CONTRACTUAL LEGISLATION AND COMPANY LAW

BY J. N. FINN, M.A., LL.B.(HONS) (*Cantuar*)
Lecturer in Law, University of Canterbury

INTRODUCTION

In recent years the common law of contract has been greatly altered by the provisions of the Illegal Contracts Act 1970, the Contractual Mistakes Act 1977 and the Contractual Remedies Act 1979. Each of these statutes was based on a report of the Contracts and Commercial Law Reform Committee and each was conceived as a purely contractual reform. Yet the law of contract does not exist in vacuo. Many contracts impinge upon other fields of law. It is a common feature of each of the Reports of the Committee that the effect of the contractual reform on such other areas of law is not considered.[1] This is the more curious since before completion of the reports upon which the Contractual Mistakes Act and the Contractual Remedies Act were based the applicability of the earlier Illegal Contracts Act in the company law area had already been canvassed.[2] The purpose of this article is to consider the possible application of the Contractual Mistakes Act and the Contractual Remedies Act to various areas of company law.

THE CONTRACTUAL STATUTES

(1) *The Contractual Mistakes Act 1977*

The Contractual Mistakes Act was designed to replace the common law relating to mistake. It is a code, and thus completely replaces the old rules except those areas exempted in s.5(2) of the Act. These include rectification, non est factum, and "misrepresentation, whether fraudulent or innocent".[3] Relief is to be given only where the party seeking relief can bring himself within the criteria laid down in s.6(1). Firstly he must show that he was mistaken as to a material matter, and that this mistake was known to the other party to the contract, or that all the parties to the contract were influenced by the same mistake, or that at least two parties to the contract (being parties with dissimilar interests under it), were influenced by different mistakes as to the same matter. Then he must show that the mistake caused a substantially unequal exchange of values or the conferment of a benefit or imposition of an obligation disproportionate to the consideration therefor. Lastly he must show that if there is any term in the contract which obliges one party to take the risk of a mistake, that

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[1] The Report on Misrepresentation and Breach does cite certain company law cases, e.g. on its discussion of the bars to rescission at p.60, but no consideration is given to specific rules of company law. The Report on Privity of Contract does consider the wider application of the proposed reform, but the draft Bill appears, in part, to run counter to the view taken in the report itself.

[2] See the discussion by Mahon J in *Coleman* v *Myers* [1977] 2 NZLR 225, 287 of the possible validation of a contract rendered illegal by s.62 of the Companies Act 1955.

[3] C.M.A. s.5(2)(c).

he is not that party. (It must be borne in mind that the actual application for relief need not come from the party making the mistake, it may be made by a party claiming through him, or by any other person for whom it is material to know if relief would be granted.[4]) Once the grounds for relief are established, the court has a very wide range of possible remedies (set out in s.7, though limited as against third parties by s.8). These remedies are not, however, supposed to be exercised "in such a way as to prejudice the general security of contractual relationships."[5]

A key provision, and one which may greatly increase the applicability of the Contractual Mistakes Act to company law, is the definition of mistake. The Act broadens the field of mistake to include mistake of law as well as mistake of fact. A mistake in the interpretation of a document is generally to be a mistake of law.[6] Certainly the only purpose of the reformers was to get away from the difficulties found at common law in deciding whether a case was one of mistake of fact or of law, but it is clear that the possible ambit of the Act has been greatly widened by the inclusion of mistake of law.

The second key provision in the statute is that of s.2(3)—that there is a contract for the purposes of the Act "where a contract would have come into existence but for circumstances of the kind described in s.6(1)(a) of this Act". This cannot mean that the Act only applies where the mistake would at common law have rendered the contract void, because clearly the Act covers cases where the contract would have been voidable in equity as well. Thus some other meaning must be found, and it is submitted that the provision covers the situation where there would have been a contract if the position had been as the mistaken party or parties believed it to be. Provided the error has had the effect of putting one party at a disadvantage, the Act may give relief. If this interpretation is correct, it widens the applicability of the Act, because there are many situations where an error of law by the parties will prevent them from forming the contract they thought they had made.

The third provision of the Act which is critical to its application to the company law field is s.4(2). This makes it clear that the provisions of the Act are supplementary to other remedies for things other than mistakes, but goes on to say that the new remedies "are not to be exercised in such a way as to prejudice the general security of contractual relationships." That provision was inserted by the Statutes Revision Committee of Parliament, apparently to allay the fears of some sectors of the commercial world that this Act would provide an easy escape route for persons wishing to escape from contracts which had ceased to be as profitable as expected. The criteria for mistake alone render the provision almost superfluous, but it may check the willingness of the courts to use the Act in fields outside the traditional contract law area. It is however, suggested that in many cases to give relief under the Mistakes Act will be to *increase* commercial certainty, in that the current rules of company law often disappoint the expectations of one or both parties at the time of making the agreement later impeached.

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[4] C.M.A. s.7(4).

