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Differentiation of Mistake and Fraud as Grounds for Rescission of Transaction

1. Introduction

The General Part of the Civil Code Act[*1] (GPCCA) that entered into force in Estonia on 1 July 2002 reflects positions of modern European contract theory. Inter alia, the regulation of transactions as provided in the GPCCA contains the main sets of substantive elements for rescission of transactions, including rescission on the grounds of mistake (§ 92) and fraud (§ 94). The Principles of International Commercial Contracts[*2] (PICC), prepared by the UNIDROIT Institute, the Principles of European Contract Law[*3] (PECL), prepared by the Commission on European Contract Law acting under the leadership of Professor Ole Lando of the Copenhagen Business School, and the Dutch Civil Code (*Burgerlijk Wetboek*[*4], NBW) may be cited as the sources of the respective provisions.[*5]

The general elements of mistake and fraud in the GPCCA are highly similar — both mistake and fraud defined in the GPCCA may consist in the disclosure of inaccurate circumstances or the non-disclosure of circumstances which should have been disclosed according to the principle of good faith by one party to the transaction to the other. The notion of fraud is defined through the notion of mistake, to which intent adds as the component describing the state of mind of the deceiving person. This gives rise to the issue of finding more specific criteria for differentiating these two institutes both on practical and theoretical grounds. Mistake and fraud are undoubtedly among the most common grounds for cancelling a transaction in legal practice because they relate to the discrepancy between the actual intent of a party to the transaction and the legal consequences brought about by the transaction.[*6]

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1 Tsiviilseadustiku üldosa seadus. – RT I 2002, 35, 216, 2007, 24, 128 (in Estonian). English translation available at http://www.legaltext.ee/et/andmebaas/tekst.asp?loc=text&dok=X30082K2&keel=en&pg=1&ptyyp=RT&tyyp=X&query=%FCldosa+seadus (21.06.2007).

2 Available at http://www.unidroit.org/english/principles/contracts/main.htm (21.06.2007).

3 O. Lando, H. Beale. Principles of European Contract Law, Parts I and II. Kluwer Law International 2000.

4 Entered into force on 1 January 1992. Available at http://www.civil-code.nl/index.htm (15.07.2007).

5 Explanatory memorandum to the proposal of the GPCCA. Available at http://web.riigikogu.ee/ems/saros-bin/mgetdoc?itemid=991600043&login=proov&password=&system=ems&server=ragne11 (21.06.2007) (in Estonian).

6 See also M. Käerdi. Eksimuse käsitlus tsiviilõiguses. Magistritöö (Treatment of Mistake in Civil Law. Master's Thesis). Tallinn 2002, p. 7 (in Estonian).

The issue of substantive identification of the sets of elements of mistake and/or fraud is topical and problematic in contemporary European legal order on a wider scale.[*7] It appears from the published studies that in an identical factual situation some legal orders would allow rescission of a transaction based on either mistake or fraud only, others on both mistake and fraud. Furthermore, even within the same legal order, the practice need not always be uniformly clear as to whether a case involves a mistake or a fraud.

The main aim of this article is to analyse issues related to differentiation of the two institutes for cancelling transactions, and to pinpoint the main differences of these institutions. The article does not aim at describing all the substantive elements of mistake and fraud and the legal meaning of such components, but only at focussing on the elements that both allow for and complicate the distinction-making between those institutes. The limited scope of the article does not allow for a discussion on relationships of mistake and fraud with other institutes of civil law, above all with the violation of obligations arising from pre-contractual negotiations (*culpa in contrahendo*, see Law of Obligations Act (LOA) § 14) and failure to perform a prestation that entails liability (LOA Chapter 5) foreseen by the (LOA).[*8]

2. Substantive elements of mistake and fraud

Modern contract theory on which both the PECL and PICC can be considered to be founded, and which has been taken as the basis for the provisions of the NBW (article 6:228) and GPCCA (§ 92), proceeds from the principles of protection of trust and distribution of risks (see PECL article 4:103 and PICC article 3.5).[*9] Contrary to this, the classical transaction studies used as a guide by the compilers of the German Civil Code[*10] (BGB), for example, have in its treatment of mistake, mostly proceeded from the theory of intent (above all, BGB § 119 (1)), according to which mistake can be interpreted as a discrepancy between the actual intent of a person and the objective declaration of intent. A situation in which legal consequences, which the person did not in fact desire, follow for a person declaring his or her intentions, is not in conformity with the right of self-determination of a person (principle of autonomy of will).[*11] Such a subjective approach to mistake obviously does not take into account the need to protect the trust of third parties and the practice of legal transactions. Critical approaches towards the BGB have referred to the legal consequences of a unilateral subjective mistake arising regardless of its objective recognisability or outward expression.[*12]

Along the lines of modern legal theory, provisions of the GPCCA do not foresee mistake as nonconformity of the intent with the declaration of intent but rather as the development of intent — based on false circumstances. According to GPCCA § 92 (1), mistake is an erroneous assumption relating to existing facts. One cannot speak of a legally relevant mistake in a case where the risk of proceeding from the correct circumstances rests with the person who declared his or her intent (see GPCCA § 92 (5)). Thus, it may be presumed that modern contract theory proceeds from the principle that each person bears the risk of his or her intent having evolved from correct presumptions and having taken into account all circumstances relevant for the particular transaction. The mistake that entitles the person making a declaration of intent to cancel the transaction entered into, serves as an exception, and with the view to the protection of legal usage and trust presumes a situation in which the partner of the mistaken person does not have confidence in the other party making a declaration of intent that lacks mistakes. Such a situation may arise, above all, when the other party to the transaction acts in bad faith or is also mistaken about the relevant circumstances related to the transaction.

