

## Reminder of some rules relating to rescission from the High Court

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Rescission offers a powerful remedy for some misrepresentation claims. The recent decision of Adam Johnson J in *Krishna Holdco Ltd v Gowrie Holdings Ltd & Others* [2023] EWHC 1538 is a helpful reminder of some potential limitations.

### Recap on rescission

Rescission is a remedy available where there has been a defect in the formation of a contract, such as a misrepresentation. When available, the remedy requires the parties to be returned to the positions that they were in before they entered into the impugned contract, unravelling any transfers or other consequences of that contract. It can be particularly helpful when the contract transferred property that has substantially increased in value.

Action subsequent to the entry into the contract can, however, have the effect that rescission ceases to be available – these are known as bars to rescission. The most important of these are where the position has changed such that the parties cannot be restored to their pre-contractual position (referred to as *restitutio in integrum*); where the rights of a bona fide third party would be prejudiced by unravelling the contract; where the contract has been affirmed; or where there has been undue delay seeking rescission.

*Krishna Holdco Ltd v Gowrie Holdings Ltd & Ors* [2023] EWHC 1538 (Ch) provides a useful consideration of the operation of two of these bars to rescission – affirmation and the ability of the court to return the parties to their pre contract position. The court also considered the effect of the illegality doctrine, as well as providing pointers as to possible contractual provisions that might have avoided some of the issues that arose.

### The decision in *Krishna Holdco Ltd v Gowrie Holdings Ltd*

The background to the rescission claim in *Krishna v Gowrie* is complex. The dispute ultimately arose out of a merger of two pharmaceutical businesses and a fraudulent misrepresentation claim tried alongside an unfair prejudice petition. The rescission sought had an

important role in the quantification of the relief sought under the petition.

It is beyond the scope of this note to summarise the full context of the misrepresentation claim, but it related to the defendant making fraudulent representations leading to the entry into the '2013 Agreement' which adjusted the parties' entitlements under the prior merger. The court rejected all the allegations of misrepresentation except for one as to the source of £4.5m of funding which had been used to encourage the claimant to enter into the 2013 Agreement (*para 231*).

The claimant sought rescission of the 2013 Agreement, and the defendant sought to rely on two bars to rescission: affirmation and the alleged impossibility of restoring the parties to their pre-contractual position; as well as the illegality principle.

### Affirmation

The defendant contended that the claimant had affirmed the 2013 Agreement by refraining from taking earlier action to seek rescission and by participating in a further transaction in the knowledge of the misrepresentation found by the judge.

The alleged lapse of time was not, however, itself sufficient to constitute a bar to rescission. Instead, the court accepted that lapse of time after discovery that there has been a misrepresentation may be evidence of affirmation. But this meant that discovery of the misrepresentation remained critical. In relation to this, the court noted two important principles:

- A party entitled to rescind a contract will not be held to have affirmed it unless they had knowledge of the relevant facts, and were aware that those facts gave rise to a right to rescind (*SK Shipping Europe Plc v. Capital VLCC 3 Corp* [2020] EWHC 3448 (Comm) at [202]-[203].)

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- Knowledge of the relevant facts in this context means actual knowledge and not merely a means of acquiring or discovering that knowledge. Suspicion is not therefore itself enough to bar rescission but could provide a basis for inferring actual knowledge (*SK Shipping* at [202]).

Applying these principles, the court held that there had not been affirmation.

The claimant had known of another potential misrepresentation and had a general suspicion as to the conduct of the defendant, but had not been aware of the precise facts that had been found to constitute an actionable misrepresentation. This was not sufficient to bar rescission (paras 271-275).

### ‘Restitutio in integrum’

The defendant also contended that the parties could not be returned to the position that they had been before the contract was entered into. This will often be a relevant bar to rescission where assets that would have to be returned have either been changed or no longer exist.

In this case the defendant:

- Alleged that as a result of its entry into the 2013 Agreement it had chosen not to pursue certain claims that it had at the time, but that those claims were now statute barred such that it had sustained losses for which it could no longer recover damages.
- The 2013 Agreement had led it enter into a later settlement agreement, which would remain in force prejudicing its rights. It was alleged that it was impossible to unravel the 2013 Agreement and restore the rights that it had previously held.

