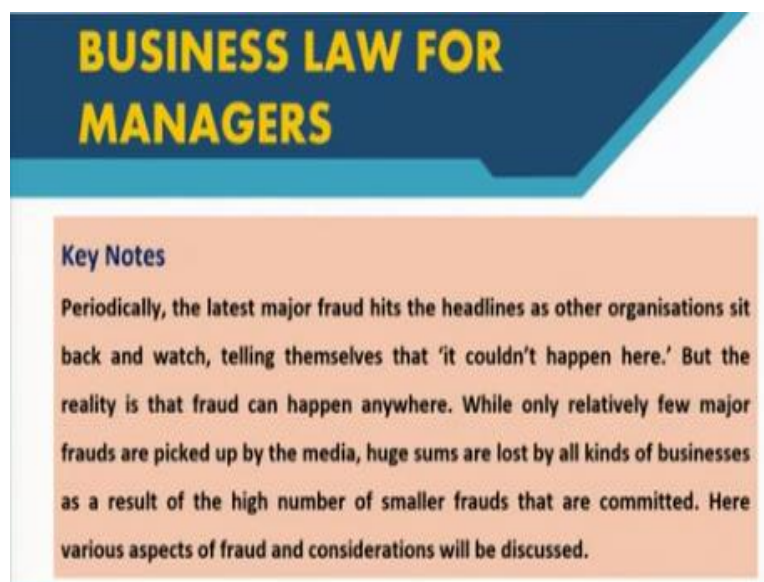


Business Law for Managers
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Module-4: Law of Contract

Lecture - 18
Concept of Fraud, Misrepresentation and Consideration

Good afternoon. This is model 4 lecture 18, Concept of Fraud, Misrepresentation and Consideration.

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In contracts, frauds and misrepresentations obviously are two sides and it is not desirable, but it happens. If it happens, then what happens actually that is what we need to discuss. How we need to treat. And frauds does make the contract void no doubt, but misrepresentations make the contract voidable at the option of the sufferer. So, these are the basic two ingredients of fraud and misrepresentation.

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KEY POINTS

- Concept of Fraud
- Remedies in case of Fraud and Misrepresentation
- Consideration
- Restraint of Legal Procedure

Now we will also touch upon consideration which is a big subject, consideration of different natures. And we will also look into restraint of legal procedure. That is something which needs to be understood because many things arise from restraint of legal procedures when a contract comes to a standstill, further it cannot be developed. And why it happens?

Whether it is avoidable and if at all it is avoidable, what is to be done to make this avoidable. But most of the times it happens that we do a postmortem, before that it cannot be stopped. It has already happened and then we are doing a postmortem because of situations. Not anything else, but because of situations there is a restraint on the legal procedure.

But while entering the contract, if we draft the contract, and if we check all the nuances of the wordings in the contract, to a large extent it is avoidable.

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Concept of Fraud

Introduction

The evidence reveals that the incidence of fraud and financial scandal to be historically contingent and skewed towards certain sectors, particularly banking and finance, international capital mobility, and mediated by managerial incentives and ownership concentration.

In the development of interconnected and international business networks, which, combined with wider financial deregulation, has led to a resurgence of fraud and financial scandal.

Fraud is deliberate. Fraud is something we should deal with the mindset. Purposeful, done with an intent to cheat, that is a fraud. There is no other definition. Is a clear-cut intention being there to cheat and in Latin it is called men's area which means a mind to cheat, a mind which is clear, identifiable. Mala fide intention is totally there to cheat. That is a fraud.

It is not innocent, it is not inadvertence, it is not misrepresentation, it is not mistake. It is a clear cut delivered action.

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Concept of Fraud

What is Fraud ?

- Fraud means inducing any other parties to enter into contract to deceive other parties.
- Section 17 of the Indian Contract Act defines fraud in contracts that – Fraud implies and involves any of the following acts committed by a contracting party or his connivance or his agent with the intention of deceiving or inciting another party or his agent to enter into the agreement.