Proceeding from the above, three main sets of elements are identified in the PECL, PICC, NBW as well as GPCCA: (1) a mistake caused by the other party (GPCCA § 92 (3) 1)); (2) a mistake that was known/should have been known to the other party (GPCCA § 92 (3) 2)); (3) a common mistake of the parties (GPCCA § 92 (3) 3)). In the case of both a caused and a known mistake, the mistaken party is given the opportunity to cancel the transaction on the grounds that the other party to the transaction is related to circumstances or acts in bad faith concerning the circumstances about which the mistaken party erred, and consequently his or her confidence in maintaining the validity of the transaction does not deserve to be protected. In the case of a caused mistake, erroneous assumptions are directly caused by the other party, whereas in the case of the recognised (recognisable) mistake, the other party is blamed because he or she knew or should have known about the mistake, and proceeding from the principle of good faith, was obliged to inform the mistaken party thereof. In order to cancel a transaction due to a mistake, it must always be a relevant mistake, i.e., a mistake

7 See, e.g., R. Sefton-Green. Mistake, Fraud and Duties to Inform in European Contract Law. Cambridge University Press 2005.

8 Võlaõigusseadus. – RT I 2001, 81, 487; 2005, 61, 473 (in Estonian). English translation available at http://www.legaltext.ee/et/andmebaas/tekst.asp?loc=text&dok=X60032K1&keel=en&pg=1&ptyyp=RT&tyyp=X&query=v%F5la%F5igus (21.06.2007).

9 K. Larenz, M. Wolf. Allgemeiner Teil des bürgerlichen Rechts. München: Verlag C. H. Beck 2004, p. 642.

10 Bürgerliches Gesetzbuch (Civil Code of Federal Republic of Germany), adopted on 18 August 1896. – RGBl., p. 195.

11 H. Köhler. Tsiviilseadustik. Üldosa (Civil Code. General Part). Tallinn 1998, p. 108 (in Estonian).

12 M. Käerdi (Note 6), p. 39.

concerning a circumstance of sufficient importance to influence a reasonable person, similar to the person who entered into the transaction, to enter into the particular transaction under the particular circumstances (GPCCA § 92 (2)).

Similarly, fraud also involves a mistake, while the liability for the mistake arising rests with the other party to the transaction. Thus, fraud is associated with the two main sets of elements of the mistake, i.e., the mistake caused by the other party to the transaction and the recognised mistake. Fraud presumes that the other party to the transaction is led into or left in error either by disclosing false information or by failing to disclose such circumstances that are subject to the duty to disclose under the principle of good faith (see GPCCA § 94 (1) and (2)). A case of disclosing some information as correct without actually verifying its correctness is deemed to be equal to disclosure of false circumstances (GPCCA § 94 (2)) if subsequently such information proves to be false. It is important that, unlike a mistake, only intentional leading into or leaving in error can be regarded as a fraud.

In the situation where the notion of fraud is described through the notion of mistake and the sets of elements of both may be related to the disclosure or non-disclosure of circumstances by one party of the transaction to the other, a more precise delimitation of the sets of elements of mistake and fraud is vital. While in the case of mistake, the right to cancel the transaction, inter alia, procedurally presumes proving that the mistake by the mistaken person was relevant, in the case of fraud, the relevance of the mistake is of no significance. In case of fraud, it is necessary to establish the deceiving person's intent in leading into or leaving the other party in error, with the purpose of inducing the other person to enter into the transaction. Thus, the circumstances that need to be established and proved differ in the case of mistake and fraud.

3. Intent to deceive

In order to distinguish between fraud and mistake, the main criterion is the deceiving party to lead into or leave the other party in error and thereby induce the latter to enter into the transaction. Intent to deceive has been established as the main component of the concept of fraud.*[13] According to GPCCA § 94 (1), the intent of the deceiving party must be aimed at leading into or leaving the person in error and the deceiving party must have the purpose of inducing the other person to enter into the transaction thereby. Intent may be either direct or indirect; yet in the case of negligence, fraud is excluded under Estonian civil law. The comments on article 3.8 of the PICC also require the existence of a special intent to deceive*[14], but it is noteworthy that, according to both the comments on the PECL*[15] and the Dutch legal theory*[16], negligence may suffice to detect fraud — regardless of the fact that in the texts of both PECL article 4:107 (2) and NBW article 3:44 (3) intent is required for fraud.