[5] C.M.A. s.4(2).

[6] C.M.A. s.2(2).

(2) *The Contractual Remedies Act 1979*

This measure makes two major changes to the law relating to misrepresentation, repudiation and breach of contract. The first is that any misrepresentation, be it fraudulent, negligent or innocent, gives rise to an action for damages. Damages are to be assessed as if the representation were a term of the contract that has been broken.[7] The second is the substitution of a new procedure called "cancellation" for rescission and discharge for breach. Cancellation of a contract freezes the parties' position as at the time of cancellation, excusing further performance but not requiring the return of any property or money transferred pursuant to the contract. However, cancellation may be complemented by an action for damages for breach or misrepresentation so that cancellation does not determine the position of the parties.[8] The grounds for cancellation are set out in s.7 of the Act. Repudiation of all or part of the contract entitles the other party to cancel at any time. Misrepresentation will entitle cancellation if the parties have impliedly or expressly agreed that the truth of the representation is essential to the cancelling party or its falseness substantially reduces his benefits or increases his burdens under the contract. A breach entitling cancellation must also be as to a matter agreed to be essential or where non-performance substantially weakens the cancelling party's position. However, cancellation may be available where the breach is still in the future, if it is obvious that it will occur.

Under the Act, the court may make orders for compensation to be paid to any party to a cancelled contract, or for property to be transferred from one party to another. Where damages have been awarded for breach or misrepresentation, the amount to be awarded must be reduced by the amount of any compensation awarded to the person recovering damages. Thus there is a discretionary remedy available which is in addition to damages, and may be used where damages do not lie. If damages are available, however, the injured party is entitled to them. Thus the Contractual Remedies Act differs from the Contractual Mistakes Act in that the remedies available are not totally discretionary.

There is one major difference between the applicability of this Act and that of the Contractual Mistakes Act. The Contractual Remedies Act is not a code, and it may be expressly contracted out of by providing for other remedies in the contract itself,[9] or it may be made inapplicable by other statutes. There are a number of specific statutes exempted from the ambit of the Act, and s.15(h) provides that nothing in the Act shall affect "any other enactment so far as it prescribes or governs terms of contracts or remedies available in respect of contracts, or governs the enforcement of contracts". This last provision is of considerable importance in terms of the company law, as there are some fields where there are specific statutory rules which may override the provisions of the Contractual Remedies Act.

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[7] C.R.A. s.6(1).

[8] C.R.A. s.8.

[9] C.R.A. s.5.

The Relationships between the Statutes

The Contractual Mistakes Act is expressed not to affect the law relating to misrepresentation[10] and the Contractual Remedies Act is expressed not to affect the law relating to mistake.[11] Thus it would seem that neither statute excludes the other, and therefore where appropriate relief may be sought under either or both acts. As Dawson and MacLauchlan point out[12] every misrepresentation, if believed, gives rise to a mistake—thus a deliberate misrepresentation by one party may lead to a mistake coming within s.6(1)(a)(i) of the Contractual Mistakes Act, and an innocent misrepresentation bring a situation covered by s.6(1)(a)(ii) of that Act. It must be said that not all mistake cases will arise from a misrepresentation, in that the erroneous views of the parties may have arisen otherwise than from statements by the parties to the contract.

Dawson and MacLauchlan conclude that in some cases relief should be sought in the alternative under each statute, but in the cases where the actionable misrepresentation is clear "there is probably little to be gained from pursuing a remedy for mistake".[13]

It may well be that the case for reliance on the Contractual Remedies Act where possible is stronger than this would indicate. The critical difference between the Acts is that relief, whether it be compensation, setting aside or other relief under the Contractual Mistakes Act is entirely discretionary. Thus even though a person may have fulfilled the pre-conditions for relief under that Act, the court may deny relief either on the merits or in pursuance of the statutory directive in s.4(2). Under the Contractual Remedies Act cancellation and/or damages may be available as a matter of right. This of course carries with it the advantage that the injured party may terminate of his own volition, rather than having to wait for a court to decide to exercise its discretion in his favour.

It is curious that the relief provided by the two Acts should be differentiated in this way, in that there are some circumstances where the same fact situation would merit relief under either Act. If A has been induced to enter the contract by a misrepresentation, and the falsity of the misrepresentation substantially reduces the value of his bagain, he would appear to be able to cancel under the Contractual Remedies Act, and to seek the discretionary relief under the Contractual Mistakes Act. It would be easier to rely solely on the former where the loss of value is clearly established.

There will of course be cases where the Contractual Mistakes Act can be prayed in aid but not the Contractual Remedies Act. Where one or both parties is acting under a misapprehension as to the true facts, and the misapprehension has not arisen from the statements of the parties or their agents, there may be a mistake which would entitle relief. In these cases the applicant for relief will still have to show that there has resulted serious inequality of value of some kind.

In other cases, where the parties have expressly or impliedly agreed that a particular matter is essential, there is a right to cancel for misrepresenta-

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[10] C.M.A. s.5(2)(c).