Inducing any other parties to enter into a contract to deceive other parties. Now intent is to deceive, to cheat.

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Concept of Fraud

Ingredients of Section 17 of Indian Contract Act

When analysed s 17(1) shows the following ingredients:

- i. There should be a suggestion as to a fact;
- ii. The fact suggested should not be true;
- iii. The suggestion should have been made by a person who does not believe it to be true; and
- iv. The suggestion should be made with intent either to deceive or to induce the other party to enter into the contract.

The various instances what happens ingredients there should be a suggestion as to a fact. The fact suggested should not be true. Knowing fully well it is not true the fact will be placed before that. The suggestion should have been made by a person who does not believe it to be true. He does not believe it to be true, yet he does it. So, if he believes it to be true, and he does it, then it becomes actually a case of misrepresentation.

The suggestion should be made with the intent either to deceive or to induce other party to enter into a contract. So, induce other party to enter into a contract is also a fraud because he will then enter into that liability knowing fully well, that this is not going to happen.

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Concept of Misrepresentation

Misrepresentation

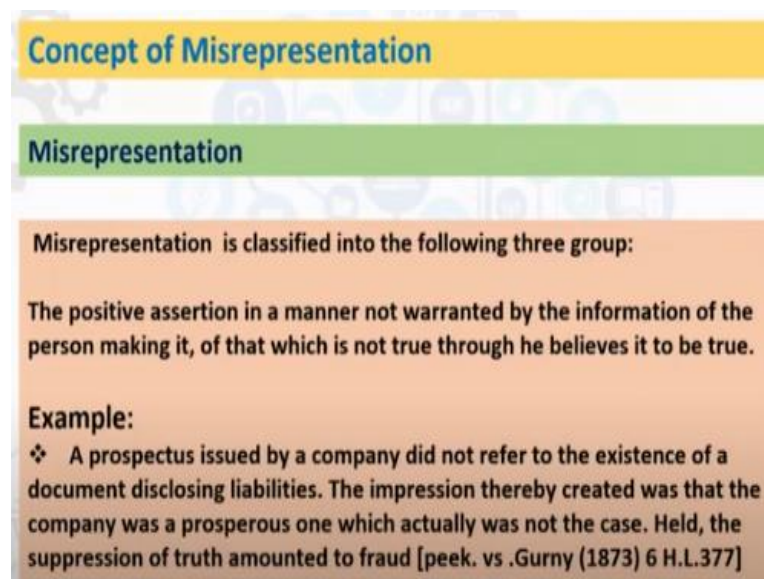
A misrepresentation is an untrue statement of a material fact made by one party which affects the other party's decision in corresponding to a contract.

If the misrepresentation is identified, the contract can be declared void and depending on the situation, the unfavorably impacted party may seek damages.

A misrepresentation on the other side is an untrue statement of a material fact, made by one party which affects the other party's decision in corresponding to a contract. It is material. It is an untrue statement of material fact. If misrepresentation identifies the contract can be declared void and depending on the situation, the unfavorable party impacted may seek damages.

So, there is no penalty here. Because there is no intent to cheat. The moment there is an intent to cheat, a fraud, the penalty word comes in, it is damage. The other party has affected damage on the other party, and therefore has to compensate for the damage. But nothing more than that. Penalty is an over and above damages.

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Concept of Misrepresentation

Misrepresentation

Misrepresentation is classified into the following three group:

The positive assertion in a manner not warranted by the information of the person making it, of that which is not true though he believes it to be true.

Example:

- ❖ A prospectus issued by a company did not refer to the existence of a document disclosing liabilities. The impression thereby created was that the company was a prosperous one which actually was not the case. Held, the suppression of truth amounted to fraud [peek. vs .Gurny (1873) 6 H.L.377]

Misrepresentation can be classified in the following group, the positive assertion in a manner not warranted by the information of the person making it, which is not true, though he believes it to be true. That is the point. He believes it to be true. In case of fraud, he did not believe it to be true. So here he believes it to be true. And therefore, he is passing on that information.