The analysis of intent gives rise to the question of whether only a particular person can be intentionally induced to enter into a transaction or is fraud also possible in a situation in which the other party to the transaction is not known. Entry into a contract at auction could serve as an example here, in which case the deceptive information has initially been intentionally disclosed to all participants, although pursuant to GPCCA § 94 it has legal significance as fraud only in respect of the person with whom the contract is entered into. The question has been also raised in literature concerning possible fraud in issue of securities — if an issuer of securities prepares and publishes a misleading prospectus, would it be necessary to prove the issuer's acknowledged purpose to lead a **particular person** into error in order to establish presence of intent to deceive?*[17] The authors believe that it is possible to assume the position that neither mistake nor fraud requires that at the moment when the other party to the transaction discloses false information (including as defined in GPCCA § 94 (2)), he or she must know the particular person that will enter into legal relationship with him or her in the future, but the intent to deceive may be aimed at the "wider public". If a party to a future transaction calls upon the public to make declarations of intent, by presenting for this purpose false (including unverified) information, intent to deceive may be established regardless of the fact that the intent was not aimed at a specifically identified person, but rather at unidentified persons as potential parties to the contract.

It is not relevant if the defrauding party intends to profit on account of or cause damage to the defrauded party.*[18] The mere wish to induce the other party to enter into a transaction is sufficient. There is no intent to deceive

[13] See, e.g., R. Sefton-Green (Note 7), p. 24.

[14] UNIDROIT Principles and official comments. Available at http://www.unilex.info/dynasite.cfm?dssid=2377&dsmid=13637&x=1 (18.02.2007).

[15] O. Lando, H. Beale (Note 3), p. 252.

[16] See D. Busch, E. Hondius, H. J. Van Kooten, H. Schelhaas, W. M. Schrama. The Principles of European Contract Law and Dutch Law. The Hague: Kluwer Law International 2002, p. 208.

[17] M. Hint. Avalikustamiskohustuse rikkumine Eesti väärtpaberituruõiguses (Violation of Notification in Estonian Security Market Law). – Juridica 2003/6, pp. 408–415 (in Estonian).

[18] O. Palandt. Kommentar zum Bürgerlichen Gesetzbuch. 65. Aufl. München: Verlag C. H. Beck 2006, § 123, paragraph 2. Commentator: H. Heinrichs. The comments on the PICC, on the contrary, require such goal: "[...] conduct is fraudulent if it is intended to lead the other party into error and thereby to gain an advantage to the detriment of the other party." See UNIDROIT Principles and official comments (Note 14).

if the allegedly defrauding party presumed and could presume that the other party was sufficiently informed about the circumstances (e.g., through a third party whose knowledge can be ascribed to the defrauded party or for whom the defrauded party is liable).*[19]

Next we will proceed to separately analyse the intent to deceive in comparison to the mistake caused separately (GPCCA § 92 (3) 1)) and recognised mistake (GPCCA § 92 (3) 2)).

3.1. Intent to deceive and a caused mistake

Differentiating a case of a mistake caused by the other party to the transaction (GPCCA § 92 (3) 1)) from that of a fraud is one of the most problematic issues in legal practice.

Prior to the entry into a transaction, parties to a transaction are required to submit to each other only accurate information; the prohibition on disclosing inaccurate information derives from the obligations borne by the parties during pre-contractual negotiations (LOA § 14 (1)). As a general rule, the prohibition to disclose inaccurate information relates to the disclosure of factual data, not of subjective opinions or values.*[20] However, any objectively substantiated position of a professional must be regarded as data subject to the prohibition. The substance of such false information may vary and may related to, for instance, the object of the transaction (its properties) as well as to any other circumstances that have an effect on the entry into the transaction by the other party. The party cancelling the contract must prove that the defrauding party was aware of the circumstances at the moment of entering into the contract.*[21]

In addition to the disclosure of false information, both mistake and fraud may be established when a party to the transaction has a good faith duty to inform the other party of circumstances relevant to the entry into the transaction which the party fails to disclose, creating an incorrect perception of the actual circumstances for the other party. The notification obligation will be reviewed in greater detail in part 4 of this article.

In the case of both disclosure of false information and non-disclosure of relevant information, the question arises: when can such activities be considered as intentional with regard to the other party? Establishing intent is further complicated by the rule that disclosure of unverified circumstances as correct is deemed to be equal to disclosure of false circumstances if the unverified circumstances subsequently prove to be false (GPCCA § 94 (2)). Thus, a case may involve fraud when the person disclosing the circumstances does not know that he or she is disclosing false information, but he or she does not apply the care required for verification of their authenticity. Based on the above, we may assume the position that according to the regulation of fraud under Estonian law, a case cannot involve fraud when the alleged defrauding party lacks any information about the incorrectness of the disclosed information and he or she has with due case conducted verification of the information. It is disputable of course at what point it is possible to assume that the person has verified the disclosed circumstances sufficiently and when not. For example, when a person buys a used vehicle and, upon a further transfer of the vehicle relies on the confirmation initially given by the former owner or independent expert that the vehicle had been in no accidents, the case does not constitute fraud even if such confirmation proves incorrect later on (although it may involve a relevant mistake). However, when for example, a seller of a used vehicle does not rely on any confirmation of the former owner but claims, without verifying the facts first, that the vehicle has been in no accidents, the case involves disclosure of false circumstances as defined in GPCCA § 94 (2).

