No justice for innocent purchasers of dishonestly obtained goods: Shogun Finance v Hudson

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Table of Contents

[there is no table of contents for this document]

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Hire Purchase Act 1964 s.27, s.29(4)

***J.B.L. 381** In *Shogun Finance v Hudson* [1] the House of Lords was concerned with the law on mistaken identity in relation to contracting parties. Regrettably, its judgment continues an injustice to innocent purchasers of dishonestly obtained goods. A fraudster visited the showrooms of a car dealer in Leicester and agreed to buy a Mitsubishi Shogun for £22,250 on hire purchase terms. The fraudster signed a draft finance agreement in the name of Durlabh Patel, presenting a stolen driving licence as proof of his name and address. The dealer sent the signed document and a copy of the licence to Shogun Finance. Shogun confirmed the credit rating of Durlabh Patel and approved the sale. The fraudster paid a 10 per cent deposit and was allowed to drive the car away with its paperwork.

Because of the finance arrangements, the dealer sold the car to the finance company, who in turn hired it to the customer under the hire purchase agreement. Thus, the finance company became the new owner, and the customer only had possession of the car with an option to purchase the car after paying all the hire charges. In fact, the fraudster immediately sold the car for £17,000 to an innocent purchaser, Mr Hudson, and disappeared. Shogun later found out about the fraud and traced the car to Mr Hudson. As they were the owners, they sued him for the return of the car, or its value. They were successful before the Court of Appeal. Mr Hudson appealed to the House of Lords.

The House of Lords rejected the appeal. Shogun was entitled to the return of the car. The hire purchase contract was void. The fraudster could therefore pass no title on to Hudson, as he had no title to pass.

Hire Purchase Act 1964

It is a fundamental principle of the English law that vendors cannot convey to purchasers a better title to property than that which they themselves enjoy. There are however exceptions to this rule. One arises under the Hire Purchase Act 1964, as re-enacted in the Consumer Credit Act 1974. Under this legislation, an ***J.B.L. 382*** innocent private purchaser of a motor vehicle subject to hire purchase obtains good title. Section 27 of the Hire Purchase Act provides:

"where a motor vehicle has been bailed … under a hire purchase agreement … and, before the property in the vehicle has become vested in the debtor, he disposes of the vehicle to another person … [who is] a private purchaser [who has purchased] the motor vehicle in good faith without notice of the hire purchase … agreement … that disposition shall have effect as if the creditor's title to the vehicle has been vested in the debtor immediately before that disposition."

就目前而言，第29（4）條將債務人定義為車輛被保釋的人。

Section 29(4) defines the debtor as, for present purposes, the person to whom the vehicle is bailed. The critical issue in this case was, therefore, whether a hire purchase agreement had been concluded between Shogun and the fraudster. If an agreement had been concluded, then the fraudster was the "debtor" under s.27 of the 1964 Act and passed good title in the vehicle to Mr Hudson. If no agreement had been concluded, then the fraudster could not pass ownership in the car to Mr Hudson.

Shogun argued that the Hire Purchase Act could not apply because the hire purchase agreement in question was void. In particular, they argued that the agreement was void for mistake because they had intended to contract not with the rogue, but with Durlabh Patel. In order to decide this issue, the House of Lords ruled that they had to focus on the written agreement, and determine whether in the light of the written agreement applying the objective principle rendered the contract void.

Interpreting the written agreement

The majority of the House of Lords considered that, under established law, they were required to focus on the written agreement to decide this case. Normally, when interpreting a contract, the courts are looking for the intention of the parties, though the intention in this context is the intention that they objectively appear to have. Applying a test of intention to determine the parties to a contract causes problems where there is some form of personal contact between the parties, and where one lies as to their identity. In this situation, innocent parties will have in mind, when considering with whom they are contracting, both the person with whom they are in contact and the third party whom they imagine that person to be.

Where the contract is exclusively in writing, these difficulties are resolved by the court purely focusing on the written contract. Lord Phillips stated that:

"the identity of a party to a contract in writing falls to be determined by a process of construction of the putative contract itself … The process of construction will lead inexorably to the conclusion that the person with whom the other party intended to contract was the person thus described." [2]

J.B.L. 383 Because the contracting parties were specifically identified in the document, oral and other extrinsic evidence was not admissible to prove that one of the contracting parties was actually the fraudster and not Mr Durlabh Patel. Thus, evidence that the fraudster was the person who came into the dealer's office, negotiated a price with the dealer and signed the form in the presence of the dealer, would not be taken into account by the court. The House felt that this restrictive approach to the interpretation of the contract was "fundamental to the mercantile law of this country; the bargain is the document; the certainty of the contract depends on it". [3]

對合同解釋的限制性方法是"這個國家商業法的基礎；討價還價就是檔案；合同的確定性取決於它"

Lord Hobhouse cited with approval *Hector v Lyons* [4] where Browne-Wilkinson V.C. stated "the identity of the vendor and of the purchaser is established by the names of the parties included in the written contract". [5]

The present case was similar to *Cundy v Lindsay* [6] where the court commented:

