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### Fraud or Error

**Citation for published version:**

MacQueen, H & Reid, D 2013, 'Fraud or Error: A Thought Experiment?', *Edinburgh Law Review*, vol. 17, no. 3, pp. 343-69. <https://doi.org/10.3366/elr.2013.0171>

**Digital Object Identifier (DOI):**

[10.3366/elr.2013.0171](https://doi.org/10.3366/elr.2013.0171)

**Link:**

[Link to publication record in Edinburgh Research Explorer](#)

**Published In:**

Edinburgh Law Review

**Publisher Rights Statement:**

© MacQueen, H., & Reid, D. (2013). Fraud or Error: A Thought Experiment?. *Edinburgh Law Review*, 17(3), 343-69. [10.3366/elr.2013.0171](https://doi.org/10.3366/elr.2013.0171)

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# Fraud or Error: A Thought Experiment?

*Dot Reid and Hector MacQueen\**

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## A. INTRODUCTION

Students of the Scots law of contract over the last fifty years have been all too familiar – or, in some cases, not familiar enough – with the conundrum presented by the need to reconcile the differing results of the seemingly all but identical cases of *Morrisson v Robertson*<sup>1</sup> and *MacLeod v Kerr*.<sup>2</sup> In both a plausible rogue pretending to be someone else thereby tricked the owner of goods into selling them to him: in the first case, on the credit of the party for whom the rogue was pretending to act; in the second, by paying with a cheque from a stolen chequebook which was thereafter dishonoured. In both cases the rogue sold the

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1 1908 SC 332.

2 1965 SC 253.

goods on to a good faith third party. Again in both cases the rogue was later convicted of the crime of theft. The question in our two subsequent civil cases was whether the original owner/seller or the good faith third party was entitled to the goods. In *Morrisson* it was held that the original owner/seller had acted under an essential error as to the identity of his buyer, that the contract was accordingly void, that the rogue had therefore never acquired title to the goods and so neither did the good faith third party. In *MacLeod*, by contrast, the original owner/seller's error as to his buyer's identity was held not to be essential, that he was rather the victim of fraud, that the contract was voidable and that, it not having been avoided at the time the rogue sold to the good faith third party, the latter obtained good title to the goods.

Although clearly the cases present major issues for the law of property as much as for the law of contract,<sup>3</sup> our primary focus here will be on the questions which they raise in the latter. What is the distinction between fraud and error as grounds of invalidity in that context? It is evident that the two concepts overlap considerably in substance. If fraud is about the deception of one by another, as the classic Scottish definitions of it agree,<sup>4</sup> then the victim is always somebody who labours under error. One distinction which our cases suggest is that fraud in general only makes a contract voidable, while it is void if the error is in "the essentials" (i.e. as to the identity of the other contracting party, the contract's subject matter, the price, the quality of the subject matter, and the nature of the contract). So fraud may graduate, so to speak, into essential error, and this is what happened in *Morrisson*. However, there is long-standing uncertainty as to whether or not an error which is indeed in the essentials always makes a contract void or if there are limits to that proposition, for instance the suggestion that the error must also be "*justus et probabilis*".<sup>5</sup>

McBryde has coined the phrase "error plus" to indicate that in modern Scots law error requires an additional factor for it to be legally relevant: it must be induced, taken advantage of, mutual (that is, shared) or part of a gratuitous transaction.<sup>6</sup> The present article is concerned with the first of those factors, induced or caused error, which has considerably enlarged the scope of the doctrine and is probably the largest sub-category of the modern law of error. In this guise, error need not be in the essentials and where a material error

3 On the property dimensions see D Reid, *Fraud in Scots Law* (PhD, University of Edinburgh, 2012) 24-31, and text accompanying nn 148-152 below.

4 Erskine, *Inst* III.1.16; Bell, *Prin* § 13.

5 J J Gow, "Mistake and Error" (1952) 1 ICLQ 472 at 478; T B Smith, *A Short Commentary on the Law of Scotland* (1962) 832.

6 W W McBryde, *The Law of Contract in Scotland*, 3<sup>rd</sup> edn (2007) paras 15-16 and 15-23.

is induced by another party's misrepresentation and causes the victim to enter the contract, that contract may be voidable. The misrepresentation need not be fraudulent; there is said to be a category of "innocent" misrepresentation. But if a fraudulent misrepresentation induces a party to contract, it seems to be the law that the victim has a free choice as to whether the remedy of reduction is based on fraud *simpliciter* or on error induced by misrepresentation. One view is that, as a result of these developments, "the law on error induced by misrepresentation has overtaken the old-fashioned concept of annulment of a contract on the ground of fraud per se".<sup>7</sup>

This has however created a structural anomaly for commentators on contract law. The result of having a category of induced error means that misrepresentation has to be divided into two basic categories: intentional misrepresentation and unintentional misrepresentation (whether negligent or "innocent"). The former is part of the law of fraud; the latter part of the law of error. So in Gloag's classic work on contract law, first published in 1914, and which reached a second edition in 1929, error was treated first in one chapter, followed by another on misrepresentation and concealment and then another on fraud (which included facility and circumvention along with undue influence).<sup>8</sup> The attempt to treat each separately is only partly successful: his discussion of error and fraud is laced with the concept of misrepresentation; that of misrepresentation frequently digresses into fraud and error, and includes an explanation of essential error.<sup>9</sup> Modern commentators are faced with no lesser difficulty.<sup>10</sup> Moreover, errors induced by fraudulent or negligent misrepresentations are thus imported into the law of delict for damages can be claimed; innocent misrepresentations, by contrast, only have contractual effect.<sup>11</sup>

The preference for a taxonomy based on fraud or on error brings into sharp contrast the way in which civil and common law jurisdictions approach the question.<sup>12</sup> At the level of broad generalisation the former focuses on the error itself, the latter on how the error was caused; the former protects the free

7 H L MacQueen and J Thomson, *Contract Law in Scotland*, 3<sup>rd</sup> edn (2012) para 4.27.

8 W M Gloag, *The Law of Contract* (1914) chs XXII-IV; 2<sup>nd</sup> edn (1929) chs XXVI-VIII.

9 Gloag, *Contract*, 2<sup>nd</sup> edn (n 8) 472.

10 See McBryde, *Contract* (n 6) paras 14-10-14-18 (fraud) and paras 15-43-15-87 (induced error); W M Gloag and R C Henderson, *The Law of Scotland*, 13<sup>th</sup> edn by H L MacQueen et al (2012) paras 7.13-7.16 (fraud) and paras 7.33-7.38 (induced error); MacQueen and Thomson consider misrepresentation only as part of the law of error, see MacQueen and Thomson, *Contract* (n 7) paras 4.57-4.66.

11 In English law damages may be awarded for any type of misrepresentation: Misrepresentation Act 1967 s 2(2).

12 K Zweigert and H Kötz, *An Introduction to Comparative Law*, 3<sup>rd</sup> edn (tr T Weir, 1998) 411-424; R Sefton-Green, "Comparative conclusions", in R Sefton-Green (ed), *Mistake, Fraud and Duties to*

intention of the contracting parties, the latter punishes the actions of the one who induced the error; the former has a broad and more subjective concept of error; the latter an expansive doctrine of misrepresentation, which has a tortious character, and a restrictive category of mistake.<sup>13</sup>

Peter Stein noted 55 years ago that Scots law was in a muddle in this regard because it had failed to make a conscious structural choice:<sup>14</sup>

... instead of making a deliberate choice, the exponents of Scots law adopted a muddled mixture of the two, taking the rules laid down in English cases, and clothing them in pseudo-civilian dress.

In a sophisticated modern legal system classification is important and ought to be discernible with more certainty than is presently the case. This article will offer an explanation of how the current taxonomy came about and will propose a thought experiment, namely that all misrepresentations leading to an error ought to be part of the Scots law of fraud.

## B. THE HISTORICAL SCOPE OF FRAUD<sup>15</sup>

Despite the fact that fraud has always been with us, there remain doubts about its definition and its classification. In modern Scots law fraud is most commonly defined, using Erskine's formulation, as "a machination or contrivance to deceive",<sup>16</sup> itself a rendition of the classic or Labeonic definition of *dolus malus* in Justinian's *Digest: omnem calliditatem fallaciam machinationem ad circumveniendum fallendum decipiendum alterum adhibitam*.<sup>17</sup> The primary meaning of fraud, therefore, involves intentional deceit. However, Erskine's definition was always incomplete for there is evidence that in the seventeenth and eighteenth centuries the Scottish courts significantly extended the scope of fraud to cover fact scenarios where deceit was not present but fraud could nevertheless be presumed. The doctrine of presumptive fraud was broad and well-developed, and was applied in a wide range of circumstances in which one party gained an advantage by causing (intentionally or unintentionally) lesion to another.