[11] C.R.A. s.5(b)

[12] "The Contractual Remedies Act 1979", Sweet and Maxwell (NZ) Ltd, 1981, p.200.

[13] Loc.cit.

tion, though there may not always be relief available under the Contractual Mistakes Act. It is not difficult to conceive of cases where although the parties are mistaken as to a matter essential to them, there is no substantial inequality of value where value is objectively measured. If A has stipulated that he will lend money to B Co., only if the company is active in a particular area, the stipulation as to its activities may be an essential matter to him, but it may well not affect the security provided for the loan. If the company is not in fact active in this area, there may be a right to cancel under the Contractual Remedies Act, but there would be no relief for mistake.

Thus it would seem that although the Contractual Remedies Act and the Contractual Mistakes Act may well both apply to many fact situations, where the Contractual Remedies Act does apply it will never be less favourable to an injured party, and will often be more favourable.

The Statutes and Company Law

It is now intended to look at certain selected areas of company law where either or both of these statutes may apply in place of, or in conjunction with, the existing law. It is suggested that in many cases the results of the application of these statutes will yield results not foreseen by the Law Reform Committee, and which clearly indicate a need for a review of the contractual statutes.

(1) *Pre-Incorporation Contracts*

The general position here is that any contract made by a person claiming to act on behalf of a company to be formed will be ineffective. If the contract discloses an intention by the "agent" to be personally liable, then the contract is binding upon him. The company is never bound.[14] Yet the cases disclose a number of situations in which these pre-incorporation contracts occur, and in some cases, at least, the new statutes may provide relief.[15]

The first situation is where the parties have accurately described their position. A is contracting as "agent" or "trustee" for a company to be formed, and the other party is aware of this. Clearly there is no misrepresentation, and A cannot be liable for breach of warranty of authority, because he has not claimed full authority. If he represents that the pre-incorporation agreement will be binding, the representation is one of law,

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[14] See such cases as *Kelner* v *Baxter* (1866) LR 2 CP 174. *Newborne* v *Sensolid (Great Britain) Ltd* [1954] 1 QB 45.

[15] If the draft Bill proposed by the Contracts and Commercial Law Reform Committee in their Report on Privity of Contract and currently before Parliament is enacted without significant change, a contract between two parties which confers a benefit on a third party whether or not in existence will give that party a right to enforce the benefit. This would clearly allow the company a right to enforce contracts made with its promoters prior to incorporation. Where the company does attempt to enforce the benefit, the promisor of the benefit has available any defences which he would have had against the other contracting party. That the draft bill should have potential application to pre-incorporation contracts is surprising, as the Report, p.12, makes it clear that the Committee thought this area of the law was outside the scope of their brief.

and is almost certainly not covered by the Contractual Remedies Act. However, if such a representation was made with knowledge of its falsity, it would come within s.6(1)(a)(i) of the Contractual Mistakes Act, or if made without such knowledge, the position would come within s.6(1)-(a)(ii). An independently formed erroneous opinion on each side would lead again to the latter result. (It is not absolutely clear how the error arose in *Official Assignee of Motion* v *New Zealand Sero-Vaccines Ltd*[16] but it appears to have been induced innocently by one of the agents for the company.) The question will then be whether in such circumstances a substantial inequality of value or consideration can be found so as to entitle either party to seek relief under the Act. Here there are difficulties entailed in the terminology usually applied. Since the general law holds a pre-incorporation contract to be void, there are no binding obligations, and since neither side is bound, there is no inequality. Under the Contractual Mistakes Act, however, the question, where there is an arrangement that would have been a contract but for the mistake, is whether the mistake resulted in what would have been an unequal exchange if the contract were otherwise valid. Where a person has supplied chattels or goods which are to be used for the purposes of the company to be formed, and relies for payment upon a belief that he may recover validly from the company, he may be able to claim that s.6(1)(b)(ii) of the Contractual Mistakes Act applies—in that he has conferred a benefit upon the other party which is substantially disproportionate to the consideration therefore. He has executed his part of the bargain, and is relying on an unenforceable promise that the company, when incorporated, will carry out its side of the arrangement. The advantage to the applicant in relying on the Contractual Mistakes Act, rather than the possible alternative of an action for a quantum meruit or quantum valebant[17] is that, in appropriate cases he might recover at least some of the profit available. In other cases, the consideration actually provided by the contractor might be such that no quantum meruit action would be available—as where A contracts with a company to be formed that he will cease to carry on an existing business which would be in competition with the company to be formed. If he has carried out his bargain, and closed his business, he has suffered a detriment which would not appear to be recoverable under any other action than one for relief under the Contractual Mistakes Act. If the agreement were declared valid, the expectations of the parties would be fulfilled. Holding parties to a bargain they thought they had made can hardly be described as threatening the security of contractual relationships. The discretionary nature of the remedy would allow the court to refuse relief or vary the terms of the agreement if the original agreement was unfair to the company. As the law stands at present, the remedies of the contractor with an unincorporated company are extremely limited. Even a discretionary (and therefore uncertain) remedy under the Contractual Mistakes Act would be an improvement.