Here, it is important to emphasise the difference between German and Estonian law as regards to proving intent to deceive under GPCCA § 94 (2). In Estonian law, disclosure of unverified circumstances that subsequently turn out to be false, is deemed to be equal to disclosure of false circumstances, but intent to deceive must be proven in addition (GPCCA § 94 (1)). At the same time, according to German law, disclosure of unverified information is considered in itself evidence of intent to deceive, although the person disclosing it had to consider it possible that the information was incorrect.*[22] German courts have developed a rule that *bedingter Vorsatz* or conditional intent is sufficient to identify fraud. Thus, disclosures made without definitive certainty that the facts are as claimed, and on the contrary, when it is known that the disclosure may be incorrect (*Angaben ins Blaue hinein*) are qualified as fraud.*[23] The above position is illustrated, e.g., by German court decisions that impose on a professional trader in used vehicles the notification obligation in a situation where the trader has or should have reasonable doubt about the vehicle's involvement in an accident. When the seller does not check upon such doubts, a fraud is involved and there is no need for a separate establishment of intent to deceive. The reason is that in the case of a professional trader in used vehicles, clients presume that the seller has care-

[19] Decision of the Supreme Court of the Federal Republic of Germany of 26.01.1996. – Neue Juristische Wochenschrift Rechtschprechung Report (NJW-RR) 1996, pp. 690 ff.

[20] PICC (Note 14); O. Lando, H. Beale (Note 3), pp. 252–253.

[21] O. Palandt, H. Heinrichs (Note 18), § 123, paragraph 30.

[22] H. Köhler (Note 11), p. 124.

[23] O. Palandt, H. Heinrichs (Note 18), § 123, paragraph 11; see also K. Larenz, M. Wolf (Note 9), p. 686.

fully inspected the vehicle for possible previous accidents and other deficiencies, and are consequently willing to pay a higher price as a rule. The particular case concerned the sale of a five-year-old Mercedes that had been restored after a major crash. It could only be proven that the seller was aware that the vehicle had in a large part been repainted (*nachlackiert*). The court established that since the seller had already been aware of such a fact, they at least had to suspect that the repainting was undertaken to repair the damage caused as a result of a crash. As the vehicle was of an appreciated make and without any damage from corrosion, the seller had no reason to assume that a five-year-old Mercedes would be repainted for no particular reason. For a professional, it should have been much more obvious that the vehicle was repainted because of the damage caused by an accident.[*24]

If adjudicating the same case according to Estonian law, based on applicable law and legal literature, the court would also have had to establish the existence of separate intent to deceive in order to qualify the seller's behaviour as fraud. Yet such a solution does not seem to be justified. The authors of the article are of the opinion that, as in German law, it should suffice to prove an intent to deceive if the defrauding party has disclosed information the correctness of which he or she has not verified, although he or she should have done so, and which later proves to be false.

3.2. Intent to deceive and a recognised mistake

Compared to the mistake caused by the other party, differentiating the case of a mistake recognised by the other party from that of a fraud has a little less significance in practice, but is no less problematic.

In the case of a mistake recognised by the other party, the latter knew or should have known that the party making a declaration of intent had an incorrect perception of the actual circumstances when making the declaration of intent (see GPCCA § 92 (3) 2); PECL article 4:103 a ii; PICC article 3.5 a; NBW article 6:228 b). In the case of recognisable mistake, the problem can be solved through the interpretation of the declaration of intent made (see GPCCA § 75) — in the case of a mistake about a circumstance serving as substance of the declaration of intent, which the other party knows or should have known, the transaction is considered entered into on the conditions that conform to the actual intent of the person making the declaration of intent.[*25] If there is a mistake recognised by the other party in the circumstance that cannot be solved through interpretation of the declaration of intent, a question arises what is the difference between situations in which (a) the addressee of the declaration of intent knows about the mistake of the person making the declaration of intent (GPCCA § 92 (3) 2)) and (b) the other party intentionally leaves the person making the declaration of intent in error (i.e., it is fraud), e.g., by non-disclosure of information that should have been disclosed according to the principle of good faith. The legal standard for distinguishing between the described situations can obviously be the establishment of the subjective f intent to deceive by a person (or non-establishment thereof in the case of a mistake), which is aimed at influencing the development of the intent of the other person.[*26]