One manifestation of presumptive fraud is to be found in the use of the Latin maxim *culpa lata dolo aequiparatur*,<sup>18</sup> the effect of which was to deem as fraud

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*Inform in European Contract Law* (2005) 369 at 380-386; H Beale, *Mistake and Non-Disclosure of Facts: Models for English Contract Law* (2012); DCFR Arts II-7:201-205.

13 On the historical development see C MacMillan, *Mistakes in Contract Law* (2010).

14 P G Stein, *Fault in the Formation of Contract in Roman Law and Scots Law* (1958) 191-192.

15 A more detailed analysis is given in Reid, *Fraud* (n 3) ch 2.

16 Erskine, *Inst* III.1.16.

17 D.4.3.1.2.

18 Reid, *Fraud* (n 3) 48-65.

(*dolus*) conduct which did not meet the delictual standard of intentional deceit. It most commonly occurred in relation to agency and the behaviour of fiduciaries (where it still has some currency in modern law<sup>19</sup>). But it was also used in a wider context as a means of attributing liability for fraud where behaviour was considered “unwarrantable”,<sup>20</sup> or where there was a lack of due care akin to what we would now consider negligent behaviour. *Culpa lata* appears in Stair’s account of the law of delict where he contrasts it with *dolus*:<sup>21</sup>

For the difference betwixt *dolus* and *lata culpa* is, that *dolus est magis animi*, and oftentimes by positive acts, and *lata culpa* is rather *facti*, and by omission of that which the party is obliged to show.

Stair’s philosophical observation is that the kind of wrongdoing inherent in *dolus* is principally about intention, motive, the territory of the mind. By contrast, *culpa lata* is about *facti*, about deeds or things done, i.e. it is presumed from facts or circumstances. A second distinction lies in the fact that *dolus* concerns positive actions, whereas *culpa lata* is principally about omissions,<sup>22</sup> often situations amounting to a lack of due care. This distinction was still apparent in *Faulds v Townsend*,<sup>23</sup> where Lord Ardmillan equated *culpa lata* with a more general notion of “fault”.<sup>24</sup>

Want of care and caution is fault—not always *culpa lata*; but it may be *culpa lata* in circumstances where great care and caution are required, and are not given. The peculiar circumstances which demand great care and caution raise the character of the *culpa* which consists in the want of that care and caution.

In the Scottish courts *culpa lata*—part of the law of fraud—was a familiar characterisation of unwarrantable behaviour that could not be classified as either a crime or an intentional delict, but which amounted to fault inferred on grounds of public policy.<sup>25</sup> This in turn made it a suitable vehicle for dealing with breaches of fiduciary duty by trustees, executors and partners, as well as unintentional misrepresentations.<sup>26</sup> According to Stein, in older Scots law

19 *Ferguson v Paterson* (1900) 2 F (HL) 37; see Discussion Paper on *Breach of Trust* (Scot Law Com DP No 123, 2003) paras 3.23-3.30.

20 *Scot v Cheisly* (1670) Mor 4867; *Oliver v Suttie* (1840) 2 D 514; *Callendar v Milligan* (1849) 11 D 1174; *Adamson v Glasgow Water-Works Commissioners* (1859) 21 D 1012; *Boyd & Forrest v Glasgow & SW Ry Co* 1912 SC (HL) 93.

21 Stair, *Inst* I.9.11.

22 H L MacQueen and W D H Sellar, “Negligence” in K Reid and R Zimmermann (eds), *A History of Private Law in Scotland, Vol 2: Obligations* (2000) 517 at 544-545.

23 (1861) 23 D 437.

24 At 439-440.

25 Reid, *Fraud* (n 3) 55-58.

26 See e.g. *McPherson’s Trs v Watt* (1877) 4 R 601, rev 1878 5 R (HL) 9; *Knox v Mackinnon* (1888) 15 R (HL) 83; *Raes v Meek* (1889) 16 R (HL) 31; *Carruthers v Carruthers* (1896) 23 R (HL) 55.

unintentional misrepresentation was dealt with in two different ways: by an implied warranty against latent defects (also a species of presumptive fraud) and “by applying the principle that *culpa lata* is the equivalent of *dolus*”.<sup>27</sup> The principle is little found in modern case law outwith the context of trusts,<sup>28</sup> but was certainly familiar to the courts of the eighteenth and nineteenth centuries. Together with rules on latent insufficiency in the context of sale,<sup>29</sup> it was the means by which unintentional misstatements were brought within the ambit of fraud.

### C. THE HISTORICAL SCOPE OF ERROR

To a modern Scots lawyer misrepresentations are inextricably linked to the law of error, not the law of fraud. Indeed, one modern commentator classifies fraud in a contractual context as “a particular aspect of error”.<sup>30</sup> The process of mutation from fraud to error began in the middle of the nineteenth century. The “mischief” which the courts were attempting to address was the issue of unintentional misstatements. Despite the fact that Scots law contained native solutions to the problem, the socio-economic and legal conditions in nineteenth-century Scotland were such that the courts were looking for new ways to deal with old problems. A significant landmark on the journey was the English decision in *Derry v Peek*,<sup>31</sup> which narrowed the definition of fraud to intentional or reckless deceit and was enthusiastically embraced by the Scottish judiciary. That narrowing was accompanied by a conceptual relocation of misrepresentation from the law of fraud to the law of error.

McBryde has pointed out that “[i]f there had been a major textbook writer on Contract, writing at the beginning of the 1850s it is doubtful if the law on error would have been taken much further than the institutional writers”.<sup>32</sup> Unlike modern text-writers, the Scottish Institutional writers provide only cursory treatments of error, while devoting considerable attention to the law of fraud.<sup>33</sup> Moreover, they make a very clear distinction between fraud and error, from which it is clear that induced error is an almost entirely modern concept.

27 Stein, *Fault in the Formation of Contract* (n 14) 171-172 and 186 ff.

28 For recent consideration of the principle in Scots law see *Spread Trustee Company Ltd v Hutcheson* [2011] UKPC 13, [2012] 2 AC 194.

29 Reid, *Fraud* (n 3) at 176-178.

30 J Thomson, “Fraud” in *The Laws of Scotland: Stair Memorial Encyclopaedia* vol 11 (1990) para 707.

31 (1889) LR 14 App Cas 337.

32 W W McBryde, “Error” in Reid and Zimmermann (eds), *A History of Private Law in Scotland, Vol 2* (n 22) 80.

33 For details see Stein, *Fault in the Formation of Contract* (n 14) ch 14; McBryde (n 32).

For Stair fraud belongs conceptually amongst the obediential rather than the conventional obligations, and it occupies a considerable part of his title on reparation (I, 9). Error, on the other hand, is discussed in title I.10 on conventional obligations. In a crucially important passage, Stair reinforces the distinction between fraud and error by focusing attention on the “cause” of the contract:<sup>34</sup>

... and though deceit were used, yet where it was not deceit, that was *the cause of the obligation or deed*, but the party's proper motion, inclination or an equivalent cause onerous, it infers not circumvention. So neither doth error or mistake, though it be the cause of the obligation or deed and be very prejudicial to the erring party. And though, if it had been fraudulently induced by the other party, it would have been sufficient; yet not being so, there is no circumvention; and the deed is valid, unless the error be in the substantial of the deed, and then there is no true consent, and the deed is null ... But if the error or mistake, which *gave the cause to the contract*, were by machination, project or endeavour, of any other than the party errant, it would be circumvention. So that there is nothing more frequently to be adverted, than whether the error be through the party's own fault, or through the deceit of another; and therefore *errore lapsus* and *dolo circumventus* are distinct defects in deeds.

To paraphrase:

- (a) If error is the cause of the obligation, it will not infer fraud, and there can only be reduction if the error is in the substantial because there is no consent between the parties.
- (b) If, however, the error has been fraudulently induced by the other contracting party, it amounts to circumvention (fraud).<sup>35</sup>

Stair recognises a close relationship between error and fraud but draws a clear distinction between the two. In one passage he does appear to acknowledge a concept of induced error, using a Biblical example. In the story of Jacob and Rachel in Genesis 29 v 21-30, Jacob fell in love with Rachel and worked seven years for her hand, but on the wedding night her father deceived Jacob by sending her older sister Leah to lie down with him instead of Rachel. Jacob then had to work another seven years for the younger sister too. Did he make an error or was he deceived? A nice question. Stair's view is that he was certainly deceived, but it “was by his own fault”.<sup>36</sup> Had Jacob *spoken* to Leah in the dark he would immediately have known. McBryde acknowledges that “to the

<sup>34</sup> *Inst* I.9.9, emphasis added. This passage is also discussed in some detail in J MacLeod, “Before Bell: the roots of error in the Scots law of contract” (2010) 14 *EdinLR* 385 at 394-399.

