter had been destroyed. Thus it would appear that, in Canada, a great deal of deterioration will be allowed where there is fraud, but, to have rescission, the subject matter must be capable of being returned as an entity. However, two exceptions to this general rule appear from the cases:

(a) where the goods transferred under the contract are intended for use in trade, and

(b) where the loss or destruction of the goods is owing to the fault of the fraudulent party.

Two Ontario cases illustrate the first exception. In the first,[51] the plaintiff bought a retail store having been told that it did business to the value of $3600. per month. In fact the turnover was only $1600. per month and, after three months, the plaintiff sued for rescission. Although the court found fraud, they were faced with a difficult task in trying to achieve *restitutio in integrum*. The solution they adopted (in a unanimous decision of the Court of Appeal) can be seen by quoting from the judgment:[52]

> . . . 'practical justice' can best be satisfied and can well be satisfied by having an account taken of the assets of the business at the time

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49 *Waterloo Motors Ltd. v. Flood*, [1913] 1 D.L.R. 762 (N.B.C.A.). Damages were awarded for deceit in this case.

50 *Wiebe v. Butchart's Motors*, [1949] 4 D.L.R. 838 (B.C.C.A.). In fact, one of the judges allowing rescission in this case treated the misrepresentation as innocent.

51 *Carter v. Golland*, [1937] 4 D.L.R. 513 (Ont. C.A.).

52 *Ibid.*, at p. 517.

of the rescission and at the time of the acquisition of the business, just allowance being made for the expense of carrying on the business and for any depreciation that may have taken place.

This obviously goes beyond mere compensation for deterioration, unless it can be said that the "business' 'as an entity is being returned.

In another case, sixty dozen cigar lighters were sold to a wholesaler on the basis of the misrepresentation that no other wholesaler in the area had any. After selling thirteen dozen, the falsehood was discovered and rescission was attempted by offering back the remaining forty-seven dozen accompanied by payment of the lighters sold. The court allowed rescission on this basis saying:[53] "full *restitutio in integrum* is not necessary in a case of this sort, where many articles are sold with the intention that they be immediately put in trade and resold."

The second exception is illustrated in *Hines v. McCallum*[54] where a contract was made for the sale of land, with the purchaser taking immediate possession. One encumbrance, a mortgage, had been declared by the vendor, but others had not. After raising one crop (that failed) and the passage of some nine months, the purchaser found out about the additional encumbrances and declared his intention to rescind. Before the rescission, the land and the chattels on it had been seized as a result of the encumbrances. Finding fraud, the court allowed rescission because the loss of the property was the fault of the vendor in not paying off the encumbrances. This application of the law has been supported by at least one other case in Canada[55] and has also been supported in England;[56] so the principle, that the fraudulent party cannot cite changes owing to his own fault in bar of rescission, is proably valid.

A recent case in British Columbia, *Kupchak v. Dayson Holdings Co.*,[57] indicates a radical change in the application of the doctrine of *restitutio in integrum* in equitable rescission in Canada if it is followed. There Kupchak had transferred two separate properties to Dayson Holdings Ltd. in exchange for shares in a motel and a $64,500. mortgage. The transaction had been induced by fraud. Following the transaction, Dayson Holdings Ltd. transferred an undivided half-interest in one of the properties to a third party and, in conjunction with the third party, erected a large modern

53 *Trans-Canada Trading Co. Limited v. M. Loeb Limited*, [1947] O.W.N. 432, at p. 436 (Ont. High Ct.).

54 [1925] 2 D.L.R. 403 (Man. Dysart J.).

55 *Kupchak v. Dayson Holdings Ltd.* (1965), 53 W.W.R. 65 (B.C.C.A.).

56 *Spence v. Crawford*, [1939] 3 All E.R. 271 (H.L.Sc.).

57 (1965), 53 W.W.R. 65 (B.C.C.A.).

apartment building on the property. In addition, the property was subject to mortgages of a total value of $575,000. The court granted rescission ordering cancellation of the mortgage for $64,500., return of the unaltered property (with an account for all profits, a change in the mortgage, etc.), return of the motel shares (with an accounting for all dividends) and *payment* by Dayson Holdings Ltd. *of the value of the property that could not be returned* (with interest dating from the time of the transaction). It is in justifying this last step that the court introduced a radical new idea. Here they were not merely compensating for deterioration with money, but allowed money to substitute completely for property transferred under the transaction.

In a rather sketchy justification of this step, Davey J.A.,[58] began by quoting Lord Wright as follows:[59]

> . . . in the case of fraud the court will exercise its jurisdiction to the full in order, if possible, to prevent the defendent from enjoying the benefit of his fraud at the expense of the innocent plaintiff . . . Certainly in a case of fraud the court will do its best to unravel the complexities of any particular case, which may in some cases involve adjustments on both sides.

He then went on to say that ". . . equity's power to remove inequities resulting from rescission and deficiencies in restitution by compensation, account or indemnity must be kept in mind".[60] After conceding that this was not a payment arising out of equity's traditional powers of account and indemnity, he went on to say:[61]

> Rescission is an equitable remedy and, in my opinion, equity has the same power, operating on the conscience of the parties, to order one to pay compensation to the other in order to effect substantial restitution under a decree for rescission, as it has to order one party to pay money on account, or by way of indemnity. The jurisdiction to order compensation is, I think, inherent in the decree for rescission and incidental to it, and flows from what Lord Blackburn described in the *Erlanger* case as equity's power to do what is practically just, though it cannot restore the parties precisely to the state they were in before the contract.