The second situation is where the one or both of the parties acts on the mistaken belief that the company has already been incorporated. This belief may arise in several different ways, and different remedies may

[16] [1935] NZLR 856, [1935] GLR 712.

[17] See *Re Empress Engineering Co.* (1880) 16 Ch.D 125.

apply in the different cases. The first and simplest possibility is where, as in *Wickberg* v *Shatsky*,[18] there is a deliberate misrepresentation by the person allegedly acting as the company's agent. In that case the plaintiff signed a contract of employment with a firm described in the contract as a limited liability company, and signed by the defendant as "President" of the company. The defendant knew that the firm was not incorporated. Dryer J held that there was no intention that the defendant be personally bound by the contract, and so no contractual remedy was available to the plaintiff. An action for breach of warranty of authority succeeded, but in this case the damages were purely nominal. Although the defendant had no authority to make such a contract, the plaintiff's loss by the termination of his employment was not due to the breach but to the insolvency of the firm. It is interesting that no tortious remedy for negligent misstatement or deceit was sought against the defendant.

It would appear that in a similar situation in New Zealand, the aggrieved party would have a number of options. If he elects to proceed against the "agent" he would have actions for breach of warranty of authority, but as *Wickberg's* case shows, he may have difficulty in showing that the breach was the real cause of his losses. A deceit action certainly would lie, but although loss of profit may be recovered in deceit,[19] it may be that the agent is not worth suing. Certainly at common law, there could be no recourse against the company. The Contractual Remedies Act is of no application, because there is no contract with either the agent or the company. If any relief against the company is to be sought, it must come through the Contractual Mistakes Act. Here there is a position where if the circumstances had been as the deceived person believed them to be there would have been a contract.

Where the parties are acting in good faith, but erroneously believe that the company has been incorporated, there is clearly a common mistake of fact. There will have been misrepresentation by the persons holding themselves out to be directors or agents of the company, simply by their description of themselves as such. But, again, there was no contract induced by the misrepresentation. Deceit will not lie for the statement if made in good faith, and the problems of causation may discourage reliance on the action for breach of warranty of authority.[19a] However, there is again a position where if the situation had been as the parties envisaged it, there would have been a contract. On that basis relief ought to be available under the Contractual Mistakes Act. However the mistake as to incorporation arose, the applicant would have to establish an inequality of value, but there may be cases where this can be done. The facts of *Hawkes Bay Milk Corporation* v *Watson*[20] may serve as an example. The plaintiff supplied large quantities of yoghurt to Endeavour Suppliers, believing, as did

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[18] (1969) 4 DLR 744.

[19] See *Jewson & Son* v *Arcos Ltd* (1933) 47 Ll.Rep. 93, *Kitchen* v *Fordham* [1955] 2 Ll. Rep. 705 and *Hornal* v *Neuburger Products Ltd* [1957] 1 QB 247.

[19a] A claim for damages for breach of warranty of authority against the "agent" of an unincorporated "company" was upheld in the recent case of *Lomax* v *Dankel* (1982) 29 SASR 68.

[20] [1974] 1 NZLR 236.

the agents of that "company", that it had been incorporated. The company was later incorporated, but went into liquidation. If the company had not gone into liquidation, but had refused to pay for the yoghurt supplied (and apparently resold) prior to incorporation, no action in contract would have lain. The only remedy open to the supplier would have been for a quantum meruit, and that might not be regarded as sufficient—in that he would not recoup his loss of profit, but merely his direct costs. It might also be the case that a person makes a long-term contract with what he believes to be an incorporated company for the exclusive supply of a certain product. If he expends time and money on adapting his business to enable him to perform that contract, and it is later disavowed by the company after it has been incorporated, (or even after they have accepted his goods for a short period) he has no recourse under the existing company law for his costs. Yet there might well be a sufficient inequality of value in such circumstances to satisfy a court that relief ought to be given under the Contractual Mistakes Act. The real argument against the extension of the Contractual Mistakes Act to this area is that it will necessarily involve a form of lifting the corporate veil. To investigate the merits of the action, and the relative equities in the dispute, the courts will have to look at the position within the company of the persons who had acted for it prior to its incorporation. If they are in reality the controllers of the company, it seems that the objections to binding the company to observe the bargains they had sought to make should be much diminished. In the case of fraudulent misrepresentation by an "agent" who is in fact a controlling figure of the company when incorporated (as was the defendant in *Wickberg* v *Shatsky*) the element of fraud alone should encourage the court to disregard the alleged separation of identities. In almost all the other reported cases on pre-incorporation contracts it appears that those "contracting" for it prior to incorporation have in fact taken office in it as directors. The reality of the cases is then that the directors have sought to avoid, by the operation of the legal rule making the contracts invalid, the consequences of the bargain they sought earlier to make. As Windeyer J said in *Black* v *Smallwood*, this does not accord well with a belief that bargains should be kept.[21] Where the company after incorporation cannot be so identified with the promoters or the "agents" or "directors", the court would be unlikely to give relief to the aggrieved party against the company, and would be likely to leave him to pursue his remedies against the "agent".