<sup>35</sup> For Stair, circumvention was synonymous with fraud. It was only later that circumvention came to denote the various species of fraud which did not involve intentional deceit: see *Mann v Smith* (1861) 23 D 435; *McDougal v McDougal's Trs* 1931 SC 102.

<sup>36</sup> *Inst* IV.40.24.

extent that the example of Rachel and Leah reflected the thinking on the subject the Scots law of error was being built on a shaky foundation”.<sup>37</sup> The foundations would undoubtedly be shaky because, given his earlier clarity on the subject, it is likely that Stair saw the situation as one of fraud rather than error.

Fraud and error are, therefore, two distinct, albeit related, doctrines, with different consequences. And, importantly, if an error is induced by machination or intrigue, it amounts to fraud and not error. For Stair at least, error was a no-fault category. It could annul a contract if it was *in substantialibus* and could be proved, but if it was induced, that was fraud and the remedy was either restitution or damages.<sup>38</sup>

Bell is the institutional writer who deals with the law of error in most detail. But in the early editions of his *Principles*, there is no category of induced error.<sup>39</sup> In the second edition he begins, “Error in substantials, whether in fact or in law, invalidates consent, where reliance is placed on the particular in question”, and then goes on to outline the five categories widely known to constitute error in the substantials.<sup>40</sup> If we compare this same passage in later editions, we can see how the law was developing in the nineteenth century. In the fourth edition, also written by Bell in 1839, he introduces error caused by fraud:<sup>41</sup>

Error by fraud of the former kind, though not in substantials, if induced by stratagem sufficient to deceive a person of ordinary capacity; or accompanied by imbecility and loss on the party of the obligor; or induced in a case in which the obligor relied on the obligee for his information, as in insurance contracts; will ground an action for reducing the contract, or an exception in defence against an action grounded on it: error by fraud of the latter kind, will give relief by damages only.

Arguably, since the remedy is in damages, this is still essentially fraud and not error. It is therefore questionable whether Scots law had a category of induced error even when Bell was writing.<sup>42</sup> However, by the tenth edition of the *Principles*, edited by Guthrie in 1899 at a time when the definition of fraud was hotly debated in the wake of *Derry v Peek*, error caused by misrepresentation had become part of the taxonomy of error:<sup>43</sup>

37 McBryde (n 32) at 74.

38 *Inst* I.9.4.

39 See also McBryde (n 32) at 77.

40 Bell, *Prin* (2<sup>nd</sup> edn) § 11.

41 Bell, *Prin* (4<sup>th</sup> edn) § 13.

42 “Much of the Scottish case law on error . . . was after Bell’s death in 1843” (McBryde (n 32) at 78).

43 Bell, *Prin* (10<sup>th</sup> edn) I.11.

Error has in itself no legal effect. It becomes operative on a man's legal position only in exceptional cases. . . obligations and contracts are annulled or dissolved on the ground either of essential error, or of error produced by misrepresentation or fraud.

The discussion of error is now interlaced with a discussion of fraud and misrepresentation in a structure which lacks clarity. However, this is consistent with what was happening in the courts at the same period.

There are few cases of error in older Scots law sources. Morison's Dictionary, for instance, contains no title on error; but a very significant title on fraud covers a vast range of situations. Error clearly did not come before the courts often although the historical waters are muddied by a modern tendency to re-classify fraud or presumptive fraud cases retrospectively as illustrations of error.<sup>44</sup> In a recent study of the law of error John MacLeod convincingly argues that error was regarded by the Scottish Institutional writers as "a side effect of the rules of formation"<sup>45</sup> rather than an independent doctrine on a par with fraud or force. It was a way of describing the absence of consent and hence the lack of a foundation for the existence of a contract, and as such it had little in the way of structure because it did not need one. Fraud, on the other hand, had a very wide definition with clear rules, and it came often before the courts in circumstances which ranged far beyond intentional deceit. The question then is why and how a transformation took place which chose the doctrine of error as the best location for dealing with misrepresentations of all kinds, whilst simultaneously emasculating the law of fraud.

#### D. THE TRANSITION FROM FRAUD TO ERROR

It is perhaps unsurprising that solutions designed to deal with the problems of an agrarian economy in seventeenth- and eighteenth-century Scotland, such as unsound horses<sup>46</sup> or unreliable seed,<sup>47</sup> would prove inadequate to deal with the complexities of the financial services world which emerged in the nineteenth. As commerce and industry grew, as companies formed and shares were listed, as a certain creativity was brought to finance and banking, the political and legal pressure grew to protect entrepreneurs and company directors. The Western Bank collapsed in 1857 and the City of Glasgow Bank followed in 1878.

44 Several of the cases cited by Bell himself as illustrations of the doctrine of error were in fact decided on grounds of fraud (Stein, *Fault in the Formation of Contract* (n 14) 185).

45 MacLeod (n 34) at 394.

46 *Ralston v Robertson* (1758) Mor 14238.

47 *Adamson v Smith* (1799) Mor 14244.

Both were “run on aggressive lines”,<sup>48</sup> and had over-extended their lending by offering higher interest rates than their more conservative Edinburgh counterparts.<sup>49</sup> The losers were ordinary shareholders and, in the case of the City of Glasgow Bank, there was the added complication of fraudulent behaviour by the directors of the bank who had attempted to conceal problems by falsifying the balance sheets.<sup>50</sup>

History repeats itself, they say, but in the nineteenth century there was no question of the government stepping in to bail out failing banks. Instead the courts were left to deal with the aftermath. Most of the actions raised by shareholders alleged fraud and misrepresentation and this is the context in which the mutation from fraud to error took place. One of the difficulties may have been a semantic one in that fraud sounds like (and is) a criminal offence,<sup>51</sup> and many company directors were professional people, including judges and lawyers. It may have been a step too far to label their contemporaries fraudsters simply for an inaccuracy in the share prospectus or in the accounts. In addition, there is little doubt that the Mercantile Law Amendment (Scotland) Act 1856 had a role to play. The rule in contracts of sale until then was that there was an implied warranty of quality and, in effect, the seller was liable for any misstatement about the goods regardless of his intention. Under the new legislation, the seller would only be liable for unknown defects where he had given an express warranty or where the goods were sold for a specified purpose.<sup>52</sup> It is perhaps no coincidence that most of the problematic cases of misrepresentation which perplexed the Scottish courts arose in the second half of the nineteenth century, and that there was an increase in litigation after the passing of the 1856 Act.<sup>53</sup>

48 B Lenman, *An Economic History of Modern Scotland 1660-1976* (1977) 158. See further R S Shiels, “The criminal trial of the directors of the City of Glasgow Bank” 2013 JR 27; and K G C Reid, “Embalmed in Rettie: the City of Glasgow Bank and the liability of trustees”, in A Burrows et al (eds), *Judge and Jurist: Essays in Memory of Lord Rodger of Earlsferry* (2013) 489.

49 R H Campbell, *Scotland since 1707*, 2<sup>nd</sup> edn (1985) 112-114.

50 Lenman (n 48) 114.

51 The directors of the City of Glasgow Bank did in fact go to prison: Campbell (n 49) 114; Shiels (n 48).

52 Mercantile Law Amendment (Scotland) Act 1856 s 5; also W M Gordon, “Sale” in Reid and Zimmermann (eds), *A History of Private Law in Scotland*, Vol 2 (n 22) 305 at 326-327.

53 A non-exhaustive list includes: *Wardlaw v Mackenzie* (1859) 21 D 940; *Adamson v Glasgow Water-Works Commissioners* (1859) 21 D 1012; *Wilson v Caledonian Railway Company* (1860) 22 D 1408; *Hogg v Campbell* (1864) 2 M 848; *Graham v Western Bank* (1864) 2 M 559; *Addie v Western Bank* (1865) 3 M 899; *Western Bank of Scotland v Addie* (1867) 5 M (HL) 80; *Hare v Hopes* (1870) 8 SLR 189; *Dempster v Raes* (1873) 11 M 843; *Beresford's Trs v Gardner* (1877) 4 R 363; *Houldsworth v City of Glasgow Bank* (1879) 6 R 1164, (1880) 7 R (HL) 53; *Tennent v City of Glasgow Bank* (1879) 6 R 554; *Lees v Todd* (1882) 9 R 807; *Young v Clydesdale Bank* (1889) 17 R 231; *Stewart v Kennedy* (1889) 16 R 857; *Menzies v Menzies* (1890) 17 R 881, (1893) 20 R (HL) 108; *Smyth v Muir* (1891) 19 R 81; *Woods v Tulloch* (1893) 20 R 477; *Manners v Whitehead* (1898) 1 F 171.

