Rescission: A Broader Remedy Than You Think?

By William E. McNally and Barbara E. Cotton[1]

There seems to be a commonly held opinion among legal practitioners that *restitutio in integrum* is a *sine qua non* of the remedy of rescission. Upon this view, if the original parties to a contract cannot be restored to their original positions through return of the subject matter of the contract, the remedy of rescission will not be available.

This is actually not the case. The law has evolved such that rescission can be granted even though *restitutio in integrum* is not achievable, if it is "practically just" in the circumstances.

This principle has developed from the seminal case of *Erlanger* v. *New Sombrero Phosphate Company* (1878), 3 App. Cas. 1218, and thus there is in fact nothing new to be revealed in this brief article. The concept that *restitutio in integrum* is a fundamental requirement for rescission seems to be so ingrained, however, that this article will briefly review development of the "practically just" principle and its entrenchment in Canadian law.

As early as 1878 the House of Lords per Lord Blackburn articulated in *Erlanger* that the inability to effect *restitutio in integrum* should not place a roadblock in the way of granting the remedy of rescission, and stated in its following oft-quoted passage at pp. 1278-1279:

> ". . . But 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 account of profits and make allowances for deterioration; and I think the practise 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 that they were in before the contract."

A leading Canadian case applying this principle is *Wandinger* v. *Lake et al.* (1977), 78 D.L.R. (3d) 305, a decision of the Ontario Court of Appeal of Justice per Lerner J. In this case the plaintiffs were induced to purchase a motel and restaurant by reason of fraud. The motel was

represented by the vendor to generate a profit of at least $10,000 per year. The plaintiffs commenced operating the properties and received significantly less revenue. They sued for rescission of the agreement and it was argued that, because they had removed goods, chattels, furniture and equipment from the motel and restaurant, *restitutio in integrum* was no longer possible. Rescission was granted, however, with Lerner J. stating at pp. 314, 315:

> "A party sometimes has the right to rescind a transaction and be restored to his or her former position. The right to rescind is a right which a party to a transaction sometimes has to set that transaction aside and be restored to his or her former position . . . It is the equitable right to annul the legal effect of the contract, and to re-establish the parties, as nearly as this may be done, to the position they were in before the making of the contract. This remedy is available where a person has been induced into making a contract by material, false, fraudulent misrepresentations. The wrong party may rescind and also claim damages for deceit: . . .
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> A valid defence to an action for rescission arises where *restitutio in integrum* cannot be accomplished because the defendant is entitled to be restored substantially to the position he was in at the time of the making of the contract. In the instant case, some of the goods, chattels, furniture and equipment of the motel and restaurant have been removed by the plaintiffs. However, the defendant company need not be restored to exactly the same position it was in before making the contract; this is generally impossible. However, the Court does have full power to do whatever is practically just to restore the parties to their former position . . ."

Erlanger has been applied by the Alberta Supreme Court [Appellate Division] in *Keatley* v. *Churchmond,* [1922] 2 W.W.R. 993, wherein Clarke J.A. stated: "The general rule is that as a condition of rescission there must be *restitutio in integrum* but the trend of the later cases seems to be towards a reasonable and equitable application of the rule and to hold that it requires the parties seeking rescission to do merely what equitably he ought to do. . .".

This view is now expressed in the current editions of the secondary materials. For example, it is stated in *Hanbury & Martin's Modern Equity*[2]:

> "... A contract will cease to be capable of rescission if the parties can no longer be restored to their original position. Any money paid or other property transferred under the contract must be restored. But a precise restoration is not required, particularly in cases involving fraud. Equity is concerned to restore the parties, and especially the defendant, to their former position so far as practically possible. This might be achieved by, for example, ordering an account of profits and making allowances for deterioration of the property, or by ordering fair compensation in equity where it is not possible to restore the property nor (because its value has since been lost) to account for profits."

In *Snell's Equity*[3] it is stated:

> "... In general, a contract that is liable to be rescinded remains valid until it is set aside. A contract may cease to be capable of being rescinded as where the parties cannot be restored to their original position. ... But the rule is not applied very strictly; for equity will relieve wherever it can do what is practically just, even though it cannot restore the parties precisely to the state in which they were before the contract was made. ..." [4]

How then to effect a "practically just" restoration of a party to his/her/its pre-contractual position? The secondary materials and the case law seem to suggest several alternatives, including: (1) <u>monetary compensation</u> for the property disposed of or deteriorated, *etc*; (2) an <u>accounting</u> for any deterioration to the property or benefits received from possession of the property; and, possibly, (3) a return of <u>replacement property</u> *in specie*.