(2) *Contracts Ultra vires the powers of the Company*

Contracts made by a company which are outside the objects of the company are void and therefore unenforceable by either party.[22]

Such contracts may be ultra vires in three ways. They may be concerned with matters that the company can never validly involve itself in: they may involve the company in some transaction beyond a limitation in the

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[21] (1965-6) 39 ALJR 405, 408.

[22] The rule has its origins in *Ashbury Railway Carriage & Iron Co. Ltd* v *Riche* (1857) LR HL 653.

memorandum on its involvement; or they may be concerned with something the company has a power to do, if for a purpose stated in the memorandum, but the power is being exercised for a purpose not so stated. Of these only the first and last are of real importance. The second category is unlikely to arise except in the context of a lending transaction, and s.34(3) of the Companies Act protects such loans unless there has been express notice of the breach of the limitation in the memorandum or articles. Within the other two categories there are a number of possible ways in which the parties can have conducted their dealings. In some of them relief may be available under the Contractual Mistakes Act. Because an ultra vires contract is void, the Contractual Remedies Act can have no application, and misrepresentations as to the company's ability to undertake the enterprise in question have not resulted in a contract. Even if such void contracts were covered, such a representation would be one of law, and it seems most unlikely that the Contractual Remedies Act could cover representations of law. It must be noted that the action for breach of warranty of authority may lie against the persons acting for the company, and in this situation there may be fewer difficulties in proving that the lack of authority was the cause of the would-be outside contractor's loss.

However, where both parties have actually turned their minds to the question of what the capacity of the company is, but are in error, there is a possibility of mistake. This situation may well be very rare, in that it seems few people in dealing with a company do actually consider what the capacity of the company is. In an exceptional case though, the matter is considered important by the parties (as it was in *Christchurch City Corporation* v *Flamingo Coffee Lounge Ltd*[23]). If the parties erroneously conclude that the company does have capacity to enter the contract, then there has been a mistake in the interpretation of a document (the relevant company memorandum and articles)—and that is a mistake of law. If the situation had been as the parties had believed it to be there would be a contract. In such circumstances, it may be more just to allow a remedy under the Contractual Mistakes Act than to leave the outside contractor to pursue the rather uncertain restitutionary and equitable remedies that may be available. The argument for the granting of a remedy is stronger where the company's officers know that the transaction is ultra vires and are taking advantage of the outside contractor's error in interpretation. The requirement of inequality of value may be satisfied where the outside contractor has rendered services or supplied perishable or consumable goods and not received a return.[24] The advantage of the Contractual Mistakes Act over any restitutionary or quasi-contractual remedy is that under the Act he may be allowed to recover damages for loss of profit as well as the cost of the goods or services. Equally, the company may be the loser by the contract being ultra vires. There seems no reason why the company could not seek a remedy under the Act, in such circumstances as are outlined above.

The position is more difficult where the company is acting for a purpose which is ultra vires, but under a power which would be valid if the pur-

[23] [1959] NZLR 986.

[24] Some of the instances of inequality of value discussed in relation to pre-incorporation contracts might also, mutatis mutandis, be applicable here also.

pose was intra vires. Here the courts have held that the contract is only unenforceable by an outside contractor if he knew of the actual purpose of the company.[25] If the contract is void, the Contractual Remedies Act has no application, but if it is not, it seems that it can add little to the rights of the outside contractor. In some situations the Contractual Mistakes Act might be applicable. The first possibility is where the parties have both considered the nature of the power and have erroneously concluded that it could be validly exercised for the purpose intended. This would be a mistake of law and the position ought to be similar to that discussed above. Where neither party or only one of the parties has considered the issue, the position is more complicated. The outside contractor is fixed with constructive knowledge of the objects of the company, although he will only rarely have actual knowledge of them. Is acting inconsistently with the constructive knowledge one is held to have sufficient to establish a mistake? It is submitted that the courts are unlikely to find this sufficient.[26] If that is the case, then the outside contractor can only claim a mistake where he has actually turned his mind to the question of whether the company had the capacity to enter the contract. The company, on the other hand, surely had actual knowledge of its own capacity. Thus purporting to act inconsistently with its own capacity may be evidence of a mistake. If there can be established a common mistake, or a case where the outside contractor attempts to take advantage of the company's errors, the company ought to be able to seek relief under the Contractual Mistakes Act.