However, even after the passing of the 1856 Act we still find affirmation that if statements are false they are assumed to be fraudulent. In *Lees v Todd*,<sup>54</sup> a shareholder case, Lord President Inglis appears to suggest that false statements may in themselves amount to dishonesty depending on the relationship of the parties and the question of reliance:<sup>55</sup>

If the speaker, having no actual belief in the statement, though not believing it to be untrue, volunteers the statement, inconsistent with facts, to a person interested in the statement, and likely to act on it, he is dishonest and guilty of deceit, because he produces, and intends to produce, on the mind of the listener a belief which he does not himself entertain.

On this definition, many, if not most, misrepresentations could be considered not “innocent”.<sup>56</sup>

### (1) Fraud, *culpa lata*, misrepresentation and error

The difficulty the courts had was where to locate unintentional misrepresentations structurally if they were not to be treated as fraud. The *culpa lata* principle was used in an unsuccessful argument for unintentional misrepresentation in *Oliver v Suttie*<sup>57</sup> in the mid-nineteenth century, the point at which the conflation of fraud and induced error began to take place. The Lord Ordinary held that there was “no room or authority, or sound principle, for any mid plea between fraud and unintentional error”<sup>58</sup> although had the pursuers been able to prove *culpa lata* it would have been treated as a case of fraud (and not error).<sup>59</sup>

The issue was also addressed in *Adamson v Glasgow Water-Works Commissioners*<sup>60</sup> which concerned the building of the Mugdock tunnel and reservoir. The pursuers had tendered for the work relying on technical information supplied by the defenders which turned out to be wrong, so that the cost of the work

54 (1882) 9 R 807.

55 At 854.

56 For a similar definition see also *Mair v Rio Grande Rubber Estates Ltd* 1913 SC (HL) 74 at 82 per Lord Shaw.

57 (1840) 2 D 514.

58 At 516.

59 Stein notes that this case cannot be regarded as rejecting the doctrine of innocent misrepresentation because it was an action for damages and the pursuers may have been entitled to reduction (Stein, *Fault in the Formation of Contract* (n 14) 195). Another contributing factor to the confusion surrounding fraud is indiscriminate use of the case law by courts and commentators regardless of whether the context is delictual or contractual, the most obvious example being *Derry v Peek*.

60 (1859) 21 D 1012. Walker identifies *Adamson* as the recognition of innocent misrepresentation in Scots law (D M Walker, *The Law of Civil Remedies in Scotland* (1974) 130); McBryde disagrees both with Walker and Stein (McBryde, *Contract* (n 6) para 15-47 n 116). This is hotly disputed territory.

was significantly higher than anticipated. This was a difficult case, and there was extensive debate between counsel on the correct form of the issue.<sup>61</sup> The majority of the Inner House thought the case was one of essential error induced by misrepresentation, but Lord Deas was clearly uncomfortable with this approach:<sup>62</sup>

The case is in a very embarrassing predicament, for the parties have agreed upon an issue, and at the same time differ as to its meaning. The Court also differs as to its interpretation, for I do not agree with Lord Curriehill that the substance of the case is essential error. I think it is misrepresentation on an essential point; - misrepresentation, involving *culpa lata*, which the law holds equivalent to fraud. If the case does not come up to that, there is no case at all. I would have kept out essential error altogether.

Lord Deas adopted the same stance in the important case of *Hogg v Campbell*,<sup>63</sup> and his doubts about this use of the law of error would support the view that it was a novel argument.<sup>64</sup> In *Hogg* it was argued that a deed had been “fraudulently impetrated”, also that it had been signed under essential error induced by fraud. Much of the debate again turned on the correct form of the issues, and whether an induced essential error was distinguishable from fraud.<sup>65</sup>

Now the difficulty which I had mainly in regard to that, was a difficulty in seeing exactly what case could be presented to the jury of error, induced by William Campbell, which was not also a case of fraud.

In *Hogg*, however, we see the court in *obiter* remarks beginning to outline the territory of induced essential error. The Lord President speculated that perhaps induced error would be relevant where the defender:<sup>66</sup>

... by his silence, or by his actings – by his silence after previous actings – whether silence fraudulently maintained, or inadvertently, or it may have been in failing to make [the pursuer] aware of doubt as to whether the clause had been included or no [sic].

Lord Curriehill thought that an error arising as a result of “a mistake or misunderstanding or carelessness”<sup>67</sup> could perhaps be relevant. Misrepresentations

61 The difficulty of distinguishing between fraud and error is commonplace at this period: see *McConechy v McIndoe* (1853) 16 D 315; *Purdon v Rowatt's Trs* (1856) 19 D 206; *Wilson v Caledonian Railway Company* (1860) 22 D 1408; *Graham v Western Bank* (1864) 2 M 559; *Hogg v Campbell* (1864) 2 MacPh 848; *Harris v Robertson* (1864) 2 Macph 664; *Hare v Hopes* (1870) 8 SLR 189; *Dempster v Raes* (1873) 11 M 843; *Munro v Strain* (1874) 1 R 522; *Beresford's Trs v Gardner* (1877) 4 R 363.

62 (1859) 21 D 1012 at 1020 per Lord Deas.

63 (1864) 2 M 848.

64 At 860.

65 At 858 per Lord President McNeill.

66 *Ibid.*

67 At 859.

which were careless or negligent were being relocated in the law of error rather than the older *culpa lata* principle.

“Innocent” misrepresentations made the same transition shortly afterwards. In *Hare v Hopes*,<sup>68</sup> the context was an alleged fraudulent balance sheet on the basis of which the pursuer became a partner. This was held to be fraud, but again in *obiter* remarks Lord President Inglis attempted to delineate the territory of induced error:<sup>69</sup>

... if the misrepresentations and concealment averred had been *innocent* it might have been a good case for reduction upon essential error.

The “error” analysis was gaining ground, particularly in relation to careless or “innocent” misstatements. Hence, we find statements such as “essential error is a well established ground of reduction. It is properly connected with misrepresentation, in the case of an onerous contract, in which both parties are not said to have been deceived, but one to have misled the other”.<sup>70</sup> And yet essential error combined with misrepresentation was clearly not well established by 1870, as the above case law shows.

## (2) Taking advantage of another’s mistake

The shift from presumptive fraud to error is also apparent in a group of cases<sup>71</sup> in which one party is labouring under an (uninduced unilateral) error which the other party knows about and takes advantage of; a type of concealment in other words. In these cases the *caveat emptor* principle does not seem to apply, hence their exceptional nature, and the party in error has been granted a remedy where the error in question is known to and taken advantage of by the other party in an unwarrantable fashion. In modern law these cases are considered controversial<sup>72</sup> and at most a narrow exception to the rule that an uninduced unilateral error is

68 (1870) 8 SLR 189.

69 At 192, emphasis added.

70 *Wilson v Caledonian Railway Company* (1860) 22 D 1408 at 1409 per the Lord Ordinary (Jerviswoode).

71 *Sword v Sinclairs* (1771) Mor 14241; *Hepburn v Campbell* (1781) Mor 14168; *Purdon v Rowatt’s Trs* (1856) 19 D 206; *Steuart’s Trs v Hart* (1875) 3 R 192; *Inglis’ Trs v Inglis* (1887) 14 R 740.

72 Glog, *Contract*, 2<sup>nd</sup> edn (n 8) 438, who explicitly thought that *Steuart’s Trs v Hart* breached the *caveat emptor* rule; D M Walker, *The Law of Contract and Related Obligations in Scotland*, 3<sup>rd</sup> edn (1995) para 14.41; Thomson (n 30) para 694; McBryde, *Contract* (n 6) paras 15.30-15.33; MacQueen and Thomson, *Contract* (n 7) paras 4.53-4.55. Modern cases which have followed *Steuart’s Trs v Hart* include: *Anderson v Lambie* 1954 SC (HL) 43; *Angus v Bryden* 1992 SLT 884; *Parvaiz v Thresher Wines Acquisition Ltd* [2008] CSOH 160, 2009 SC 151; *Wills v Strategic Procurement (UK) Ltd* [2013] CSOH 26; those doubting or not applying it include: *Brooker Simpson v Duncan Logan (Builders)* 1969 SLT 304; *Steel v Bradley Homes (Scotland) Ltd* 1972 SC 48; *Spook Erections (Northern) v Kaye* 1990 SLT 676.

not sufficient to annul a contract. But in their earliest guise the courts seemed more inclined to approach them as instances of presumptive fraud.