However, that is a material wrong information. Maybe he has not used his due diligence, he has done his due diligence property. Maybe his competency level is less but it is still not a fraud. A prospectus issued by a company did not refer to the existence of a document disclosing liability. The impression thereby created was that the company was a prosperous one, which actually was not the case.

Held the truth, suppression of truth amounted to fraud. So, document disclosing liabilities purposefully or suppressed, so that a loss-making company looks like a profit-making company and duping others to enter into a contract by buying the shares of that company knowing fully well there are documents, we should clearly show the company is in red.

But you are showing the company is in black by removing those documents or not disclosing those liabilities so that others can come and buy the shares. It is a clear case of fraud to deceit or cheat the other party.

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The slide is titled "Concept of Misrepresentation" in a yellow header. Below it is a green bar with the word "Misrepresentation". Underneath is an orange box labeled "Example" which contains the following text:

- ❖ Satyam case
- ❖ Similarly in the prospectus one of the contingent liabilities was not appearing as a disclosure as the company interpreted it differently but should have disclosed by a Note It is a case of misrepresentation.

Satyam case was a clear case of fraud knowing fully well he siphoned the funds from Satyam to Maytas. He cannot say that it was a misrepresentation, it is a mistake, they can never happen. A misrepresentation and a mistake cannot take the place of a fraud in a situation given like this.

And anyone would, any sane person would understand that it cannot happen, that you will give the money to another group company and send all those money without any interest, without any record, without any logic, without any business decision making just to help the other company. And you are saying it is a misrepresentation, it is a mistake.

It cannot happen. Similarly, in the prospectus one of the contingent liabilities is not appearing as a disclosure, as the company interpreted it differently, but should have

disclosed by a note is a case of misrepresentation. Now here is a question of interpretation. Here is a clear case of interpretation. What is a contingent liability? A liability which can happen in the future but however, today it is not a liability.

For example, there is a huge tax demand on the company. However, the company is contesting the tax demand. The company is saying that no this tax demand is not payable. Therefore, the demand that has come from the income tax authorities is now, the company is engaged lawyers, solicitors and it is being placed before the judicial authority, the process of law will decide what is the right what is wrong.

But we have challenged and that has been challenged and that is laying in the for the decision of the court. And there are series of hierarchies for that. If you lose in one court, you go to the higher court, then you go to the higher court. So, it will take time. Even the first stage we have not come.

So, in such a case, if the company feels and there is a legal opinion backed, saying that no it is not a case of contingent liability, the company is clearly within its right not to pay that tax, backed by a legal opinion from a company solicitor. In that case, if the company has not disclosed that in the prospectus, even by way of a note, now can it be taken as a misrepresentation or a fraud is really a question debatable, depending upon the amount then.

The amount will be immaterial. If the amount which he is been talking of is only a small amount compared to the profit the company is showing, and it will not eventually make the profit into loss or reduce the profit by more than 50% then it can be still be taken as a misrepresentation.

But if the profit can be loss because of this demand, and still it is not being shown as a note at least in the prospectus, then there is a serious doubt whether it is done deliberately or it is a misrepresentation. Because if it is shown, the entire prospectus will go to red from black.

So, you know this fine thread of difference between misrepresentation and fraud many times will depend on the situation, on the quantum, on the impact it will have.

So, by clearly saying that it is a misrepresentation and is not fraud may not be possible, case to case it will vary.

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Fraud and Misrepresentation

Difference between Two

- ❖ Fraud is deliberate whereas Misrepresentation is innocent.
- ❖ Fraud – remedy is voidable & damages whereas in case of misrepresentation it is voidable only.

Misrepresentation is normally innocent. Misrepresentation is normally not intended. It is unintentional. Whereas fraud is deliberate. Fraud remedy is void and damages, not voidable it should be void and damages. Whereas in case of misrepresentation, it is voidable only, and damages also and in case of fraud damages plus penalty. Damages would include penalty as well.

Misrepresentation is voidable and damages. It can be negotiated. But it is definitely voidable and the other one is void.