(3) *Contracts intra vires the company but defectively made*

A contract which is made on behalf of the company and is intra vires may be open to attack in a number of ways. The first possibility is that although the officers of the company have the power to make the contract if they are acting for a proper purpose, the officers have in fact acted for other, improper, purposes. The second is where the company has the power to make the contract, but the officers in making it have exceeded their powers or were purporting to exercise the powers of an office within the company to which they were not validly appointed. The third is where the contract purportedly created is in a document not properly executed and therefore not binding.

The general position in the first case is that a person unaware of the improper purpose of the directors is entitled to rely on the contract. If the outside contractor does know of the improper purpose, then he cannot enforce. It seems from a dictum of Pennycuick J in the *Charterbridge Corporation*[27] case that the outside contractor must not only know of the purpose, but know of its impropriety. In these circumstances there seems

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[25] See *Re David Payne & Co Ltd* [1904] 2 Ch. 608, *Charterbridge Corporation Ltd* v *Lloyds Bank Ltd* [1970] Ch. 62 and *Hill* v *Manchester Salford Water Works Co.* (1831) 2 B & A. 544.

[26] The doctrine of constructive notice was laid down in *Mahoney* v *East Holyford Mining Co. Ltd* [1875] LR 7 HL 869. As to constructive notice and mistake, it is submitted that the courts will require actual advertence to the issue about which the alleged mistake occurred, see the views of Somers J in *Moot* v *Crown Crystal Glass Ltd* [1976] 2 NZLR 268, 275 and the authorities discussed there.

[27] [1970] Ch. 62, 75.

little scope for the application of either of the contractual statutes. If the outside knew of the impropriety, he would not be under any misapprehension, and in any case hardly merits any relief.

The second position is a little more difficult. The cases indicate that an outside contractor may rely on the contract made if either the company has in some way held the agent with whom he dealt to have authority to make the contract, even though he does not[28] or, to the actual knowledge of the outside contractor, the articles could have conferred on the agent the powers he claims to exercise and there is nothing to put the outsider on notice that the agent may not have the authority he claims.[29] The company can always ratify contracts not originally binding on the company because of a defect of the classes outlined above. These contracts must then be considered to be voidable only, and therefore they are contracts to which the Contractual Remedies Act may apply. The problem is whether the representations of the officers or agents of the company are "representations made by or on behalf of" the company.[30] On the one hand they are, almost by definition, representations which the company has not authorised the officers or agents to make. In that sense, the company should not have to take responsibility for them. Yet on the other hand, clearly they may be representations made, which have induced the outside contractor to enter the contract. On that basis, the wording of the Contractual Remedies Act would appear to give the outside contractor a right to sue on the misrepresentation.[31] If so, the damages are to be as if the representation were a term of the contract which had been breached. The damages would, it would appear, thus be the loss the outside contractor had suffered because the contract was not binding. This may well compel the company to give effect to the contract, or risk heavy damages. It may be that the courts, in deciding which interpretation of the two offered above will take the view that the legislature could not have intended to overthrow well-established rules of company law in such a roundabout manner. Yet the wording of the statute does force the courts to consider the matter. It must be added that in some situations the representation made by the agents or officers of the company may be able to be classified as a representation of law, (i.e. that their authority is sufficient to conclude the contract[32] and the courts could then refuse relief under the Contractual Remedies Act by saying that that act does not cover representations of law. Where the representation is clearly one of fact—as it would be by a statement that the agent is, for instance, the managing director of the company, the issues discussed above will be squarely raised.

In this category of cases, too, there may be some occasions where the outside contractor may seek relief under the Contractual Mistakes Act. If both the company's agent and the outside contractor believe, as a

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[28] As in *Freeman & Lockyer* v *Buckhurst Park Properties (Mangal) Ltd* [1964] 2 QB 480.

[29] As in the cases on the rule in *Royal British Bank* v *Turquand* (1856) 6 E & B 327.

[30] C.R.A. s.6(1).

[31] The Act covers representations by agents. A misrepresentation by the agent which is outside his authority should also be covered.

[32] *Beattie* v *Lord Ebury* (1872) 7 Ch.App. 777.

matter of law, that the agent can conclude a contract binding on the company, there is a mistake of law which has prevented a contract coming into existence. If the company is made a party to the proceedings the court can make an order for compensation against the company.[33] It is even possible that an application for relief under this Act can be made where the outside contractor has been put on notice that there may be something defective about the agent's authority, but has concluded, erroneously, that the agent's authority is adequate to conclude the contract. If that error is known to the agent, then s.6(1)(a)(i) may be fulfilled, and if the error is shared by the agent, then s.6(1)(a)(ii) should apply. It may well be that the courts would not give relief, but the fact that it may be available does nothing to clear up a rather complex area of the law.