So, in *Sword v Sinclairs*<sup>73</sup> it was clearly relevant that an inexperienced apprentice who copied down a mistaken price without querying it was taken advantage of by an experienced buyer.<sup>74</sup> In *Purdon v Rowatt's Trs*<sup>75</sup> the action was to reduce a deed, alleging that the granter was a person not fully capable of understanding the deed, he had no independent legal advice and, in addition, the transaction was gratuitous. Separate issues of fraud and error were sent to the jury, who did not find fraud but nonetheless held the deed obtained by "unfair practices on the part of Mr Gebbie, their agent, unduly taking advantage of the situation of Robert Purdon in the absence of his legal advisor".<sup>76</sup> On appeal, the court was clearly of the view that those circumstances could amount to fraud and Lord Murray questioned why the jury did not return such a finding.

In the leading case, *Steuart's Trustees v Hart*,<sup>77</sup> a property owner accepted a lower price for land because he mistakenly believed it to be burdened with a higher feu duty than it was (he claimed that ridding himself of the feu duty was one of the reasons for selling). However, the purchaser knew that only a small feu duty was payable and that the seller had made an error. The court reduced the sale "on grounds of essential error known to the purchaser and taken advantage of by him".<sup>78</sup> It is clear that a remedy was granted because the defender was taking "unfair advantage",<sup>79</sup> or as Lord President Inglis put it, "I am not prepared to say that this is a wrong without a remedy".<sup>80</sup> In the Outer House Lord Shand had suggested the circumstances might amount to fraud.<sup>81</sup>

If it were necessary, however, that fraud should be established in order to give the pursuers that remedy, I am disposed to think there is enough in the case to entitle the pursuers to succeed.

There is of course hesitation on the part of the judges to find that mere private knowledge is effective to set aside a property sale, particularly at this period in the nineteenth century. After all, the purchaser had done nothing other than remain silent. In an earlier era these facts could have amounted to presumptive fraud,<sup>82</sup>

73 (1771) Mor 14241.

74 See W W McBryde, "A note on *Sword v Sinclair* and the law of error" 1997 JR 281.

75 (1856) 19 D 206.

76 At 211.

77 (1875) 3 R 192.

78 At 200 per Lord President Inglis.

79 At 195 per Lord Shand.

80 At 199; see also at 201 per Lord Ardmillan.

81 At 198.

82 For the scope of presumptive fraud in a contractual context see Reid, *Fraud* (n 3) 65-90.

but the court now preferred an approach based on error. *Stewart's Trustees* comes close to the wider meaning of fraud because of the imbalance of knowledge between the parties and the unscrupulousness of the defender, but there are two reasons for doubting whether such an argument would have been effective. First, the courts were now too unfamiliar with the categories of presumptive fraud for it to be a useful device. Secondly, the traditional roles are reversed in *Stewart's Trustees* in that it would normally be the seller who was in a position of knowledge or who had access to information about the property. Had the mistake been the purchaser's, an argument based on fraud might have been more convincing.

These cases do appear, however, to be another instance of importing what amounts to considerations of wrongful behaviour or fault into the law of error, and they present great difficulties as a result. In *Stewart's Trustees* the court is clear that the defender's behaviour was "injurious"<sup>83</sup> to the pursuer, but despite the fact that this is the language of delict, the remedy comes from the law of contract and enrichment: reduction of the sale, plus reimbursement of expenditure (although Lord Ardmillan calls it "restitution"<sup>84</sup>). Perhaps this is reparation in the broad sense in which Stair used it, whereby it can encompass restitution of property as well as pecuniary damages.

In other examples of the rule, some cases involve parties in a close relationship and are more easily classified as fraud, in the presumptive sense. A lawyer taking advantage of the other party's weakness and ignorance, as in *Purdon v Rowatt's Trs*, was clearly seen as such a case in 1856. Similarly, *Inglis' Trs v Inglis*<sup>85</sup> was a succession case where a sister had elected for legitim instead of a testamentary provision in the mistaken belief that she was entitled to the whole legitim fund, subsequent to which her brother asserted his claim to one half. The First Division allowed her to revoke her election on grounds of essential error. The reason for the decision appears to be an error which is taken advantage of by the other party, relying on *Stewart's Trustees*.<sup>86</sup> The court's focus was clearly on the behaviour of the brother, which is variously referred to as a lack of "fair play"<sup>87</sup> and "fault".<sup>88</sup> The key question for the court was not the error *per se*, but "how was the misapprehension brought about?"<sup>89</sup>

83 (1875) 3 R 192 at 201 per Lord Ardmillan.

84 Ibid.

85 (1887) 14 R 740; affd (1890) 17 R (HL) 76.

86 (1875) 3 R 192.

87 (1887) 14 R 740 at 746 per the Lord Ordinary (Trayner).

88 At 758 per Lord President Inglis.

89 At 751.

This is consistent with the approach of the Scottish courts at this time. They were, of course, concerned with vitiated consent, but the way in which it was vitiated (the cause) was more important than the flawed consent in itself (the result). Of course, both were necessary for a successful challenge to a deed previously granted. Hence, on the face of it, this was a successful challenge on grounds of essential error, but in reality the taking advantage of the woman's ignorance in the context of a family relationship was conclusive. An "erroneous belief" brought about by "the fault" of the brother<sup>90</sup> could conceptually have founded a fraud case. As Lord Shand explained, the underlying policy considerations were about maintaining honest relations between transacting parties:<sup>91</sup>

That doctrine has been made part of the law for the purpose of enforcing honest dealing between parties to pecuniary transactions, and has been enforced in many cases with the result of compelling parties to act honestly towards each other.

This is the territory of substantive justice, of "unfairness" or "dishonest dealing", once the territory of the law of fraud, now identified as essential error; but the key determinant of liability is the "fault" of the other party.

Cases where there is no relationship of trust are more difficult because in a commercial context, in theory, each party should look out for his interests without the law's intervention. However, as in *Steuart's Trustees*, it is still the behaviour of the parties which is under scrutiny and the courts appear to be enforcing a standard of honesty, particularly where there is inequality in the knowledge of the parties.

### **(3) The final steps**

We now must turn to *Derry v Peek*,<sup>92</sup> which was decided in 1889, at a time when there was still confusion in the Scottish courts about the scope of fraud and which was greeted with some enthusiasm north of the border. *Derry v Peek* was an action in tort, in substance typical of the late nineteenth century, where the plaintiff had bought shares in a tramway company relying on the company prospectus which claimed that it had the right to use steam instead of horse power, thus making it considerably more profitable than its competitors. In fact, permission to use steam power was subject to the consent of the Board of Trade, and was not granted. The shareholder brought an action of deceit against the

<sup>90</sup> At 758.

<sup>91</sup> At 760 per Lord Shand.

<sup>92</sup> (1889) LR 14 App Cas 337.

directors of the company alleging they had made a false statement and claiming damages for fraudulent misrepresentation. The arguments turned on whether or not an action in deceit required intention, whether a negligent misstatement would suffice, and the effect of honest belief on the part of the defendants. In the leading speech Lord Herschell held that:<sup>93</sup>

... fraud is proved when it is shewn 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.

This definition of fraud meant that a misstatement must be wilfully or knowingly made.<sup>94</sup> Mere inaccuracy was not enough,<sup>95</sup> nor was carelessness.<sup>96</sup>

Even after *Derry v Peek* the Scottish courts did sporadically attempt to found on the *culpa lata* principle to deal with unintentional misrepresentations, albeit with decreasing enthusiasm. Two important cases—*Menzies v Menzies*<sup>97</sup> in 1893 and *Boyd & Forrest v Glasgow & SW Railway Co*<sup>98</sup> between 1911 and 1915—mark the end point in the process of detaching fraud from its historical roots and together they demonstrate that Scots law now looked to the law of error to solve the problem of misrepresentation.

In *Menzies v Menzies* a son raised an action to have an agreement with his father reduced on grounds of fraudulent misrepresentation and concealment. The son was in debt to the tune of £6000 and had been led to believe that signing it was the only way to avoid financial ruin. He argued that he was under the mistaken belief that he would not otherwise be able to raise money to pay his debts, a belief induced by the representations of his father's solicitor. The Lord Ordinary (Low) reduced the agreement because of a combination of factors: this was a family relationship; the pursuer had no independent legal advice; and the misrepresentations caused lesion to the pursuer, who had surrendered valuable rights for inadequate consideration,<sup>99</sup> a classic case of presumptive fraud. There is no mention of error.