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Remedies in case of Fraud and Representation

In case of misrepresentation, the party aggrieved or wronged has two remedies viz,

- He can avoid the performance of the contract
- He can insist that the contract shall be performed and that shall be put in the position in which he would have been if the representation made has been true.

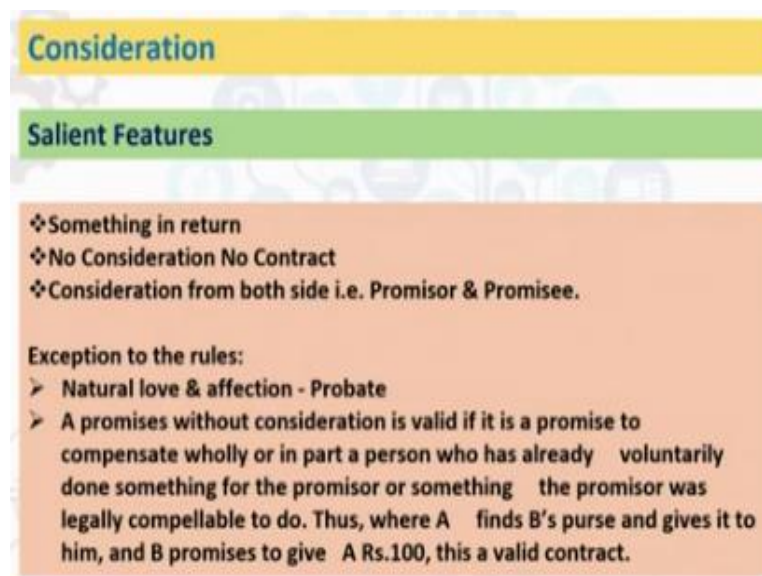
In case of fraud he has an additional remedy i.e., he can sue for damages.

In case of misrepresentation a party aggrieved or wronged has two remedies. For example, he can avoid the performance of the contract that is voidable at the option of the sufferer. He can insist that the contract will be performed that is he goes on in performance of the contract specific performance, please perform the contract. I am okay with that aberration or error.

And he will be put in the position which should have been if the representation made has been true. So, it is called specific performance. You do it, but either we accept it or you put me back the position I was there had the representation been true. Meaning, if you have said you are selling, you are selling this car to me, you should sell me only that car which you have told me.

So, I am not taking the contract as void. I am asking you to specifically perform the contract. So that becomes a specific performance contract. He can ensure that that is voidable at the option. But if it is something of a fraud, it is void at the very instance, at the very beginning it is a contract which is void. In case of fraud, he has additional remedy for damages. Damages, which means damages include penalty.

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Consideration

Salient Features

- ❖ Something in return
- ❖ No Consideration No Contract
- ❖ Consideration from both side i.e. Promisor & Promisee.

Exception to the rules:

- Natural love & affection - Probate
- A promise without consideration is valid if it is a promise to compensate wholly or in part a person who has already voluntarily done something for the promisor or something the promisor was legally compellable to do. Thus, where A finds B's purse and gives it to him, and B promises to give A Rs.100, this a valid contract.

Now consideration. Something in return. We have heard this before also in my lecture back. No consideration no contract. That is another important connotation which always comes. If there is no consideration there cannot be any contract. Consideration has to be there. That is the basic of a contract. Consideration need not be adequate, but the consideration has to be there.

And consideration has to be from both sides. If you buy a car, you pay money, you get a car. So, consideration is not only cash, the money that you pay, consideration is also the car that you get. So, consideration happens from both sides. But if there is no consideration, there is no contract. Exceptions are the first one, natural love and affection, probate or a will that is given by the parents to a son or daughter, discussed I believe one or two classes before.

A promise with consideration is valid if it is a promise to compensate wholly or in part a person who has already voluntarily done something for the promisor. Is a case where a person finds a purse and gives it to him and B promises to give him Rs. 100 is a valid contract. So, when he did that the whole thing, he did it voluntarily. He found a purse gave it back.

