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Case Comment: Whether the Case of *Derry v Peek* amounted to Fraudulent Misrepresentation

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INTRODUCTION

Within the domain of English contract law, ‘*Derry v Peek*’ is a seminal case that tackles the intricate issue of misrepresentation. When viewed through the lens of the Indian Contract Act, the principles presented by this case yield profound insights into the legal implications surrounding misrepresentation. This commentary delves into the factual backdrop of the case, studies pertinent legal provisions enshrined in the Indian Contract Act and establishes parallels within the jurisprudential context in India.

FACTS OF THE CASE

The Plymouth, Devonport and District Tramways Company released a prospectus that included information on the company's financial situation and the possibility that an Act of Parliament would authorize the intended steam tram operation. By a Special Act, the Tramways Company was authorized to make certain tramways. According to Section 35, the tramway carriages may be carried for predetermined times and per Board of Trade regulations, by animal power or,

with the Board of Trade's approval, by steam or any other mechanical power. All carriages employed on any tramway shall be propelled by the power defined by the Special Act, and where no such power is prescribed, by animal power only, according to **Section 34 of the Tramways Act 1870**¹. In February 1883, in their prospectus, the directors claimed that the company's Special Act gave it the right to substitute steam or mechanical motive power for horses. The plaintiff bought shares based on this claim. The company folded after the Board of Trade denied its request for authorization to use steam power. In 1885, the respondent brought a deceitful action against the directors because of the false declaration.

Initially, at the Trial Court, Stirling J. dismissed the action of Mr. Peek's claim but later, the Court of Appeals ordered an inquiry and reversed this decision stating that the directors were liable and lacked reasonable grounds for their belief. The defendants appealed against this decision.

LEGAL ISSUE

Whether the statements in the company's prospectus amounted to fraudulent misrepresentation and deceit and whether the plaintiff had the right to revoke the agreement he made to purchase shares of the company in reliance on the prospectus.

RULES INCORPORATED

Sections 13², 14³, 15⁴ 16⁵, 17⁶, 18⁷, 20⁸, 21⁹ and 22¹⁰ of the Indian Contracts Act 1872.

¹ Tramways Act 1870, S 34

² Indian Contract Act 1872, s 13

³ Indian Contract Act 1872, s 14

⁴ Indian Contract Act 1872, s 15

⁵ Indian Contract Act 1872, s 16

⁶ Indian Contract Act 1872, s 17

⁷ Indian Contract Act 1872, s 18

⁸ Indian Contract Act 1872, s 20

⁹ Indian Contract Act 1872, s 21

¹⁰ Indian Contract Act 1872, s 22

PLAINTIFF'S CONTENTIONS

In the given case of *Derry v Peek*, Derry claimed that the company's prospectus made deceptive claims about the company's financial status and the chances of passing legislation in Parliament. The prospectus issued by the defendant firm stated that the corporation was permitted to use steam-powered trams rather than horses. Since it required clearance from the Board of Trade, the company actually lacked this authority. In these situations, getting the Board's approval for such a claim was considered merely a formality; hence the claim was made in the prospectus knowing this. However, the Board later turned down the company's request for this power. The people who had invested in the business and relied on the statement brought a deception claim against the defendant corporation after it was liquidated. According to the plaintiff, he was induced to purchase company stock as a result of these deceptive representations, and as a result, his consent was not freely granted.

Derry, the plaintiff, claimed that the information in the prospectus for the company was materially false and deceptive. He said that the prospectus made claims about the company's high level of financial stability and the possibility that a Parliamentary act authorizing the use of steam power for trams would be obtained. Derry asserted that the company's actual financial status and its chances of gaining the required legal approval were not accurately portrayed by these assertions. He claimed that he was persuaded to invest in the company as a result of the prospectus's fabrications. He asserted that he would not have made an investment in the business or bought shares if he had realized the company's true financial situation and the slim chance of getting the act of Parliament. **Derry's primary defense of his position in court focused on the contract's formation lacking free consent.** He asserted that he was significantly influenced by the prospectus' fraudulent representations when making decisions, which prevented him from freely and voluntarily agreeing to the contract. He claimed that the deception had an impact on his investing choice. The appellant demanded compensation for the losses he suffered as a result of his investment in the company based on the deceptive statements. He argued that because the defendants made false statements, they were responsible for the losses he sustained.