However, the accepted definition of fraud having been narrowed to intentional deceit, the Inner House held that there was no fraud on the part of the solicitor, and certainly no fraud could be inferred despite the fact that the son had no

93 At 374 per Lord Herschell.

94 At 362.

95 At 344 per Lord Halsbury.

96 At 369 and 375 per Lord Herschell.

97 (1890) 17 R 881; the full history is given in the House of Lords report of the case at (1893) 20 R (HL) 108.

98 1911 SC 33, revd 1912 SC (HL) 93; 1914 SC 472, revd 1915 SC (HL) 20.

99 (1893) 20 R (HL) 108 at 114-115.

independent legal advice and was acting on the advice of his father's agent to his great lesion. When the case came before the Inner House for a second time, the issue was whether there could be misrepresentation without fraud, the answer to which was negative.<sup>100</sup> However, on appeal the House of Lords reversed the Inner House decision, and supported the dissenting judgments of Lord Low and Lord Rutherford Clark. Lord Watson held that the representations made by the father's agent, which induced the pursuer to surrender valuable rights, were "sufficient to infer the appellant's right to rescind".<sup>101</sup> He then made his infamous pronouncement about the law of error:<sup>102</sup>

Error becomes essential whenever it is shown that but for it one of the parties would have declined to contract. He cannot rescind unless his error was induced by the representations of the other contracting party, or of his agent, made in the course of negotiation, and with reference to the subject matter of the contract. If his error is proved to have been so induced, the fact that the misleading representations were made in good faith affords no defence. . .

Error had not been argued up to that point and Lord Watson's reference to it appears to come almost out of the blue. *Menzies* is not a case about the law of error; it is about the effect of non-fraudulent misrepresentation in the context of a family relationship where a son was not independently advised and was therefore in ignorance as to his legal rights. As Lord Field put it:<sup>103</sup>

Necessity and weakness on the one side, and advantage in fact on the other, gained by a representation untrue in fact, and materially inducing the bargain, render it contrary to good conscience.

The significance of *Menzies* for the law of error is well-known,<sup>104</sup> but insufficient attention has been given to the context of Lord Watson's dictum, and the reason why error was even referred to. *Menzies* began as a fraud case. It raised questions of definition and motive, and the legal issue was whether a non-fraudulent misrepresentation was actionable. In the second appeal to the Inner House—fraud having been rejected in the first—Lord Rutherford Clark suggested that the pursuer's agreement was induced either "by fraudulent misrepresentation, or by misrepresentation which led him into essential error".<sup>105</sup> It is against that background that the case was appealed to the House of

100 (1890) 17 R 881 at 895 per Lord Justice-Clerk Macdonald.

101 (1893) 20 R (HL) 108 at 142 per Lord Watson.

102 *Ibid.*

103 At 148 per Lord Field.

104 The usual interpretation of *Menzies* is that Lord Watson's (*obiter*) remarks altered the meaning of essential error, lowering the standard from the 5 categories set out in Bell's *Principles* §11 to simply a material error: see McBryde, *Contract* (n 6) para 15-64.

105 (1893) 20 R (HL) 108 at 122 per Lord Rutherford Clark.

Lords. It began as non-fraudulent misrepresentation and ended up as induced error,<sup>106</sup> a pattern repeated time and again in the case law of the nineteenth century.

The final destination on the journey from fraud to error is the extended litigation in *Boyd & Forrest v Glasgow & SW Railway Co*, now the leading case on the doctrine of innocent misrepresentation.<sup>107</sup> It was the last attempt to use the principle *culpa lata dolo aequiparatur* to find a remedy for an “innocent” misrepresentation. The Scottish courts accepted the argument that providing inaccurate information in relation to the geology of the ground upon which a railway line was to be constructed amounted to *culpa lata*, which was equivalent to fraud. It is highly significant, as well as historically consistent, that it could still be argued successfully before a Scottish court that the whole of the law of misrepresentation – fraudulent, negligent or innocent – was conceptually located within the doctrine of fraud. The Lord Ordinary (Johnstone) held that the defender was not guilty of “intentional fraud, but I cannot acquit him of such recklessness as *aequiparatur dolo*”.<sup>108</sup> This was affirmed by the Second Division:<sup>109</sup>

This was, in my opinion, a most reckless thing to do; although possibly not done in conscious fraud, yet it was equal to dolo. . . . But, if there is unfair dealing, as I hold there is here, a party cannot take benefit by his own fraud, or reckless conduct *quod aequiparatur dolo*.

However, the decision of the Scottish courts was overturned by the House of Lords relying on the narrow definition of fraud laid down in *Derry v Peek*.<sup>110</sup> Lord Shaw found that the defender’s behaviour was neither fraud nor “equal to fraud”<sup>111</sup> but he did accept that the *culpa lata* principle could have been relevant had relevant facts been established. In the second round of appeals, fraud having been rejected, the Inner House held that although not fraudulent, Mr Melville’s behaviour amounted to essential error induced by innocent misrepresentation. In terms of legal doctrine, fraud had been rejected as had the *culpa lata* principle. The only route left to provide a remedy – which the Scottish courts clearly wanted to do – was to look to the law of error and conceptually to combine unintentional misrepresentation with essential error:<sup>112</sup>

106 Although it should be noted that this was not the *ratio* of the decision. Lord Rutherford Clark held it to be a fraudulent misrepresentation, for it was made recklessly.

107 1911 SC 33, revd 1912 SC (HL) 93; 1914 SC 472, revd 1915 SC (HL) 20.

108 1911 SC 33 at 49 per Lord Johnstone.

109 At 61 per Lord Justice-Clerk Macdonald.

110 1912 SC (HL) 93 at 99 per Lord Atkinson.

111 At 105 per Lord Shaw.

112 1914 SC 472 at 495 per Lord President Dundas.

I consider that the pursuers entered into this contract under essential error, induced by misrepresentation and concealment (though without any fraud).

This is an understandable development. In the history of the case the House of Lords had rejected the notion that innocent misrepresentation could be equated with fraud by an enlargement of the notion of *culpa*. The only remaining option was to situate it somewhere else, removing any suggestion of fault, dishonesty or bad faith and dissociating it from the moral overtones inherent in the word “fraud”. Thus, the historical link between fraud and misrepresentation was severed.

### E. RATIONALISING FRAUD, ERROR AND MISREPRESENTATION

Undoubtedly, the view which emerged at the end of the nineteenth century, namely that unintentional misrepresentation was part of the law of error, presented taxonomical difficulties for those attempting to systematise Scots law in its wake. A renewed examination of error in the 1950s by the Aberdeen scholars, JJ Gow, TB Smith and Peter Stein,<sup>113</sup> was prompted by the pre-War publication of an article which contained the heresy that the English law of mistake and the Scots law of error were “almost interchangeable”.<sup>114</sup> The author suggested that *Stewart’s Trustees v Hart* might be wrongly decided,<sup>115</sup> as it appeared to go against the English rule in *Smith v Hughes*<sup>116</sup> which, he claimed, would be “fully accepted” in Scots law.<sup>117</sup> If that were the case, it would rule out unilateral mistake, including knowledge and taking advantage of another’s mistake, because there was no question of English law granting a remedy for an error in motive.<sup>118</sup> The English law of mistake is a very restrictive category, and it was the implication that the Scots law of error was similarly narrow that prompted the Aberdeen lawyers to react.

Gow and Smith were alert to the independent identity of Scots law and the risk of its being subsumed into the law of a larger and more powerful neighbour. They, therefore, pointed the finger of blame at the influence of English law

113 Stein’s views are quite different from both Gow and Smith and represent a more accurate historical account.

114 F H Lawson, “Error in substantia” (1936) 52 LQR 79 at 99 (drawing on Gloag’s account: see above text accompanying nn 8 and 9 above). For details of the debate see H L MacQueen, “Glory with Gloag or the stake with Stair? T B Smith and the Scots law of contract”, in E Reid and D L Carey Miller (eds), *A Mixed Legal System in Transition: T B Smith and the Progress of Scots Law* (2005) 138 at 150-156.

115 Lawson (n 114) at 102.

116 (1871) LR 6 QB 597.