He found a laptop in the taxi he went; the taxi driver went and gave back the laptop. When he is giving, I mean laptop back, when he is giving back the laptop back the taxi driver is not accepting anything, voluntarily he did it. But after that, you promised to pay him something for that for the good job, then that becomes a valid contract, which says a promisor without consideration is valid if it is promise to compensate.

Compensate wholly or part a person who has already volunteered on something for the promisor of something. So, he has done it voluntarily. Now if you have made a promise that becomes a valid contract.

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Consideration

Salient Features

- A promise to pay wholly or in part a debt which is barred by the Limitation Act can be enforced if it is in writing and is signed by the debtor or his authorized agent. A debt barred by limitation cannot be recovered. Therefore, a promise to pay such a debt is strictly speaking, without any consideration . But if a written Promise to pay is made by the debtor then the same is enforceable by the creditor.
- Gift
- Agreement between principal and agent

This is another case, a debt barred by limitation. Cannot be recovered. What is the limitation act, three years from the date which becomes due. So, promise to pay wholly in part a debt which is barred by limitation can be enforced, if it is in writing and signed by the debtor or its authorization.

If he writes gives in writing that yes, I will repay the debt even after three years, four years, five years, when the debt is no longer there, if he wants to repay the debt if he writes a note or a contract or a letter stating that I will repay that debt of yours along with interest or without interest whatever it is, then that letter becomes a contract and can be enforceable.

Gift is another example of no consideration no contract. An agreement between principal and an agent.

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Consideration

Rules of Consideration

- ❖ Consideration need not be adequate
- ❖ Consideration must be real & competent

Example:

- * A contract to build the home in moon for Rs. 2 cores
- ❖ Consideration must move at the desire of the promisor.
- ❖ Consideration must be legal
- ❖ Consideration may be present, past or future.

I have time and again said consideration need not be adequate. Adequacy of the consideration is not a case for making a contract valid or not valid. However, when it comes to immovable property, it is important as far as the stamp duty is concerned, what will be the stamp charges they will not consider the consideration amount they will consider the circle rate, what is the rate going at that point of time in that area.

Consideration must be real and competent. And consideration should not be something that would be something which is unreal, which is not possible to be given. Like a contract to build a home in the moon for Rs. 2 crores is impossible to perform. So that kind of consideration. And it is also some consideration which is incompetent and not real, home in the moon, even now today perhaps.

Consideration must move at the desire of the promisor, yes. The promisor should be willing to give that consideration. Consideration must be legal. Consideration may be present, past or future. You can give the consideration right now. You can give it later. You can give it before also and it has to be a legal consideration.

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Agreement Declared Void

Agreement against Public Policy

- ❖ Trading with enemy
- ❖ Agreement for sale of public offices.
- ❖ Agreement in restraint of trade.
- ❖ Agreement employing child labour
- ❖ Agreement interfering in the court of justice.
- ❖ Is agreement to prevent a person to engage to any employment or service during the period of employment in a company is a case of restraint of trade?

Agreement against public policies, again void. Trading with enemy. As I told you, if an enemy country you are doing business that business is void during that period of time. But again, the country is no longer declared as an enemy all contracts you entered thereafter would be valid contracts. Only that period when it is declared as an enemy. Everything comes to a standstill. Agreement in restraint of trade.

If you put some taxes which is forbidding others to do business in a particular area because you are protecting one industry in that area by putting huge taxes on the entry of goods in a particular state, it has happened. Then you are actually doing agreement you are doing something which is in restraint of trade.

So, if that be so in that case, you have entered into a contract by virtue of which you are stopping somebody to enter into a business, which is kind of cartelization we call it in CCI parlance. Four, five companies, they have entered into a contract to reduce the price as soon as somebody wants to enter the market, so that he cannot enter and after they stop him from entering, they again raise the prices, they control the market.

So that is a kind of agreement in restraint of trade. Those kinds of agreements are avoided illegal agreements. Agreement employing child labor is again an illegal agreement against public policy. Agreement interfering in the Court of Justice is again a wrong precedence of agreements against public policy. As I told earlier also, you cannot stop any person from joining competition.