DEFENDANT'S CONTENTIONS

On the other hand, Peek's contention that the assertions in the company's prospectus were opinions rather than statements of fact was the foundation of his defense. He said that the claims were really 'puffery' and that it was unlikely that the firm would succeed in getting a law passed by Parliament authorizing the use of steam power for trams. These assertions, according to Peek, were not meant to be interpreted as factual assurances of the company's future success. The defendant asserted that there were no false statements made with the intent to deceive or persuade the plaintiff to buy shares. He asserted that the assertions were made in good faith and were honestly held by the company's directors at the time. The defendant further claimed that the prospectus contained all relevant information and that any prospective investor, including the plaintiff, had the chance to make a well-informed decision based on the data presented. He argued that before investing, the plaintiff ought to have exercised due care and looked into the factual accuracy of the representations.

JUDGEMENT OF THE COURT

The House of Lords dismissed the shareholders' claim. It was decided that the defendants had not engaged in fraud or the tort of deceit because there was no proof that they thought the information in the prospectus was false. The court decided that the shareholders had not proven that the director of the corporation had held a false belief. The court ruled that a statement that is made with reckless or careless disregard for its accuracy is a fraudulent deception. Lord Herschell considered the meaning of fraudulent as follows: *"Fraud is proved when it is shown that a false representation has been made (i) knowingly, or (ii) without belief in its truth, or (iii) recklessly, careless whether it be true or false. Although second and third are distinct cases, third is but an instance of second, for one who makes a statement under such circumstances can have no real belief in the truth of what he states. To prevent a false statement from being fraudulent, there must always be an honest belief in its truth."*¹¹

Due to this, the plaintiff was unable to bring a deceitful business claim against the defendant.

¹ *Derry v Peek* [1889] UKHL 1

ANALYSIS

The decision of the learned Lords that the directors cannot be held liable for fraud is well appreciated. Referring to Section 17 of the Indian Contract Act, 1872 it is clear that the presence of intention to deceive or to induce the other party to enter into the contract is vital to constitute an act as fraudulent. It also requires active concealment of a fact even though having knowledge or belief of the fact. The essence of it is tricking a person into the contract. If the directors hid the requirement for the Board of Trade's authorization in order to make the bait more enticing, fraud was committed. The question then becomes, 'Was it really the purpose to make the bait more enticing? Fraud must always be demonstrated in order to sustain a deceitful activity'. It is necessary to assume that words or deeds have the desired consequences, but not to the point where honesty is substituted with deceit. Once it is proven that a person truly intends to perform his duty, nothing that happens to him can make his words or deeds appear fraudulent. There may be a duty to ensure that no false statements are made, but if there is no objective to deceive, failing to uphold that duty does not constitute fraud. Although a major untruth may be cause for rescinding a contract, fraud, and breach of contract have very distinct implications.

CONCLUSION

In *Weir v Bell*¹², the meaning of 'recklessly' was interpreted, substituting it for 'negligently,' when it actually means 'indifferent whether the statement is true or false'. In this case, the Court of Appeal ruled that a false statement made by a party without valid grounds to believe it to be real, even when the defendant genuinely believed it to be true, constitutes a deceptive act. **Lack of reasonable grounds may be a sign of fraud, although fraud is not the same as lack of reasonable grounds.** If this law is to be followed, a person who is wrong-headed or negligent is a fraud. There is no question that the untruth had some influence on the plaintiff, but there is no proof that he would not have accepted the shares, had the statement accurately described how the required consents were obtained. It is unlikely that anyone can evaluate their mental impressions to the point where they can pinpoint a specific detail in a prospectus that convinced

¹² *Weir v Bell* [1878] 3 Exch D 238

them to subscribe. Companies' promoters won't assume that they can make false claims without being held accountable. The directors had safety nets to protect themselves from losing money if the idea failed, yet they may stand to gain if it succeeded. The directors may have been less meticulous in their evaluation of the credibility of whatever comments they have made as a result of their protection from loss.