117 Lawson (n 114) at 102.

118 For a helpful overview of the English law of mistake see J Cartwright, “The rise and fall of mistake in the English law of contract” in Sefton-Green (ed), *Mistake, Fraud and Duties to Inform* (n 12) 65.

for any confusion about the law of error: Gow took a dim view of borrowings from England;<sup>119</sup> and for Smith the confusion was the result of “incautious use of English precedents and references to English legal treatises”.<sup>120</sup> In a flurry of publications they attempted to clarify the Scots law of error by relying on a historical analysis, arguing that since the time of Stair a remedy had been granted for unilateral error and, logically therefore, how much more would the pursuer deserve a remedy if the error was induced.

In essence, both Gow and Smith were arguing for a broader doctrine of error in Scotland, one capable of dealing with innocent misrepresentation. Gow’s view was that “Scots law has, in practice, failed to enlarge the ambit of error *in substantia*, or, if it did, has of recent years restricted it, and also failed consciously to develop what Professor Lawson describes as the equitable relief of innocent misrepresentation.”<sup>121</sup> Gow raised the bigger question whether “Scots law has not fallen between the two stools of Roman error *in substantia* and English equitable fraud”,<sup>122</sup> and proceeded to make the case that historically Scots law accepted a doctrine of error *in substantia* even if the error was unilateral, limited only by proving that the error was *justus et probabilis*.<sup>123</sup> It should be pointed that he cites no Scottish authority for this last proposition, the only footnote citation being to Lee’s *The South African Law of Obligations*,<sup>124</sup> and the only cases cited being ones of fraud or presumptive fraud.<sup>125</sup> Having established that unilateral error is operative, by analogy so is induced unilateral error and in this structure innocent misrepresentation is “merely one of the inductive causes of error”.<sup>126</sup> In fact the “gulf” which existed between the English and Scottish concepts of misrepresentation lay in the fact that in Scots law misrepresentation “enables a pursuer to get into the category of essential error”.<sup>127</sup>

TB Smith is an important part of the story of fraud and error, and, in a sense, he can be seen as the bridge to modern commentary on the law of fraud.<sup>128</sup> Many eminent modern scholars were his students in Edinburgh’s Old College, and his influence as writer and Law Commissioner was considerable. In an early article his interpretation of history was that “in the field of contract fraud

119 J J Gow, “Some observations on error” (1953) 65 JR 221 at 251.

120 T B Smith, “The Common Law cuckoo”, in *Studies Critical and Comparative* (1962) 99.

121 Gow (n 5) at 474.

122 Ibid.

123 Ibid.

124 At 478 n 32. Smith, *Short Commentary* (n 5) 818 and 820 n 64 also cites the same text.

125 Gow (n 5) at 478 n 33.

126 At 479.

127 Gow (n 119) at 243.

128 See further on Smith’s contribution, Reid, *Fraud* (n 3) 212-215.

either inducing contract or creating *error in substantialibus* was recognised by the Institutional writers”;<sup>129</sup> since, therefore, the Institutional writers recognised unilateral *error in substantialibus*, “it followed *a fortiori* that innocent non-fraudulent misrepresentation by one party has always been relevant to explain and establish fundamental *error in substantialibus*”.<sup>130</sup> As discussed above, it is clear that this was not how error was historically conceptualised in Scots law, indeed the expansion of error at the expense of fraud was a battleground throughout the nineteenth century. However, Smith’s writings on error are important in setting the pattern for the modern law. The narrative that the doctrine of error has historically always included induced error has never been seriously questioned since. Smith’s account can be seen as an attempt to make sense of a body of case law that was inconsistent and confusing. Alternatively, for some, adherence to what looked like a Civilian rule was an attractive option for the future of Scots law. However, much of the focus of academic critique has been on the damage done to the law of error by Lord Watson’s redefinition of it in *Stewart v Kennedy* and *Menzies v Menzies*. The damage done to the law of fraud in the process has gone largely unnoticed.

## F. CHOOSING BETWEEN FRAUD AND ERROR

To some extent the choice between fraud and error as the legal response to unintentional misstatements is one of policy, although that choice ought to be made from a well-informed position. It might be argued that so long as a legal remedy is provided it matters little where that remedy is structurally located. On the other hand, the modern law of error—still unsettled and confusing—is testament to the view that it may matter from the perspective of understanding and developing the law in a coherent and predictable way. It could also be argued that the law of error is unsuited as a vehicle for developing rules and limitations for the morally complex circumstances engendered by conduct which the law regards as unconscionable or, in Scottish parlance, unwarrantable. Error solves problems by looking at issues of consent; fraud is essentially about making distinctions between behaviour which is culpable or non-culpable. Error, therefore, concerns itself with the consent of the deceived; fraud with the behaviour of the deceiver. Error does not—or should not—concern itself with

129 T B Smith, “Error in the Scottish law of contract” (1955) 71 LQR 507 at 511.

130 At 511-512. In the same article he recognises that in the early 19<sup>th</sup> century unintentional misrepresentation was sometimes decided on grounds of what he calls “quasi-fraud” (510), which would appear to contradict the assertion that it had always been part of the law of error. The cases cited are all cases of presumptive fraud or unintentional misrepresentation (510 n 12).

questions of fault; hence the reason why traditionally the limiting criteria in the law of error concern the type of error (whether it is *in substantia*), rather than how it was caused.<sup>131</sup> Fraud, on the other hand, is quintessentially about fault and the rules of fraud—intentional or presumptive—are honed to make fine distinctions about whether or not the behaviour of the defender deserves sanction.

Hence, in the law of fraud subjective motive is important, whether intentional, negligent or “innocent”; if the latter, then the test of honest belief, and the reasonableness of the grounds for that belief, can be scrutinised (even if modern courts appear to reject the opportunity to do so). The matrix of liability could also include questions of whether or not there was gross inequality in the terms of the bargain (the most obvious example being whether or not the transaction in question was gratuitous); whether or not both parties stood on equal terms and had equal access to legal advice; and whether there was a relationship of confidence; all historically familiar categories from the old law of presumptive fraud. But error, in theory, does not concern motive. And nor should it, because in its essence error is a category of strict liability; it is about “no fault”. The attempt to transform it into an over-arching category which encompasses all forms of unintentional misrepresentation, without regard to motive or culpability, is therefore flawed.

Perhaps the most compelling reason to regret the fact that error has become the repository for unintentional misrepresentations is a structural one. *Dempster v Raes*<sup>132</sup> was an action to reduce an agreement entered in by legatees on grounds that their consent had been obtained by fraudulent misrepresentation and concealment to their great prejudice. There was also a separate issue of induced essential error. One of the defender’s arguments was that there was no duty to disclose, hence no relevant issue of concealment. Lord Justice-Clerk Moncreiff held that “[i]f the party who is to lose is in ignorance, and the party who is to gain is well-informed, it is a case of the grossest fraud”.<sup>133</sup> This is particularly so in the context of succession, but there are clear echoes of earlier presumptive fraud criteria, namely the relationship of the parties, and the inequality in their knowledge. Indeed, Lord Moncreiff foreshadows his later judgment in *Steuart’s Trustees v Hart*<sup>134</sup> when he comments in *Dempster* that “the pursuers were ignorant, and known to be ignorant by the defenders, who took advantage of this to make a most unfair bargain. It is not so much any specific error that is alleged

131 MacLeod (n 34) at 399-401.

132 (1873) 11 M 843.

133 At 846.

134 (1875) 3 R 192.

as general ignorance.”<sup>135</sup> Three of the judges in *Dempster*<sup>136</sup> took the view that there was no need for an issue of error induced by misrepresentation, only one of fraud.<sup>137</sup> Lord Benholme objected to the issue of induced error on the grounds that the *onus* is quite different depending on whether error or fraud is argued.<sup>138</sup>

My objection to the second issue is that there is no sufficient statement of essential error on record. Besides, if the issue were allowed without the word “fraudulent” it would change very much the nature of the *onus*. Now, in this case the *onus* ought to be as heavy on the pursuers as is implied in the word “fraudulent”.

Fraud has a stable set of criteria for its application, consistent over centuries, which apply to all forms of fraud, including misrepresentation. The misstatement must be material, the pursuer must have relied on it to his detriment, and there must be a causative link between the conduct and the loss caused.<sup>139</sup> However, if the focus of the enquiry is on the consent of the pursuer, the limiting criteria are whether or not the error was “essential” using Bell’s five categories, and the quality of the party’s consent. It is not necessary to investigate the misrepresentor’s honesty or good faith or whether or not there were reasonable grounds for his belief that his statement was true.<sup>140</sup> Arguably, Lord Watson’s ostensible redefinition of essential error in *Menzies v Menzies*,<sup>141</sup> which has attracted the criticism of almost all academic commentators, was simply an attempt to grapple with the impossible task of marrying the criteria of fraud with the content of error by preserving a test of causation from the former (the “but for” test) and lowering the standard from “essential” to “material” in the latter.