The final possibility is where the parties have purported to conclude a contract in a form later claimed to be defective. In the case of *Broadlands Finance Ltd* v *Gisborne Aero Club*[34] the plaintiffs had lent sizeable sums to the defendants, such sums supposedly being secured by instruments by way of security over certain chattels of the club. It was held that the instruments were defective because they had not been duly executed by the persons in the manner required by the Club rules. The court rejected arguments that the indoor management rule or the principles of ostensible authority applied, and held that in the clear absence of express authority the instruments were invalid. However, it is clear that both parties believed at the time that the mode of execution of the documents was effective to bind the club. This could be treated as a clear mistake of law common to both parties, which substantially altered the respective burdens under the transaction. If the contract supposedly made were to be validated under the Contractual Mistakes Act, the courts would merely be giving effect to the contract the parties thought they had made. In such cases, it may be that the courts would not be reluctant to grant relief.

(4) *Share Sales*

The effect of the Contractual Remedies Act on the sale of shares through the issue of a prospectus will, it appears, be dependent on whether the company was incorporated at the time of the prospectus or not. If the company has been incorporated prior to the issue of the prospectus in question, any misrepresentations made in that document will found an action for damages by the purchaser against the company, and the provisions of the Contractual Remedies Act will decide the availability and quantum of damages. However the application of the Act may have considerable effect where the purchaser discovers the misrepresentation and wishes to withdraw from the contract. The position prior to the Contractual Remedies Act was that a person who had relied on the representations made in the prospectus in his subscription for shares, could rescind the contract, provided he had not affirmed it in some way or otherwise lost his rights to rescind. It does not appear that the rescinding party had to establish fraud[35], nor

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[33] See C.M.A. s.7(5).

[34] [1974] 1 NZLR 157, affd [1975] 2 NZLR 496.

[35] See *Anderson's Case* (1881) 17 Ch. D. 373, and *In re Scottish Petroleum Co.* (1883) 23 Ch. D. 413.

did he have to show any objective diminution of value (though as most of the cases were ones of fraud this was obviously present). However, under the Contractual Remedies Act, a subscriber for shares will not only have to establish that a statement in the prospectus was inaccurate, but will have to go on to show that the misrepresentation was as to a matter which had been expressly or impliedly agreed by the parties to be essential, or that the effect of the misrepresentation will be to substantially reduce his benefit, or increase his burdens under the contract, or to substantially alter the nature of those benefits or burdens. In the absence of statements to the company by the subscriber for shares as to his particular motives for investing, it may be difficult to establish any implied or actual agreement as to what is an essential feature of the bargain (though misrepresentations as to very basic matters might well be impliedly essential). If such an agreed matter cannot be established, the subscriber must show a substantial variation in the value or nature of his bargain. It is not clear whether the Contractual Remedies Act contemplates an objective standard for value. The actual wording might suggest a subjective test—the "benefit of the contract to the cancelling party", but a purely subjective test might well defeat contractual certainty. If the test is objective, then there has been a change in the rules relating to cancellation of a sharepurchasing contract which may, in certain circumstances, operate against the buyer. The problems do not end there. It must be noted that s.9 of the Contractual Remedies Act gives the courts wide discretionary powers to adjust the position of the parties to a contract which has been cancelled. Thus even though the purchaser may have cancelled this may not be the end of the matter. The cancelling party who has actually paid money or transferred property (as most sharepurchasers will have) is not entitled, simply by his cancellation, to that property. It remains with the transferee or payee, until and unless the court exercises its discretion under s.9 to order it repaid. That discretion cannot be exercised where a third party has acquired an interest in the subject matter for valuable consideration, or where the order would be made against a party who has altered his position in reliance on the contract that an order for relief would be inequitable.[36] It may be doubted whether the position of the shareholder has in fact been improved by the introduction of the new legislation. If the company is not worth suing, the buyer may, of course, pursue the statutory remedies, discussed below.

Different considerations apply where the prospectus is issued by agents or promoters of a company to be formed. Here there can be no action against the company for any misrepresentations in the prospectus, because the company is not in existence at the time of the misrepresentations. Any action by the purchaser must be against the promoters or "agents" of the "company". The question is whether these persons are to be proceeded against under the Contractual Remedies Act or under the pre-existing Law. It might appear at first glance that this is an area of the common law which has been replaced by the statute, and thus the Act must apply. The difficulty lies in s.15(h) of the Act which states that the Act is not to apply to any statute "so far as it prescribes or governs terms of contracts or remedies available in respect of contracts, or governs the enforce-

[36] C.R.A. s.9(5), s.9(6)

ment of contracts". Both the Companies Act 1955 and the Securities Act 1978 have specific provisions providing for liability of promoters and others, for misstatements in the prospectus of a company to be formed.[37] These provisions depart from the normal rules of contract existing at that time, in that negligent misrepresentations are actionable (insofar as liability prima facie exists for misstatements, but the promoter may be exempt from liability if he proves he had reasonable grounds for believing, and did believe, them to be true). The measure of damages is on a tort basis, in that the purchaser is compensated for his loss or damage in entering into the contract. He is not compensated for loss of profit.