He also said that, in any case, compensation itself was a remedy traditionally used by equity as a court of conscience acting "*in personam*".[62]

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58 Davey, J.A., with Norris J.A. concurring, delivered the majority judgment. Shepherd J.A. dissented saying that in acting under the transaction for five years, the plaintiff had elected not to rescind.

59 *Spence v. Crawford*, [1939] 3 All E.R. 271, at pp. 288-289 (H.L.Sc.).

60 *Kupchak v. Dayson Holdings Ltd.* (1965), 53 W.W.R. 65, at p. 68 (B.C.C.A.).

61 *Ibid.*, at p. 69.

62 *Ibid.*, at p. 70. In support of this he cited *Nocton v. Ashburton (Lord)*, [1914] A.C. 932, at p. 946 (H.L.) *per* Lord Haldane.

Thus, if this case is accepted generally throughout Canada, the general restriction forbidding rescission when the subject matter as an entity cannot be returned, will be removed. As a result the courts will have a very wide discretionary power to order rescission in cases of fraud. Since the plaintiff might still forfeit his right of action through affirmation of the contract after discovering the misrepresentation, this additional discretion would not be so wide as to be objectionable. It would have the advantage, seen in this case, of allowing rescission where an innocent third party has acquired rights that forbid restitution in specie.

Innocent Misrepresentation

There are few decisions in Canada where rescission has been granted on the basis of innocent misrepresentation. In *Cole v. Pope*, the Supreme Court of Canada said that[63] "mere innocent misrepresentation will not warrant the rescission of an executed contract for the sale of an interest in land." Although this case specifically dealt with a sale of an "interest in land", the reluctance of the Canadian courts to grant rescission of any executed contract is probably based on the case. The judgment was clarified by the Supreme Court in *Redican v. Nesbitt*,[64] where it was stated that an innocent misrepresentation inducing an error in substance would justify the rescission of an executed contract. This is the law today in Canada in relation to an executed contract, but the flexibility of the courts has been increased by giving a generous meaning to error in substance. Thus a thresher with insufficient power to handle a heavy field of grain,[65] a car one year older than was represented,[66] and a truck two years older than was represented[67] have all been considered substantial enough errors to justify rescission for innocent misrepresentation.

However, there remains the necessity for *restitutio in integrum*, even if the contract can otherwise be rescinded. This requirement is, as a general rule, quite strict. Thus in a purchase of land and chattels, where some of the chattels (cattle) had been sold, there could be no *restitutio in integrum* although the cattle represented

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63 (1898), 29 S.C.R. 291, at p. 295. This was a unanimous opinion of the court.

64 [1924] S.C.R. 135. See also *Shortt v. MacLennan and MacLennan* (1958), 16 D.L.R. (2d) 161 (Can. Sup. Ct.).

65 *The Cushman Motor Works of Canada Limited v. Laing*, [1920] S.C.R. 649.

66 *O'Flaherty v. McKinlay* (1951), 30 M.P.R. 172 (Nfld. C.A.).

67 *F. & B. Transport Ltd. v. White Truck Sales Manitoba Ltd.* (1965), 51 W.W.R. 124 (Man. C.A.).

a very small portion of the transaction as a whole.[68] However, in the same case, it was pointed out that, if what was received under the contract can be returned in specie, any deterioration in it can be compensated at the discretion of the court. As a result, in recent decisions the use of a truck for nine months[69] and the use of a car for 7000 miles[70] have each been compensated for as deterioration, allowing rescission. In the last case Dunfield J. quoted[71] Lamont J.A.[72] as follows:

> The rule is that where the representee has lost or destroyed the subject matter of the contract, or so dealt with it is to produce an entire alteration in its physical, commercial or legal character, quality or substance as distinct from mere depreciation, decay or deterioration in the ordinary course of events, the representee is not entitled to rescission . . .

Backed by the authority of two provincial courts of appeal, this is probably a good statement of the law defining allowable deterioration.

In summary, rescission is available for innocent misrepresentation in Canada if a contract is unexecuted, or if only money has passed,[73] or if the contract is executed but the misrepresentation caused an error *in substantialibus*. Rescission on these grounds will only be allowed if *restitutio in integrum* is possible. To have *restitutio in integrum*, the property transferred must be returned in specie, although extensive allowances can be made for deterioration.

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68 *Thurston v. Streilen*, [1951] 4 D.L.R. 724 (Man. K.B.D.). In this judgment Montague J. pointed out that in the U.S. and in France, if a small portion cannot be returned, this is no bar to rescission if the impossibility of return arose before the misrepresentation was discovered. This seems more logical than the Canadian position as set out here.

69 *F. & B. Transport Ltd. v. White Truck Sales Manitoba Ltd.* (1965), 51 W.W.R. 124 (Man. C.A.).

70 *O'Flaherty v. McKinlay* (1951), 30 M.P.R. 172 (Nfld. C.A.).

71 *Ibid.*, at pp. 188-189.

72 *Gearhart v. Kraatz* (1918), 40 D.L.R. 26, at p. 29 (Sask. C.A.). Lamont J.A. here cites *Halsbury* as his authority.

73 For situations where deposits have been ordered returned see: *Comeller v. Billinkoff* (1954), 62 Man. R. 35 (Williams C.J.Q.B.); *Stubbs v. Downey and Downey* (1957), 8 D.L.R. (2d) 720 (Ont. C.A.); and *Guest v. Beecroft, Beecroft and F. N. Cabeldu Ltd.* (1957), 10 D.L.R. (2d) 657 (B.C. Sup. Ct.). In the last case the purchaser had painted the kitchen in the house that was to be transferred, but MacFarlane J. merely said that restitution need not be "precisely" to the former position quoting the *Erlanger* case, (1878), 3 App. Cas. 1218, at p. 1278, *per* Lord Blackburn.