The Civil Chamber of the Supreme Court of the Republic of Estonia has in its decision in civil matter 3-2-1-5-99[*27] noted that "in fraud, the intent may lie in the knowledge of the allegedly defrauding party that he or she tells a lie or withholds the truth in order to induce the other person to enter into a transaction". The recognised mistake, however, can also be perceived when the attitude of the person recognising the mistake is neutral.[*28] In such a situation, different legal orders solve the issue of delimiting mistake from fraud differently. An example could be a situation in which a person offers for sale a painting that he or she considers to be a copy of little value, but which, in actuality, is an expensive original work by a famous artist. The buyer actually gets the idea that the painting is valuable and buys it, without disclosing his or her idea to the seller. Is it a mistake or a fraud? Judging from legal literature, the buyer's behaviour must be qualified by the set of elements of fraud pursuant to the laws of some countries (e.g., France, Belgium, Greece, Austria and Portugal), under some other jurisdictions (e.g., English) it should not.[*29] As in German law[*30], the assessment of the notification obligation provided in GPCCA § 95 is of critical importance for adjudicating the case based on Estonian law. Pursuant to this section, in order to identify whether the party has the notification obligation, it must, above all, be taken into account whether the circumstance is obviously important for the other party, what specific expertise the parties have, what the reasonable options of the other party are to obtain the necessary data, and how large the costs are that the person needs to incur to obtain the data. Thus, the solution may depend on the individuals, their specific expertise and other circumstances specific to the case.

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[24] Decision of the Supreme Court of the Frankfurt Land of 19.02.1999. – NJW-RR 1999, 1064.

[25] See also M. Käerdi (Note 6), p. 55.

[26] W. Erman. Begr. Handkommentar zum Bürgerlichen Gesetzbuch, herausgegeben von Harm-Peter Westermann und Klaus Küchenhoff. Bd. 1. 9 Aufl. Münster 1993. H. Brox, paragraph 29 concerning § 123. See M. Käerdi (Note 6), p. 67.

[27] Available at http://www.riigikohus.ee/?id=11&indeks=0,2,197,440&tekst=RK/3-2-1-5-99 (15.07.2007) (in Estonian).

[28] M. Käerdi (Note 6), p. 67.

[29] R. Sefton-Green (Note 7), pp. 131–160.

[30] O. Palandt, H. Heinrichs (Note 18), § 123, paragraphs 5a–5c; M. Käerdi (Note 6), p. 67.

It is less problematic to distinguish between the above-described situation and a situation in which the other party did not know about the mistake of the person making the declaration of intent, but should have known about it, and leaving the mistaken party in error was in conflict with the principle of good faith. A situation in which a person should have been aware is related to gross negligence according to modern transaction studies. Pursuant to LOA § 15 (4), if a person was unaware of circumstances with legal effect due to gross negligence, it is deemed that the person should have been aware of the circumstances. Gross negligence is failure to exercise necessary care to a material extent (LOA § 104 (4)). Consequently, if a person fails to exercise necessary care to a material extent, is therefore unaware that the person making a declaration of intent is in error (and thus naturally fails to inform the person making the declaration of intent about his or her mistake), it cannot constitute an intentional leaving of a person in error. In the latter case, we can only speak about the right to cancel the transaction due to a (recognisable) mistake (GPCCA § 92 (3) 2)).

In case a person wishes to ground a legal claim on fraud, he or she must prove the relevant circumstances, inter alia, the substantive elements of fraud. Upon cancelling a transaction on the grounds that a person was intentionally left in error, to prove the other person's intent may present to be problematic. According to legal literature, in order to establish intent to deceive, the **subjective** perception of the defrauding party must be taken as the basis — unlike for establishing negligence when the perception of a reasonable person is taken as the basis.[*31] Nevertheless (as it is naturally impossible to submit proof as to the thoughts of a person), evidence of intent to deceive in practice actually amounts to adherence to certain objective criteria.[*32]

If a person wishes to be released from the transaction due to circumstances that provide grounds to believe that the case involves mistake and/or fraud, the transaction can be cancelled by making a unilateral declaration of rescission pursuant to GPCCA §§ 90 and 98. When making such a declaration, the transaction becomes void from the start. The above delimitation problem, however, implies that upon making a declaration for cancelling the transaction, it may be difficult for the party making the declaration of rescission to adequately assess whether the other party caused the mistake by his or her neutral attitude to the violation of the notification obligation or by the intent to induce entering into the transaction. As the existence or lack of intent to deceive can be established, above all, after learning about the explanation or position of the other party and obtaining an overview of all the circumstances related to the entry into the particular transaction, it would in practice be advisable to rely upon making the declaration of rescission besides fraud, alternatively also on mistake, in order to avoid a situation in which it may be later established that the elements of cancelling a transaction due to fraud (e.g., because of lack of intent to deceive) were missing and thus the declaration cancelling the transaction due to fraud is void.

4. Duties related to disclosure of information

Both sets of elements of mistake and fraud discussed herein involve the fact that one party's mistake is brought about by the other party to the transaction either by disclosing false circumstances or failing to disclose circumstances that should be disclosed according to the principle of good faith. Therefore, it is necessary to analyse under what circumstances a party to the transaction has a duty related to the provision of information to the other party.