There is clearly a considerable difference between the provisions of these Acts to that effect, and the provisions of the Contractual Remedies Act. There would appear to be a strong argument for the view that because there are these specific provisions in the earlier legislation which prescribe certain rights and remedies, and limit them in certain ways, that the Contractual Remedies Act has no application. In regard to the Securities Act the argument may be strengthened by reference to s.63, which grants to the court a general power to exempt, in certain circumstances, a promoter from liability for any "negligence, default or breach of duty". That very general provision might well extend, and appears to be designed to extend, to negligent statements. If it does, it clearly would indicate that there is a discretionary provision governing relief, and thus the Contractual Remedies Act is not applicable to this area of law. It is to be hoped that the position will be elucidated in the near future. If the argument is accepted that the Contractual Remedies Act does not apply to statements by promoters for companies to be formed, the curious result would emerge that a purchaser from such promoters could not sue them for an innocent misrepresentation made without negligence, but if he repeated the misrepresentations, in good faith, to another person who repurchased from him, he may be liable for innocent misrepresentation under the Contractual Remedies Act. Such a result might well seem illogical, but logic has not always been the strongest feature of the meshing of the contractual reform statutes with other areas of law.

In share sales cases where there has been a deliberate or an innocent misrepresentation, there will often be a mistake coming within s.6 of the Contractual Mistakes Act. It is not hard to think of cases where the mistaken belief of the parties has resulted in the taking up of shares that are worth far less than they would have been if the promoter's statements had been accurate. It is suggested however that although such cases meet the criteria of s.6(1) (a) and (b), it is possible to use s.6(1)(c) to filter out some of them—by holding that the investor must be taken to be bearing any risk that there may be of the company not being the envisaged success. Alternatively the courts could simply refuse relief in these circumstances as prejudicing commercial certainty. However, until there is a clear indication that the courts will take this view, the possibility of a disgruntled investor seeking relief under the Contractual Mistakes Act for misrepresentations which are not actionable because of the provisions of the Companies Act or Securities Act may have to be borne in mind by company promoters.

[37] Companies Act s.53, Securities Act ss.55, 56, 57, 63.

(5) *Contracts between a director and the company or the shareholder*

The law imposes on a director of a company certain duties where he seeks to transact business with the company of which he is a director to deal in shares with shareholders of that company. The duty on a director who seeks to deal with the company is in part regulated by the Companies Act 1955, s.199, and in part by the general law. The duty in share transaction cases arises purely from the general law. The common element in both is that the director will usually be under a duty of disclosure. Is a failure to disclose a misrepresentation for which damages or other remedies under the Contractual Remedies Act can be sought? On one hand it can be argued that the director has not in fact made any statement at all, therefore it is a misuse of language to describe the failure to speak as a misrepresentation. On the other hand, by failing to speak, he may have seriously misled the party with whom he was dealing. Dawson and MacLauchlan consider the point and conclude that the non-disclosure cases are not covered by the Contractual Remedies Act.[38] The Act will however apply where the director makes only a partial disclosure which is rendered misleading by the omission of relevant material. If this is right, then the director who makes no disclosure at all may be liable in equity for a breach of fiduciary duty, the remedy for which may be rescission or an account for profits. It appears that at the highest burden on the director is to refrain from making statements which are deliberately or carelessly misleading and to disclose matters he knows or believes are material and about which the other party may not be adequately informed.[39] If this is correct, then the director who attempts to make disclosure may be in a worse position than he who says nothing. If a director makes a partial disclosure which is misleading because of its incompleteness, he may be liable for any innocent misrepresentation involved therein. If he makes no disclosure at all, he will be liable only if he is fraudulent or negligent. If the non-disclosure cases are all covered by the Contractual Remedies Act, then a director's duties have been rendered more severe by the Contractual Remedies Act in all cases. Such a position certainly merits the attention of the legislature.

It must be noted that in many of the director's contracts cases an action for relief under the Contractual Mistakes Act would clearly be entitled to succeed. If the director has induced, by silence or by misrepresentation, the other party to enter a contract which he would not have made if he had known the true facts, and the contract is thereby less advantageous to him, the requirements of that Act would appear to have been fulfilled. In these circumstances the wider range of remedies open to the courts may be most useful.

Conclusion

The purpose of this article is to show that the reforms made in the law of contract appear to have been made without adequate consideration of their application outside the purely contractual sphere. If a number of the

[38] Op. cit., pp.20-22.

[39] See *Coleman* v *Myers* [1977] 2 NZLR 298, 333, per Cooke J.

problems envisaged above in relating the Contractual Mistakes Act and the Contractual Remedies Act to the company law field do occur, then there must be a long period of confusion while the courts attempt to reconcile the new statutes with the traditional rules of company law. It may well be that a number of the objections taken above will turn out not to be important in practice, but it is submitted that a large number will be. Failing a review of the relevant legislation it will be for litigants to bear the expense of clearing up the uncertainties and lacunae left by the reformers. It would be better if the statutes were reconsidered, and the uncertainties removed.