If you enter into a contract or an agreement with an employee that he cannot join competition after leaving this company that contract is unenforceable. What maximum can be done is basically keeping a cooling period of six months or one year. But if an agreement to prevent a person to engage in any employment or service during the period of employment is definitely not a case of restraint of trade.

If you are an employee of a company, you cannot work for another company. So that is not a case of restraint of trade. What happens in restraint of trade is when you are stopping others to enter the market by forming a cartel is restraint of trade.

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Agreement Declared Void

Agreement against Public Policy

- ❖ If a partner enters into an agreement of not getting engaged in any business of that firm or engaging to be a partner of any firm engaged in that business for a certain number of period, is it restraint of trade.
- ❖ If some of manufacturer want to regulate the sale price by an agreement, which is not against public interest, then is such agreement is restraint of trade ?
- ❖ Is service bond restraint of trade? Not really but if unreasonable - yes

If a partner enters into an agreement of not getting engaged in any business of that firm or engaging to be a partner of any firm and engage in that business for a certain number of periods, is it restraint of trade? Yes, you cannot do that. You cannot stop him from joining other firms. That you cannot do because that will be restraint of his fundamental right to join competition or to do whatever he wants to do.

Right to job, right to apply for his you know livelihoods and income. So, you cannot do that. If some of the manufacturer want to regulate the sale prices what happen is called cartelization. That is restraint of trade surely, by an agreement which is not against public interest, then such agreement is restraint. Yes, again which is not against public interest.

Even if it is not against public interest, but he is reducing the price, stopping others to enter the market, that is a restraint of trade. Is service bond restraint of trade? Service bond is something else. Service bond is you are being trained in a company, you are being nurtured in a company, your money is spent on you for your development.

In that case, the company can ask you that you should work for such many numbers of years in the company. And if you want to leave before that you can leave but you have to compensate the company back with the kind of money that the company has invested on you. A proportional amount should be returned to the company. It is a kind of bond which is done. See basically these things are very under the scanner.

You cannot do much on this because if he applies to the, if an employee goes to a court of law and raises all this issue, I think more embarrassment is there in the corporate then on the employee. So good corporates do not do much on this. There is no question of bonding an employee or restraining an employee from joining any company. So those kind of you know practices are not done in big companies.

Some companies do keep this kind of checks and balances that you do not join competition. That is done by almost all companies but in a balanced manner so that it does not hit the law, the procedural aspect in any way. It is more of saying that it is a cooling off period because you have lot of inside information. You are the key architect of this designing or manufacturing.

Therefore, you should abstain yourself from joining competition for a period of one year or two years. You know they give a prelude to the whole thing and then this comes in.

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Restraint of Legal Procedure

- ❖ An agreement between A & B in which agreement state incase of any dispute A's decision shall be final & binding on B, moreover not to take any legal recourse , is such agreement enforceable?
- ❖ A & B enter into a contract in which stated all dispute shall be mutually settled within 15 days of occurrence , and if it cannot be settled , it shall be referred to arbitration. One arbitrator to be appointed by each party, who will jointly appoint the third arbitrator, And it states that the decision of the arbitration will be final & binding & no party to take any legal recourse. Is such agreement enforceable? Yes as legal recourse has to be there unless specifically ruled out after arbitration.

Restraint of legal procedure. An agreement between A and B in which agreement state any dispute A's decision shall be final and binding and B moreover not to take any legal recourse is such agreement enforceable? This is not a case, which will be really looked into or done by a lawyer would approve this.

Because it clearly shows that you are using your power on another party and you are also saying any agreement between this and this in case of any dispute you are saying that my decision will be final and binding. Moreover, you cannot take any legal recourse. This is absolutely unjust. And this such agreement will not be enforceable because free consent is definitely questioned here.

It cannot be other than where you have free question has been you have been coerced; you have been forced to enter into that contract. Prima facie on the face of it is very clear. That if A and B enters into a contract, it says that if there is any dispute between A and B A's decision will be final. Moreover, B will not be able to take any legal recourse. Meaning B cannot go to the even to the court to apply for relief.