The Judge rejected both of these grounds following a detailed factual analysis. First he held that there had been no meaningful claims compromised by the 2013 Agreement. There were therefore no rights to be restored to the defendant (paras 280-282). Second he rejected the defendants’ argument that there had been a later settlement agreement, holding that the substance of that alleged later settlement had in fact been entered into in an earlier binding agreement before the impugned agreement. It would also not therefore be affected by the rescission, and *restitutio in integrum* was possible (paras 282–294).

### Illegality

In addition to the two bars to rescission, the defendant also sought to rely upon the illegality doctrine as a reason not to order rescission. Although not typically included in lists of bars to rescission, it can, in principle operate to exclude the remedy.

Here, the defendant contended that a dishonest arrangement to which the claimant had been a party intended to influence the outcome of the insolvency of a former subsidiary meant that rescission should not be ordered. This required the application of the considerations identified in *Patel v Mirza* [2017] AC 467 of ‘(a) considering the underlying purpose of the prohibition which has been transgressed, (b) considering conversely any other relevant public policies which may be rendered ineffective or less effective by denial of the claim, and (c) keeping in mind the possibility of overkill unless the law is applied with a due sense of proportionality.’

Adopting this approach, the Judge concluded that the purpose of the infringed rule was ensuring honesty by the parties involved in an insolvency process and would not be infringed by the unravelling of the 2013 Agreement, since only the claimant and the defendant were parties to that transaction. Rescission would not therefore prejudice the rights of third parties (paras 295 to 297). He also held that to have refused rescission on this basis would also have allowed the defendant to benefit from its own fraud.

### Scope of rescission ordered

In addition to the question of whether rescission should be ordered at all, the case is also a helpful reminder of the difficulties that can arise when determining what precisely is required to return the parties to their pre-contractual position.

In particular, the court considered whether a provision of the 2013 Agreement granting the defendant permission to carry on a competing pharmaceuticals business could stand independently of the rescinded agreement. If the rescission had the effect of withdrawing that permission, it would mean that the defendant had acted in breach of fiduciary duty, with an impact upon the determination of relief for the unfair prejudice petition. The defendant contended that this consent had been independently repeated after the 2013 Agreement, such that rescission would not lead to a conclusion of breach.

The Judge noted that an argument such as this could, in principle, succeed, even where affirmation had been rejected as a bar to rescission (see *Knight v Frost* [1999] BCC 819). But the argument was rejected on the facts—the claimant did not have sufficient knowledge to have given fully informed consent to what would have been a breach of fiduciary duty (para 311).

### Drafting suggestions

Although the terms of the 2013 Agreement were not relevant to the rescission issues determined in *Krishna*, the case serves to suggest several topics which drafters

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could bear in mind in order to seek to minimise potential disputes if circumstances permitting a rescission claim were to emerge:

- First, when parties enter into a series of agreements, consideration should be given to making clear the connection, or lack of connection, between those agreements. For example, the parties may wish to provide that a later agreement is not to be interpreted as affirming any voidable prior agreement, or they could include express warranties or representations as to the validity of prior agreements. Basis clauses could also be helpful in this context.
- Second, if the parties wish for a later agreement to be insulated from any potential rescission of a prior agreement, express provision could be made emphasising that independence and that it is to remain in force upon any rescission of the prior agreement. Basis clauses could also be considered making clear that any representations made in relation to the prior agreement had not been relied upon when entering the later agreement.
- Third, consideration should be given to recording critical matters that parties have taken into account when deciding to enter into an agreement, which may later be relied upon to evidence the positions the parties considered themselves to be in before contracting.
- Finally, although not relevant in this case, it is also important to bear in mind that in addition to seeking to limit the scope of claims for misrepresentation, parties can contract out of an entitlement to rescind in the event of a misrepresentation or choose to impose limits upon the availability of rescission such as, for example, restricting it to only fraudulent misrepresentations.

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