If the issue is one of error rather than fraud, it changes not only the *onus*, but the whole structure of the legal argument. Framing the issue in terms of the law of error is to make the taxonomic mistake of starting with the result rather than the causative event. It is axiomatic that fraud causes error, for it is in the very nature of deceit or imposition. But to start with the outcome rather than the behaviour causing the error puts the cart before the horse.

The argument that fraud should stand on the ground occupied for at least the last century by the notion of induced error has consequences for the settled understanding of the law of error in general. It would mean limiting error to the cases where (1) the parties share the error without it having been induced by

135 (1873) 11 M 843 at 847.

136 Lord Cowan accepts as relevant an issue of essential error induced by misrepresentation (at 847).

137 *Ibid.*

138 *Ibid.*

139 Clearly restated in *Ritchie v Glass* 1936 SLT 59.

140 *Boyd & Forrest v Glasgow & SW Railway Co* 1914 SC 472 at 494 per Lord Dundas.

141 (1893) 20 R (HL) 108 at 142.

a representation made by one of them;<sup>142</sup> (2) there is mutual error in that the parties have different understandings of a term in their contract which the court is unable to decide between using the normal interpretative criteria;<sup>143</sup> and (3) the uninduced unilateral error. In the last of these, as has already been discussed,<sup>144</sup> a wide understanding of fraud might reach the case where one party realises that the other is contracting under error and takes unfair advantage of the situation. That would be a better means of assessing the overall equities which would help clarify why, in Glog's famous example, the second-hand bookseller is unable to reduce the contract of sale with the buyer who realises that the seller's price is, as the result of ignorance, well below the true value of the item sold.<sup>145</sup> The bookseller is operating in a notoriously risky marketplace, and there is no basis in the buyer's conduct for challenging the validity or fairness of the transaction. On the other hand, the buyer of "fishings on the River Ayr" who knows that the seller intends to sell only the river fishings but thinks that the contract term is apt to cover the sea as well as the river fishings is someone who is attempting to snatch a bargain by unfair means if he remains silent about his different understanding during the process of negotiation.<sup>146</sup> Cases of this kind are probably at the edges where fraud and error meet, however, and do not fit entirely comfortably with either. The determining factor should be whether the contract is reduced because of the *error* (for instance, if an error as to price is an essential error) or because of the defender's *fault*, in which case it is more suited to the law of fraud.

Returning to where we began, with the problem in *Morrisson* and *MacLeod*, under the suggested analysis both would be cases of fraud rather than error. Of course, had only two parties been involved in these cases it would make little difference whether the transaction was invalid because of fraud or error; the actual purchaser would be liable either to make restitution if possible or, if not, pay the price and, perhaps, seek damages; or, if there never had been a contract, pay the value of what was received and could not be returned. However, for third parties the difference between voidability and voidness appears crucial and there is a strong policy argument that, at least in cases of identity fraud, or

142 See for a difficult recent example *McLaughlin v Thenuw Housing Association Ltd* 2008 SLT (Sh Ct) 137.

143 The classic examples are *Raffles v Wichelhaus* (1864) 2 H & C 906; *Stuart & Co v Kennedy* (1885) 13 R 221.

144 See text accompanying nn 86-107 above.

145 Glog, *Contract*, 2<sup>nd</sup> edn (n 8) 438.

146 *Angus v Bryden* 1992 SLT 884. As in this case, the court may also decide to uphold the contract in the sense in which a party made clear it understood the term in question without the other party making objection to that: see *Houldsworth v Gordon-Cumming* 1910 SC (HL) 49.

identity theft, protection of ownership has greater weight than the currency of moveables.<sup>147</sup>

TB Smith argued that *Morrisson* should have been recognised as a case of theft.<sup>148</sup> The action was for delivery of the cows from the third party on grounds of theft or alternatively essential error. There was no contract of sale because the owner's intention was to transfer the property on credit to someone else entirely, giving only possession or custody to the rogue, who was later convicted of theft. Using a theft analysis, the third party could not retain the property because of the operation of a *vitium reale* operating on the transfer of property. Smith was in effect arguing for a property law analysis of *Morrisson* based on an "abstract" theory of transfer whereby the agreement between buyer and seller (the underlying contract) is a separate question from the owner's consent to transfer (the conveyance).<sup>149</sup>

The test is whether, according to the doctrine of *justa causa traditionis*, the transferor intended to pass ownership to the person who took delivery; it is not whether the contract which may have underlain delivery was valid.

Although this theft analysis of *Morrisson* was explicitly rejected by the First Division in *MacLeod v Kerr*,<sup>150</sup> it appears to have been accepted by subsequent commentators.<sup>151</sup> So far as the underlying contract is concerned, however, Smith's view of *MacLeod* was that the contract in that case was correctly reduced for fraud (despite the rogue's conviction for theft which, as Smith also noted, raised the interesting question "as to how far the Civil Courts should take cognisance of the proceedings of the criminal courts in deciding when a *vitium reale* attaches to

147 Legal and policy issues are fully canvassed by a divided House of Lords in the context of English law in *Shogun Finance Ltd v Hudson* [2004] 1 AC 919.

148 Smith, *Short Commentary* (n 5) 816-817.

149 Smith, *Short Commentary* (n 5) 539; Gordon points out that no Scottish authority is cited in this passage (W M Gordon, *Studies in the Transfer of Property by Traditio* (1970) 216 n 2). It is, however, arguable that the decisions in both *Morrisson* and *Macleod* support a causal rather than an abstract theory of transfer. For the view that the abstract theory is neither supported by authority nor necessary see McBryde, *Contract* (n 6) paras 13-06-13-10. For discussion of abstract systems of transfer (to be distinguished from causal ones wherein contract and conveyance stand or fall together) see K G C Reid, *The Law of Property in Scotland* (1996) para 608; D L Carey Miller with D Irvine, *Corporeal Moveables in Scots Law*, 2<sup>nd</sup> edn (2005) paras 8.06-8.11.

150 1965 SC 253 at 256 per Lord President Clyde.

151 G H Gordon, *The Criminal Law of Scotland*, 3<sup>rd</sup> edn by M G A Christie (2001) vol 2 para 14.39; Reid, *Property* (n 149) para 617 (authored by W M Gordon) says of *Morrisson* "the transferee was also dishonest and his conduct would seem to amount to theft", citing as authority T B Smith, *Property Problems in Sale* (1978) 170-172 and *Corporeal Moveables: Protection of the Onerous Bona Fide Acquirer of Another's Property* (Scot Law Com Consultative Memorandum no 27, 1976) para 19. Smith was a Law Commissioner at the time, and his influence on the output of the Scottish Law Commission is evident, see Reid, *Property* (n 149) para 609 n 5.

stolen property”<sup>152</sup>). He took the view that *Morrisson* was not a case of error as to the identity of the other contracting party because the rogue only ever said that he was that person’s agent. The rogue was however a fraudulent person, practising a machination or contrivance to deceive the would-be seller. While Smith preferred not to use the language of void and voidable, it seems clear that he thought there never was a contract in *Morrisson*, not as a result of error, but because the fraud lay in pretending to be someone else’s agent. The supposed principal could not be bound by the rogue’s unauthorised activity, while the person who purported to act as agent knowing he had no authority to do so did not become a party to any contract (although liable for damages in fraud).<sup>153</sup> Thus the “seller” was bound to nobody, but had a delictual claim against the rogue. In other words, the situation in law as between these two parties was indeed one of fraud rather than error, but in the former’s obediencial character rather than as a vice of consent.

We have described this article as a thought experiment. It is too late to unwind completely (at least in the courts) the development of the law on fraud and error in contract over the last 150 years. But the experiment may show ways in which some continuing uncertainties could be better approached in future, such as the application of *Stewart’s Trustees v Hart* or the problem of identity theft. It may also show that there is indeed extensive authority for the proposition that, while it may not impose requirements of good faith, Scots contract law does set its face against various forms of bad faith. An understanding of how we got to where we are should help us stay on the path in future.

152 T B Smith, “Error and transfer of title” (1967) 12 JLSS 206 at 209; see also Smith, *Property Problems* (n 152) 172.

153 See Gloag and Henderson, *The Law of Scotland* (n 10) paras 18.19 and 18.26; L J Macgregor, “Agency and mandate” in *The Laws of Scotland: Stair Memorial Encyclopaedia, Reissue* (2002) paras 60 and 165-167.