A permit to use steam as a form of propulsion was granted to the corporation by **Section 35 of the Special Act**. The usage of steam power has not been mandated upon the corporation, but it is stated that they are free to do it if they so choose. The words 'with the consent of the Board of Trade' in Section 35 of the Special Act indicate that the right granted by the legislature to use steam as a motor could not be provided and that its absence would not revoke it. Its true nature is that it is a precaution put in place by the legislature to delay the actual exercise of the granted right until the public is provided with all reasonable safeguards against risk under the control of the Board of Trade. In order to accomplish these goals, the legislature stipulates that the Board of Trade must approve any real use of the powers it has granted.

According to Lord Cranworth in **Western Bank of Scotland v Addie**¹³, if bank directors make claims about the state of its operations that they honestly believe to be accurate, they cannot be charged with fraud because other people or the court may believe that there is insufficient evidence to support their position. In **Chandelor v Lopus**¹⁴, it was decided that if goods are damaged, and affirmative action is made with knowledge of the damage, it constitutes fraud. However, even if goods are damaged, it is not fraud if the affirmative action is made without knowledge of the damage. One of the appellants, Mr. Wilde, claims that while he was aware that the Board of Trade's approval was required, he mistakenly believed that approval had already been obtained in practice. The plans had been submitted to the Board of Trade in accordance with the Standing Orders with the declaration that both mechanical and horsepower were intended to be used. He assumed that no complaint would be raised later as long as the work was done correctly because the Board of Trade had not complained and the

³ *Western Bank of Scotland v Addie* [1867] UKHL 113

⁴ *Chandelor v Lopus* [1603] 79 ER 3

Bill had been approved. He therefore thought that the statement was true and that they had the right to use steam both practically and legally.

Thus concluding, it is apparent that the defendants were aware of the facts and were aware that their statements were false. However, it does not follow that the assertion was made dishonestly. The directors believed that the corporation had the right to use steam, as stated in the prospectus. But coming to the conclusion, that they had reasonable justifications for their beliefs, or at the very least, that such explanations were not so absurd to support accusing them of misrepresentation and fraud. A director who makes such a declaration owes it to others to ensure that there are no assertions in it that are actually incorrect and to ensure that he has a solid basis for any significant claims made in the prospectus that he intends for others to act upon. **Considering that no valid grounds for fraud could be established, there was a breach of duty.** They stand a possibility of having the contract rescinded if they don't present proof of fraud. Although we can say that the consent of the shareholders may not have been granted freely, **Section 19¹⁵ on voidability of agreements without free consent** contains an exception that prevents voidability of the contract even if the consent was obtained by misrepresentation or fraud, if the party who was wronged had a reasonable opportunity to learn the facts and the shareholders of the tramways company too could not be cognizant of the facts. **Howard Marine v Ogden¹⁶** is one of the cases that addressed the 'Derry v Peek' premise that a representation must be a statement of fact and not an opinion in order to be considered a misrepresentation subject to legal action. In **Smith v Land and House Property Corporation¹⁷**, when examining the type of representations made in prospectuses and the duty of care due by those making the representations to those relying on them, the court cited 'Derry v Peek'. **Misrepresentation Act, 1967¹⁸**, a UK law, sought to offer a statutory remedy for innocent individuals who had been persuaded to engage in contracts based on misrepresentations. It was inspired by the ideas outlined in Derry v Peek and was founded on those concepts.

¹⁵ Indian Contract Act 1872, S 19

⁵ *Howard Marine v Ogden* [1978] QB 574

⁶ *Smith v Land and House Property Corporation* [1884] LR 28 Ch. D 7

⁷ Misrepresentation Act 1967