Whether and to what extent the existence of a pre-contractual duty to disclose should be recognised largely depends on how the legal order perceives the nature of the process of entry into a contract, and how high ethical standards are imposed on the participants in the procedure. The existence and extent of the duty to disclose is a field in the contract theory where considerable differences exist between common law and continental European legal doctrines.[*33] E.g., English law takes the general position that both parties must have the right to use the existing information for their personal benefit and, consequently, the duty to disclose is recognised minimally.[*34] Knowing provision of false information to the other party is prohibited according to their judicial practice; however, the party is not required to direct the attention of the other party to circumstances that are important for the other party or to the fact that the other party proceeds from some incorrect assumption when entering into a transaction. Continental Europe values the transparency of the negotiations, trust between the parties, their solidarity and acting in good faith. That is why extensive duties to disclose are derived from the principle of good faith both in French and German law.[*35]

[31] P. Varul, I. Kull, V. Kõve, M. Käerdi (compilers). Võlaõigusseadus I. Üldosa (§§ 1–207). Kommenteeritud väljaanne (Law of Obligations Act I. General Part (§§ 1–207). Commented Edition). Tallinn 2006, p. 332 (in Estonian).

[32] For relating intent to the standard of reason see also PICC article 3.8 (Note 14).

[33] P. Gilikier. Regulating Contracting Behaviour: The Duty to Disclose in English and French Law. – European Review of Private Law 2005/5, p. 623.

[34] B. Markesinis, H. Unberath, A. Johnston. The German Law of Contract. Oxford and Portland, Oregon 2006, pp. 305–308.

[35] P. Gilikier (Note 33), pp. 624, 631. There are exceptions to this principle in contracts where a trust relationship exists between the parties: e.g., in the case of insurance contract, the policyholder must inform the insurer about all circumstances that a reasonable insurer would consider important. *Ibid*., pp. 625–626. See also O. Palandt, H. Heinrichs (Note 18), § 123, paragraphs 5a–5c.

Violations of the duty to disclose may, under certain conditions, constitute as fraud. Namely, fraud can be committed both by action (i.e., disclosure of false circumstances) and by silence (i.e., by non-disclosure of circumstances that should have been disclosed to the other party according to the principle of good faith). For example, fraud by silence is most common in German judicial practice*[36], while French legal theory is of the opinion that fraud (*dol*) may consist of silence, i.e., when the defrauding party is silent about a circumstance, knowing which the other party would not have entered into such a transaction.*[37] The Civil Chamber of the Supreme Court has in its decision in matter 3-2-1-93-05*[38] also noted that in order to establish the right to cancel a contract due to mistake, on the basis of GPCCA § 92 (3), it must be identified whether the other party to the transaction was subject to the objective duty to disclose arising from the principle of good faith.

For establishing the duty to disclose under the principle of good faith (LOA § 6), regard shall be had, above all, for the following circumstances according to GPCCA § 95*[39]: (1) whether the circumstance is clearly important to the other party, (2) to the specific expertise of the parties, (3) the reasonable opportunities of the other party to obtain the necessary information, and (4) the extent of the necessary expenses to be made by the other party in order to obtain such information. The list is not exhaustive.

4.1. Dependence of duty to disclose on the relevance of information

A party must provide information without request only if the decisive relevance of the information for the other party is recognisable to him or her.*[40] This is definitely the case when a circumstance is of such relevance that otherwise there would be no point in entering into the transaction. E.g., when a real estate is bought for development, but the seller knows that it will actually be a Nature 2000 area and thus any construction on the plot will be ruled out in the future. Recognisable deficiencies also include relevant deficiencies in the sold object, i.e., when a house is for sale and the seller knows that the walls have been affected by dry rot or a major damage by moisture.*[41] In German judicial practice, a catastrophic financial situation has been regarded as such circumstance upon the sale of shares of an enterprise or a private limited company.*[42]

German judicial practice, which imposes very extensive duties to disclose upon the obligor, has also been criticised for creating legal uncertainty and making it difficult to predict the outcome of any court case. The criteria used to decide upon the existence of the duty to disclose are allegedly also too vague.*[43] At the same time, Dutch law is of the position that if fraud has been proven, the existence of the duty to disclose is not subject to especially high standards: the acts committed by the defrauding party in bad faith constitute such a substantial argument that extremely substantial reasons would be required to overthrow the duty to disclose information.*[44] We rather agree with the position — a similar approach under Estonian law is supported by the fact that the relevance of the mistake is not important in fraud, unlike in mistake.

4.2. Dependence of duty to disclose on specific expertise of parties

The duty to disclose should also be recognised in cases when one party to the transaction has considerably more expertise in the field (is a professional) than the other party. This is caused by the fact that with the increasingly complicated transactions of the present time, and ever-increasing specialisation, there is often nothing else to do for a person than to trust the opinion of the other party as a professional. The very unequal access of the parties to the specific information gives rise to the duty to disclose upon the better-informed party.*[45] E.g., a professional seller of used vehicles has a duty to disclose information regarding the accidents in which

[36] Münchener Kommentar zum Bürgerlichen Gesetzbuch. Bd. 1: Allgemeiner Teil. 5. Aufl. München: Verlag C.H. Beck 2006, § 123, paragraph 16. Commentator: Kramer.

