



## Rescinding Contracts for Fraud – *know the limits*

Limitation periods will always be at the back of any claimant lawyer's mind when acting in a fraud claim. As the recently concluded litigation between HMRC and GE shows, it is not just the money claims arising from fraud that may carry a limitation period, but the very act of rescinding a contract induced by fraud itself. As a money judgment can only follow once the contract itself has been set aside, it is very important that practitioners know what the relevant time limits are and when they start to run, which as we will see below, is not a straightforward issue. Much significance currently attaches to the distinction between the more straightforward remedy of common law rescission, and the more flexible remedy of equitable rescission. In summary, when it comes to rescinding contracts for fraud:

-At common law there is no limitation period for rescinding a contract for fraudulent misrepresentation. Rescission is a matter of self-help by the claimant so there is no need to bring a claim to rescind the contract at all, but the claimant should be aware of other bars to rescission that may apply.

-Common law money claims consequent upon setting aside a contract will typically have limitation periods (e.g. 6 years in the case of deceit or money had and received).

Time to bring such a claim will start running only once the contract is set aside.

-In equity, it is currently a matter of doubt whether rescission can be effected by self-help or whether a claim needs to be brought; but in any event where the claimant seeks rescission but the facts as pleaded would support a claim in deceit, there is a 6-year limitation period for the claim to rescission itself, aside from any question of monetary remedies.

Think of a paradigm fraud claim – a fraudster claims a painting is an original Picasso when it is a forgery and sells it to a purchaser for £10m. In that situation, upon discovering the truth the purchaser can rescind the purchase contract and claim the £10m back. At common law there is no time limit for the purchaser to rescind the contract (although once they know their rights, they may become barred from rescinding the contract if they then affirm it, amongst other things). Once the purchaser does rescind, the limitation clock starts running for claims such as damages for deceit or restitution of the purchase price (each 6 years).

In the situation just described the act of rescission is the act of the party themselves. No court action is required. All the purchaser has to do is say to the fraudster *"This picture is a fake.*

*Give me my £10m back"* (and maybe also *"how do you want me to return the picture?"* but that is a question for another day). The court becomes involved only when the fraudster refuses to pay damages or restitution to the purchaser and the purchaser decides to commence a claim.

Traditionally the right to rescind at common law in the way described can be lost if strict counter-restitution is impossible. So the purchaser is free to rescind if the painting is in exactly the state it was when received; but if for example it has been damaged and so there was some question about returning something worth less than what was transferred under the contract, then the right to rescind at common law is, at least on one view, lost. One could then only rescind, if at all, in equity, which had the machinery to take accounts to ensure satisfactory mutual restitution.

However, the Court of Appeal has recently confirmed that in the situation where the claimant seeks to rescind for fraud in equity, then unlike at common law, there is a limitation period for rescinding the contract itself – namely 6 years by analogy with the tort of deceit – entirely separately from any limitation period relating to any associated money claims: *HMRC v IGE USA Investments Ltd* [2021] 3 WLR 313.



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Why?

We start from the unsatisfactory position that s.36(1) of the Limitation Act 1980 (“LA 1980”) states that the time limits for various actions do not apply to “claims for equitable relief” except in so far as they may be applied by the court by analogy “in a like manner as the corresponding time limit under any enactment repealed by the Limitation Act 1939 was applied before 1 July 1940”. In other words if you have an equitable claim you start by looking at whether a court sitting prior to 1 July 1940 applied a limitation period by analogy, and if it did, and it matches a limitation period in the LA 1980, you apply that period. So even figuring out what one has to do to figure out if there is a limitation period is not easy.

In *Molloy v Mutual Reserve Life Insurance Co* (1906) 94 LT 756 – a pre-1940 case – Mr Molloy sought to set aside an insurance policy for fraudulent misrepresentation and obtain return of the premiums paid. His claim was met with a limitation defence. There was argument about when the time for Mr Molloy’s claim started running, he having waited to bring his claim until a similar claim had gone through the courts, by which time more than 6 years had elapsed since he knew the relevant facts. There was no argument about whether his claim had a limitation period at all (this was assumed),

nor was there any clear distinction between whether it was the money claim or the rescission of the contract that attracted the 6-year period.

In *HMRC v IGE USA Investments* HMRC had purported to rescind a settlement reached with a taxpayer on the ground of misrepresentation, and commenced a claim seeking declarations that they had validly rescinded the settlement agreement. They applied to amend to plead that the misrepresentation was fraudulent, by which time, if there was a limitation period, the claim was allegedly statute-barred. GE said that in so far as HMRC sought to rescind at common law GE had rock-solid defences as counter-restitution was said to be impossible, and in so far as HMRC sought to rescind in equity that the claim was statute barred, relying on *Molloy*.

HMRC argued that *Molloy* was distinguishable because it was a money claim. Mr Molloy wanted his money back. HMRC were not making a money claim – all they were seeking to do was rescind the agreement that prevented them from assessing GE to tax in the usual way. Rescission at common law did not carry a limitation period but money claims consequential upon rescission did; likewise in equity the analogy was with common law rescission. Money claims in equity might have a limitation

period but not the act of rescission itself.

Zacaroli J accepted that argument at first instance, but the Court of Appeal reversed him. They held that the ratio of *Molloy* was that any claim for equitable rescission of a contract on the ground of fraudulent misrepresentation is subject to a six-year limitation period by analogy to a claim for damages in the tort of deceit, where the facts as pleaded would allow either claim.

For the busy practitioner the bottom line is that where a fraud claim depends on rescinding a contract in equity rather than at common law, then in anything other than a very unusual case there will be a 6-year limitation period. This will be particularly important in those cases where the fraud victim is not necessarily seeking monetary relief (say for example where the contract induced by fraud was one in which the victim gave negative covenants that they want to be released from without necessarily wanting to claim damages).

One has to ask whether the Court of Appeal’s decision is right though (and the Supreme Court gave HMRC leave to appeal, although the proceedings have now settled), for the following reasons:

- Section 36 of the LA 1980



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applies to “claims” for equitable relief. But there is authority from the highest level that just like at common law, rescinding a contract in equity for fraudulent misrepresentation is not a “claim”, it is an act of self-help that does not require the court’s intervention: *Reese River Silver Mining Co Ltd v Smith* (1869) LR 4 HL 64 at 73 (Lord Hatherley). There is however authority suggesting otherwise and there is a general consensus among authors on this topic that only the Supreme Court can sort the issue out.

-There are good reasons to think that *Molloy* is wrong. It stands for a proposition that was assumed rather than argued, and *Reese River* amongst other important authorities was not referred to. One also has to wonder why the court in *Molloy* considered deceit a relevant analogy where the claim was not for damages

but for the return of money paid under an ineffective contract, which does not raise the question of dishonesty at all. It may be that the Court of Appeal in *Molloy* was put off the scent because damages and restitution would have had the same quantum in that case. But that will not always be so.

Practitioners will welcome the fact that the law is at least clear now that rescission for fraudulent misrepresentation in equity carries a 6-year limitation period. (Less welcome will be needing to worry about whether it is safe to advise their clients that they can effectively rescind a contract without bringing legal proceedings). But this position is in our view an odd one where:

-Rescission at common law has no limitation period but in equity it does, apparently as a result of an analogy with the common law.

-Rescission for innocent misrepresentation has no limitation period but fraudulent misrepresentation does.

Those with a keen interest in this area will have to wait in agony for another case to reach the Supreme Court dealing with the question; for everyone else the safe working assumption should be that a 6-year limitation period applies to anything fraud-related. As to when time starts running from, that will have to be a topic for another occasion.

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