"[H]ow is it possible to imagine that in that state of things any contract could have arisen between the Respondents and Blenkarn, the dishonest man? Of him they knew nothing, and of him they never thought. With him they never intended to deal. Their minds never, even for an instant of time, rested upon him, and as between him and them there was no *consensus* of mind which could lead to any agreement or any contract whatever." [7]

An exception, where the courts will look beyond the written agreement, is where the fraudster has used a "simple alias" to disguise his or her identity, rather than pretending to be an existing person. In the former situation, there may be a contract with the fraudster. An example of a simple alias being used is the case of *King's Norton Metal v Edridge Merrett & Co.* [8] In that case a rogue named Wallis had notepaper printed in the name of Hallam & Co and, pretending to be carrying on business in that name, ordered goods from the plaintiff manufacturers. The Court of Appeal held that a contract had been concluded between the plaintiffs and Wallis, under which property in the goods had passed. It observed:

"The question was, with whom, upon this evidence, which was all one way, did the plaintiffs contract to sell the goods? Clearly with the writer of the letters. If it could have been shown that there was a separate entity called Hallam and Co and another entity called Wallis then the case might have come within the decision in *Cundy v Lindsay.* In his opinion there was a contract by the plaintiffs with the person who wrote the letters, by which the property passed to him. There was only one entity, trading it might be under an *alias,* and there was a contract by which the property passed to him."

In the present case, the fraudster had not used a simple alias, he had pretended to be another existing person. Before entering into the agreement, Shogun checked ***J.B.L. 384*** that Mr Patel existed and that he was creditworthy. On that basis they decided to contract with him and with no one else. Mr Patel was the hirer under the agreement.

Face to face principle did not apply

Hudson argued that the hire purchase agreement was not void for mistake. He submitted that the contract fell within the "face to face" principle. This principle was first spelt out in the case of *Phillips v Brooks.* [9] Under this principle, where there has been face to face contact between the contracting parties, there is a strong presumption that each party intends to contract with the other. The vendor's intention is treated as being to sell to the person present, and identified by sight and hearing. This presumption applies, even where the buyer assumed a false name, or practised any other deceit to induce the vendor to sell. The only case out of line with the principle is *Ingram v Little.* [10] The House of Lords in the present case considered that *Ingram v Little* was wrongly decided.

The face to face principle creates a strong presumption that the offer was accepted by the person to whom it was physically addressed, and exceptions to it are rare and have been further restricted by the decision of the House that *Ingram v Little* was wrongly decided. An exception would apply where a rogue attempts, face to face, to deceive a member of the family of which he claims to be part, or someone else personally acquainted with the individual whom the rogue is impersonating. Impersonation of that sort is very rare, and unlikely to succeed unless the senses of the deceived person are impaired.

當一個流氓試圖面對面欺騙他聲稱是其中的一員的家庭成員，或與流氓正在冒充的人認識的其他人

On the facts of the present case, negotiations between the rogue and Shogun were not conducted exclusively by written correspondence, but the majority of the House observed that the fraudster never had any face to face dealings with the finance company; he dealt with it solely by submitting written documents. The fraudster's only contact was with the car dealer, and not the claimant finance company with whom the contract was made. The car dealer was not Shogun's agent with the authority to make a contract on their behalf; he was merely a go-between whose role was to obtain and communicate information about the hirer to the claimant. Thus, the face to face principle could not apply.

No agreement between the parties

There was no agreement (*consensus ad idem*) between the finance company and the fraudster or the finance company and the real Mr Patel. The offer of finance was made to Mr Patel, but Mr Patel knew nothing of the offer and did not therefore authorise any acceptance. There was therefore no contract. The hirer/debtor under the "agreement" was Mr Durlabh Patel, not the fraudster. The Hire Purchase Act 1964 did not apply and the title to the car remained with the finance company.

J.B.L. 385 ***Criticism***

The last five years have seen a minor revolution in the law of mistake, with radical changes being made by the courts, which is quite exceptional for the usually calm waters of the law of contract. First, in 1998, the House of Lords ruled in *Kleinwort*

Benson Ltd v Lincoln City Council [11] that the remedy of restitution would be available for both mistakes of fact and mistakes of law. In 2002, the Court of Appeal announced in *Great Peace Shipping Ltd v Tsavliris Salvage (International) Ltd* [12] that there was no equitable doctrine of common mistake, and in the present case of *Shogun Finance* the House of Lords refined the law in relation to unilateral mistakes.

While *Kleinwort Benson Ltd* seems to have been a step in the right direction in achieving justice for the parties, and avoiding undue enrichment, the latter two cases both risk causing injustice, and this injustice seems to have the same source. In both cases the courts placed considerable emphasis on the importance of certainty for commercial law and tried to achieve this by making their starting point the interpretation of the contract itself. In interpreting the contract, it seems perfectly reasonable to look for the intention of the parties in its express terms, so that the parties can determine for themselves where the risks should lie. The danger is that if the rules on implied terms are applied too broadly contractual intention can be found under the rules of objective interpretation, where this was clearly not the subjective intention of the parties. [13] The subsequent interpretation given to the contract can appear very artificial and unfair. Thus, in *Shogun Finance* the finance company was treated as contracting with a member of the public who had no knowledge that the contract was being made, while the person who was actually physically present and signed the contract was not treated as a party to the contract at all. In *Great Peace Shipping Ltd,* no term was implied that required the *Great Peace* to be close to the sinking ship that needed to be salvaged, despite the fact that the physical location of the ship was at the heart of the contract. If they had not thought that the *Great Peace* was close there would have been no reason for entering into the contract in the first place.