[37] M. Fabre-Magnan, R. Sefton-Green. Defects of Consent in Contract Law. – Towards a European Civil Code. 3rd ed. 2004, p. 403.

[38] RT III 2005, 35, 343 (in Estonian).

[39] The circumstances provided in GPCCA § 95 verbatim coincide with those provided in PECL article 4:107 (3).

[40] See Supreme Court decision 3-2-1-93-05 (Note 38).

[41] A case obviously involves fraud when the seller has, e.g., the walls repainted to cover up the damage from moisture before the sale. See O. Lando, H. Beale (Note 3), p. 253.

[42] A decision of the Supreme Court of the Federal Republic of Germany of 4.04.2001. – NJW 2001, p. 2163.

[43] B. Markesinis et al (Note 34), p. 309.

[44] See D. Busch et al (Note 16), p. 208.

[45] See I. Parrest. Teavitamiskohustus lepingueelsetes suhetes (Notification Obligation in Precontractual Relations). – Juridica 2001/5, p. 321 (in Estonian).

the vehicle may have been.[*46] In French law, such transactions include, e.g., the sale of software, but also an investment contract between a bank and an investor who is a student; in the latter case, it was established that the bank also had to point out the risks and circumstances detrimental to the other party.[*47] The obligation to provide information also applies to cases where a trust relationship exists between the individuals entering into a contract or if such a relationship is created by entry into the contract.[*48]

If a buyer discloses to the seller the purpose for which he or she wishes to use the thing and is incompetent in technical matters himself or herself or has no previous experience in the relevant area of business, then proceeding from the principle of good faith the buyer may presume that the seller would provide the relevant information. Such a presumption applies as long as the seller knows about the incompetence of the buyer and realises the possible dangers and risks that may result when the buyer uses the thing for the specified purpose.[*49] On the contrary, in case the seller is not a professional, such duty to disclose cannot be presumed.[*50]

4.3. Dependence of duty to disclose on possibility of other party to obtain information

According to GPCCA § 95, the notification obligation depends, inter alia, on the reasonable opportunities of the other party to obtain the necessary information and the extent of the necessary expenses to be made. Once again, the obligation is tied to the professionalism of the parties: when one of the parties is a professional and the other a consumer, the latter usually has considerably worse opportunities to obtain the necessary information. Thus, it is usually much easier for providers of goods or services in the field of their economic and professional activity to obtain information about the services or goods offered by them, than it is for consumers.

It has been emphasised in German judicial practice that, for instance, when selling the shares of an enterprise or a private limited company, the buyer can obtain information about the actual economic situation of the company primarily and solely based on the balance sheet, other accounting records of the company and economic estimations, as well as information provided by the owners or managers of the company. Consequently, it is relatively difficult for a third party to obtain truthful information about the object of purchase and he or she is largely dependent on the accuracy of the information given by the owners and managers when assessing the economic situation of the company. This also justifies the imposition of obligation to disclose information upon the seller of an enterprise or shares.[*51] The duty to disclose has also been associated with the extent of the expenses to be made by the person to obtain relevant information. There is often no duty to disclose relevant information if a party has incurred considerable expenses obtaining the same. The right to cancel the contract is, in such a case, precluded by an economic consideration, according to which there would otherwise be no stimulus to invest in procuring the information, resulting in loss for both parties.[*52] The investment criterion should carry greater weight for persons who are assumed to be of an equal standing, whereas the criterion should be left in the background in relations between a professional and non-professional, and the obvious relevance of the circumstance for the non-professional should prevail.[*53]

It is reasonable to impose the duty to disclose upon the obligor if the latter already has the information relevant for the obligee without the need to incur separate expenses for that purpose (e.g., the seller of a real estate is aware of relevant circumstances concerning the estate). The notification obligation also applies to cases where so-called asymmetry of information is created, i.e., if to obtain particular kind of information would be considerably more expensive for one party than for the other (e.g., upon the sale of used vehicles, the buyer is willing to rather pay the seller a separate fee for information than to go and seek it himself or herself, which would be ultimately more costly). In such cases, it is justified to subject the seller to an enhanced duty to disclose.[*54]

46 A decision of the Supreme Court of the Federal Republic of Germany of 3.03.82. – NJW 1982, p. 1386.

47 P. Gilikier (Note 33), p. 631.

48 A decision of the Supreme Court of the Federal Republic of Germany of 7.10.91. – NJW 1992, p. 300.

49 I. Kull, I. Parrest. Teatamiskohustus võlaõigusseaduse kontekstis (Notification Obligation in the Context of the Law of Obligations Act). – Juridica 2003/4, p. 216 (in Estonian).