This concept that monetary compensation can be made to place the party back in his/her/its original pre-contract position is articulated by Fridman in *The Law of Contracts in Canada* [5] as follows:

> "There are cases from which it may be concluded that the court has the power to make monetary adjustments, thereby giving effect in principle to the notion of restitution, even though exact restitution *in specie* cannot be made. These would indicate, it is suggested, despite the apparent strictness of the language of Montague J., that the courts are willing and prepared to be more flexible and lenient than in

> former times. While restitution is a guiding principle for the courts, it will not be the master of their actions. If it is absolutely impossible to obtain restitution, formally or in effect, rescission may be denied. If some kind of satisfactory adjustment of the rights of the parties can be made, perhaps by the transfer of money between them, rescission will not be ruled out as a possible remedy in appropriate cases. . ."
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> S.M. Waddams echoes these views in *The Law of Contracts*[6].

The approach of awarding monetary compensation in lieu of *restitutio in integrum* was taken in *Kupchak* v. *Dayson Holdings Ltd.* (1965), 53 W.W.R. 65, a decision of the British Columbia Court of Appeal. In this case the Kupchaks had been induced to exchange their Haro Street and North Vancouver properties for shares of the Palms Motel Ltd. and to give mortgages over lands and chattels of the motel in the sum of $64,500 to Dayson Holdings Ltd. The purchasers then sold the Haro Street property and it could thus not be returned if the rescission order requested by the plaintiffs vendors was granted. The British Columbia Court of Appeal allowed rescission nonetheless, however, stating at pp. 68, 69:

> "In determining whether rescission is practical, equity's power to remove inequities resulting from rescission and deficiencies in restitution by compensation, account, or indemnity must be kept in mind. . .
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> . . . 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."

In this case the purchasers were compelled to pay compensation in lieu of return of the Haro Street property.

The case law is replete with examples of the court ordering an accounting, as, for example, in *Sager* v. *Manitoba Windmill & Pump Company,* [1917] 7 W.W.R. 1213, when an accounting was ordered for deterioration of the property that was to be returned.[7] The courts will also order an accounting for any benefits received by the rescinding party while in possession of the property[8].

It also seems to be arguable that replacement property can be substituted for the original property and rescission thereby effected. This view is articulated by Treitle in "The Law of Contracts"[9], wherein he states:

> ". . . On the same principle a person cannot rescind after he has disposed of the subject matter of the contract unless, perhaps, he has been able to get back that subject matter <u>or its substantial equivalent</u>." (Emphasis added.)

As an example, in *Atkins* v. *Garrett* 252 F. 280 (U.S. Dist. La., 1917)[10] the plaintiff had sold shares which were the subject matter of the contract sought to be rescinded. The Louisiana District Court allowed the plaintiff to tender other shares of the identical stock to the defendant as replacement shares and a rescission order was granted.

Thus it can be seen that the remedy of rescission may be ordered where it is "practically just", even when *restitutio in integrum* is not possible. Not late-breaking news perhaps, but possibly news to some.

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2. Jill E. Martin, *Hanbury & Martin Modern Equity* (15d) (London: Sweet & Maxwell Ltd., 1997), at pp. 838, 839.

3. John McGhee, *Snell's Equity* (30d) (London: Sweet & Maxwell, 2000), p. 688.

4. See also Sir Guenter Treitle, *The Law of Contract* (10d) (London: Sweet & Maxwell, 1999), at p. 353.

5. G.H.L. Fridman Q.C., *The Law of Contracts in Canada* (Scarborough, Ontario: Carswell Thomson Professional Publishing, 1999), at p. 866, 867.

6. S.M. Waddams, *The Law of Contracts* (4d) (Toronto: Canada Law Book Inc., 1999) at paragraph 424.

7. See also *Stewart* v. *Complex 329 Ltd. et al.* (1990), 109 N.B.R. (2d) 115.

8. See *Mahoney* v. *Purnell*, [1996] 3 All. E.R. 61.

9. *Ibid,* note 3, p. 351.

10. *Atkins* v. *Garrett* was overturned on another point by the Circuit Court of Appeals, Fifth Circuit at 261 F. 587, certiorari denied at 252 U.S. 580, but the principle was affirmed when the matter was again before the Circuit Court of Appeals, Fifth Circuit at 270 F. 939. The principle as expressed by the Circuit Court of Appeals has been applied in *Quealy* v. *Paine, Webber, Jackson & Curtis, Inc.* 475 So. 2d 756 (La. 1985). The original decision of the District Court of Louisiana has been cited for the principle in the article by C.T. Drechsler, "Rescission of Corporate Stock Sale or Transaction as Authorizing Court to Award Recovery of Requisite Number of Shares to Party Entitled to Relief", 14 *A.L.R.* 2d 855.