The result is a risk of injustice where mistakes have, as a matter of fact, been made but the objective interpretation of the contract allows the court to ignore this. Where the issue of mistake is raised before the courts, they may determine that no mistake was made at all under contract law because of an express or dubiously implied term of the contract. [14] By obstinately ignoring the reality of the transaction, relying on the justification of contractual certainty and the tradition of an objective analysis, the danger is that the courts are not achieving justice on the actual facts of the case. Clearly, contractual certainty is important, ***J.B.L. 386*** but this is only one aspect of the more important and fundamental goal of justice.

The artificial interpretation of the original contractual process, then, led in *Shogun Finance v Hudson* to a subsequent injustice to the innocent purchaser of the dishonestly obtained car. Mr Hudson, the innocent purchaser, was forced to return the car that he had paid for to the finance company, leaving him £17,000 out of pocket. But in fact it was the finance company that had given possession of the car to the fraudster without making sufficient checks about who he really was. Usually the person selling to a fraudster is in a stronger position to check their credentials than the person who buys from a fraudster, and the law should take this into account. Shogun's procedures were lax: they allowed the fraudster to take the car away on credit terms without verifying that he was the person named in the driving licence. In his dissenting judgment in the Court of Appeal, Sedley L.J. had been highly critical of Shogun's procedures. It gave £20,000 of credit on the strength of a driving licence and a credit check, which did not even prove that the real Mr Patel could afford the instalments. Although Shogun successfully argued that the identity of the customer was "absolutely crucial", their practice suggested that this was not in fact the case. It could take this casual approach to the granting of credit because it could rely on repossessing the vehicle from a subsequent innocent purchaser. Instead, the House could have recognised that a contract had been made between the fraudster and the finance company, because of the finance company's lax credit checks, and refused an order of repossession from the innocent purchaser on such facts. This would force credit companies to make more stringent credit checks in the future, from which all contracting parties would benefit.

The dissenting judgments of Lord Nicholls and Lord Millett are very persuasive. They point out the illogicality, when interpreting contracts, of applying a special approach to face to face dealings. There is, for example, no difference of substance between contracts made face to face and contracts made over the telephone, by videolink or even by post. Lord Nicholls and Lord Millett therefore proposed that where two individuals deal with each other, by whatever medium, and agree terms of a contract, then a contract will be concluded between them, notwithstanding that one has deceived the other into thinking that s/he has the identity of someone else. They would overrule the case of *Cundy v Lindsay.* [15]

The current legal analysis of this type of factual scenario is also artificial in relying on mistake rather than misrepresentation. [16] Where there has been a fraud that has induced a supplier of goods to hand over their property to a fraudster, the logical argument of the supplier of the goods is that their property was obtained by a fraudulent misrepresentation. But this argument does not provide the remedy that the innocent supplier needs, and so the supplier's argument must centre instead on the issue of whether there was a unilateral mistake which rendered the contract void. The law should reflect the reality of the situation, the heart of the problem and that there has been a fraud, and it is undesirable that the ***J.B.L. 387*** litigation focuses on how far the fraudster's conduct caused the innocent party to make a mistake.

The Law Reform Committee in its *Twelfth Report* in 1966 [17] proposed abolishing the distinction between contracts void for mistake and those voidable for misrepresentation.19 Instead, it recommended that where goods are sold under a mistake as to the buyer's identity, the contract should be voidable, and not void. This solution would favour innocent purchasers because they would obtain good title, provided the fraud had not been discovered and the contract rescinded before they purchased the goods.

<FNTI> I would like to thank Professor Robert Merkin for his helpful comments in the preparation of this commentary.</FNTI>

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Footnotes

1 [2003] UKHL 62, [2003] 3 W.L.R. 1371.
2 *ibid.* at [154].
3 *ibid.* at [49].
4 (1988) 58 P. & C.R. 156.
5 *ibid.* at 159.
6 (1878) 3 App.Cas. 459.
7 *ibid.* at 465.
8 (1897) 14 T.L.R. 98.
9 [1919] 2 K.B. 243.
10 [1961] 1 Q.B. 31.
11 [1999] 2 A.C. 349.
12 [2002] EWCA Civ 1407, [2003] Q.B. 679.
13 Jill Poole, Adrian Chandler and James Devenney, "Common mistake: Theoretical justification and remedial inflexibility" [2004] J.B.L. 34 at 58.
14 Professor Sir John Smith, "Mistake, Frustration and Implied Terms" (1994) 110 L.Q.R. 400, discussed in Poole *et al. ibid.* at 44.
15 (1878) 3 App.Cas. 459.
16 Janet O'Sullivan [2001] S.L.R. Vol.34, 22.
17 *Transfer of Title to Chattels,* Cm. 2958 (1966).