So, this is a clear case of coercion and you know force. So free consent is affected in this. Now the other way is A and B enter into a contract which stated that all disputes shall be mutually settled within 15 days of occurrence, and if it cannot be settled it shall be referred to arbitration. One arbitrator to be appointed by each party who will jointly appoint the third.

This is a perfect example, how arbitration takes place. Now decision of the arbitration will be final and binding and no party to take any legal recourse. Is such agreement enforceable? Well, this is a yes and no both. Why? Because you are yourself saying that I will appoint one arbitrator, the other party will appoint one arbitrator. So, these are our own arbitrators.

Now these two will appoint a third arbitrator called the neutral arbitrator who has no connection with me, no connection with you. And it will be he who will decide the fate of our dispute or our case. Now if he gives a decision, that decision will be final and binding. And no party can take any legal recourse on that.

Now though it can be documented like this and it can be enforced also but mostly it is seen that if this award which is given by arbitrator, the single arbitrator when he gives a judgment, it is called an award. If this single arbitrator gives an award which is prima facie biased or prima facie lacking evidence, prima facie missing important points, which has been argued by the two parties.

In that case, one can go to the court of law and ask for justice, even though it is written legal recourse cannot be taken. If you go to the court in that case, and the other party says My Lord he cannot come to the court because legal recourse is not there, then the court will still allow him to hear.

Because the judgment of the award given, he has brought out a case which clearly shows there has been a bias judgment or award or certain evidence have not been considered. Normal course you cannot. If you enter into contract, if the award is clean award, there is no prima facie evidence of being biased and that he has not, you know also considered all the points what has been done, no evidence is lacking in that case, no court will interfere in this kind of matters.

They will say no, you have yourself said you will not come to take any legal recourse then how can you come to court. So, in this particular case, it will depend on the judgment of the arbitrator. If prima facie the judgment of the arbitrator is biased, if it can be shown that it has been a one-sided judgment and the evidence provided by the other party has not been even considered in his judgment.

In that case, he can still go and take the legal recourse. Otherwise, since you have agreed, it will not take a legal recourse or court it cannot go to the court of law. Arbitration will be the final verdict in this type of matters.

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Actually, arbitration and dispute resolution these are in a contract have to be very carefully drafted and considered and more so in international arbitration, international contracts. Because if you are entering into a party in UK and here is one party is in India, then obviously the venue of arbitration is very important.

One party is in India, the other party is in UK, the venue of arbitration if he is England UK, then obviously the other party has got an advantage. Now if it is in India, the other this party has got, Indian party has got an advantage. Therefore, they say keep it at a neutral place, maybe Singapore.

So neutral place of arbitration is very important in this kind, in contracts like this, where you have got international contracts entered into and party is also new, you are not very much you know not been doing business with him for long number of years, it is an initial one or two contracts. So, in that case, it is always advisable to keep the venue of arbitration in a neutral place, number one.

Number two, what would be the law? Whether law of India or law of UK, which law will prevail? So, it is again something which is need to be discussed, deliberated.

Normally if it is international arbitration, if it is as a neutral place like Singapore, maybe laws of Singapore would prevail, because you are accepting that arbitration would be in Singapore, why not accept the judiciary also in Singapore.

Or if you want to challenge in India, you can do the challenge in India, he can do the challenge in UK also of the award. Because in that nobody will write that the award would be final and no legal recourse would be taken, that will not be written. If that is not written, you can challenge the award anywhere you want. So important that arbitration factor is decided.

Lot of contracts in which arbitration points are there finally when dispute happens, people look into the arbitration contract and say it could have been drafted better. There is scope for further improvisation in the contract. We will go to the next slide and see what is there in the other aspects of contract.

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CONCLUSION

The lecture session has briefly discussed on the concept of Fraud , remedies in case of Fraud and Misrepresentation, consideration and restraint of Legal Procedure. Learners might have learnt and get enhanced their knowledge.

We will discuss more as we go forward. Thank you.