50 O. Lando, H. Beale (Note 3), p. 254.

51 See decision of the Supreme Court of the Federal Republic of Germany of 4.04.2001. – NJW 2001, p. 2163.

52 O. Lando, H. Beale (Note 3), p. 232.

53 I. Parrest (Note 45), p. 326.

54 B. Markesinis et al (Note 34), p. 309.

4.4. Prohibition to lie

As indicated above, a distinction must be made between the duty to notify, i.e., the duty to inform the other party about certain circumstances without the other party asking about it, and the duty to tell the truth. The parties are always obliged to tell the truth, they are prohibited from lying, regardless of the duty to disclose.[*55] LOA § 14 (1) provides that information exchanged by the persons in the course of preparation for entering into the contract shall be accurate. Thus, when one person asks another whether the vehicle has been in an accident, the other person must answer truthfully, and if they have any doubts about it, they must express them.[*56]

Only on a few exceptions may it be considered lawful to also disclose untruthful information — this concerns information in respect of which the other party has no right to ask, i.e., the information obtained by unauthorised inquiry.[*57] German courts have accepted exceptions when lying in the process of entry into a contract is permitted. For example, prevailing judicial practice confirms that questions put to a person during a job interview must be reasonable, otherwise the future employee is entitled to lie.[*58] Estonian legal literature has also assumed a position that it may be considered justified to present false information during pre-contractual negotiations concerning questions that have been asked about a person's state of health if this does not relate to the performance of the particular contract; neither is it necessary to answer truthfully to inquiries about pregnancy or the intention to marry.[*59]

5. Causation

As discussed in this article, the right to rescind a transaction on the grounds of mistake and fraud presumes a causal link between the disclosure or non-disclosure of circumstances by a party and the creation of an incorrect perception of the actual circumstances by the other party.

Pursuant to GPCCA § 94 (3), a person who entered into a transaction **due to fraud** may cancel the transaction. Thus, rescission of a transaction due to fraud based on GPCCA § 94 presumes the existence of causation (*conditio sine qua non*) between the fraud (i.e., leading the defrauded party into or leaving in error) and entry into the transaction. This means that disclosure of mistaken circumstances or non-disclosure of some relevant circumstances must lead the other party into error (or leave in error) and thereby induce that party to enter into such a transaction. Such causation need not be there, e.g., in case the defrauded party actually took into account the possibility of fraud and nevertheless entered into the transaction.[*60] Thus, the Tallinn Circuit Court has established that signing a contract without reading it through does not constitute either mistake or fraud as the defendant did not exercise sufficient care when signing the contract and did not act as a reasonable person.[*61] Naturally, there is no causation also if when the defrauded party had a truthful overview of the actual state of circumstances from the very beginning (e.g., knew about the deficiency of the object of sale from the beginning).

Yet, according to German law, the right of rescission is not ruled out by the mere fact that the defrauded party was unaware of the fraud through his or her negligence or gross negligence.[*62] The activities of the deceiving party need not be the only reason behind the fraud, but it suffices when it is one of the reasons that brought about the mistake for the other party.[*63] The defrauded party must prove the existence of causation; however, it is found in some legal orders that if the intentional provision of wrong information by the deceiving party has been proven, it is presumed to have also affected the defrauded party into making the transaction.[*64]

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55 P. Varul et al (Note 31), p. 59.

56 O. Palandt, H. Heinrichs (Note 18), § 123, paragraph 5a.

57 K. Larenz (Note 9), p. 684.

58 B. Markesinis et al (Note 34), pp. 303–304.

59 P. Varul et al (Note 31), p. 60.

60 MüKo/Kramer (Note 36), § 123, paragraph 12.

61 Civil matter 2-2/901/04 of the Tallinn Circuit Court, available at http://kola.just.ee/docs/public/dokument_180443.pdf (21.06.2007) (in Estonian).

62 MüKo/Kramer (Note 36), § 123, paragraph 12.

63 *Ibid*., § 123, paragraph 12.

64 O. Lando, H. Beale (Note 3), p. 255.

6. Conclusions

In order to distinguish between the so-called caused mistake or recognised/recognisable mistake and the set of elements of fraud, according to law applicable in Estonia and modern legal theory, attention must be paid to the following circumstances: (1) in the case of fraud, it is necessary to identify the intent to deceive, i.e., a direct or indirect intent to induce the other party to enter into the transaction; (2) fraud may be either active — submission of false information for the purpose of deception — or passive — failure to follow the duty to disclose or leaving the other party in recognisable mistake; (3) the existence and extent of the duty to disclose must be determined on a case by case basis, taking into account GPCCA § 95, while the prohibition to disclose false information applies at all times; (4) unlike rescission based on mistake, fraud does not require relevancy of the mistake although the false information must impose a significant effect on entering into the transaction on the specific terms; (5) a causal link must be identified between intentional deceit and entry into the contract. A case does not constitute fraud when an intentional deceit took place but did not bring about the fact of entry into the contract. As criticism of law in force at present, the authors point out the need to simplify proving intent to deceive in case a party has disclosed unverified false information despite of being obliged to verify it under the circumstances. The authors of the article are of the opinion that similarly to German law, the fact that the defrauding party has disclosed unverified information which should have been verified and which proves incorrect later, should serve as sufficient evidence as to the intent to deceive of the same party. Neither is it possible to demand that the establishment of intent to deceive in other cases of fraud involve the definite demonstration of knowledge by the defrauding party.