

interests of himself and others similarly situated.<sup>54</sup> Nor should there be a stay if a state-court defendant should ever be able to show that the state suit had been brought solely to frustrate and delay his valid claim against the state-court plaintiff.<sup>55</sup> There should also be discretion to stay if the federal plaintiff's cause of action has arisen after suit was filed against him in the state forum. In this case, he has had no opportunity to choose his forum prior to commencement of the state suit, and his current choice might be honored even though the two causes of action turn on a common issue, such as the construction of a contract or the scope of one party's agency.

Except for unusual situations such as these, however, practical considerations favor stays of federal actions which duplicate state suits, just as in other instances of duplicate proceedings.

## LAUDATORY MISREPRESENTATION OF CREDIT STANDING\*

ACCURATE information concerning a man's ability to repay his obligations is vital to the proper functioning of our highly complex credit economy. Since personal knowledge is seldom the rule today, the prospective creditor must rely on statements furnished by credit agencies, banks or individuals who have the necessary first-hand information.<sup>1</sup> Their misrepresentations of

54. See notes 29, 30, and 31 *supra*. Here the arguments for a stay because of burdens on courts and defendants is less persuasive. The defendants, who are seeking to settle for less than their true liability, deserve little protection. And the court may eventually be put to the trouble of another trial anyway, since a showing of fraud or collusion in the first suit makes possible a successful attack on the judgment there rendered. *BALLANTINE, CORPORATIONS* § 155 (rev. ed. 1946).

55. For example, a plaintiff may bring a state suit purposely to forestall any federal proceedings by a needy opponent and to utilize crowded dockets in the state court, see note 25 *supra*, as a means of forcing him into an unfair settlement. The state-court defendant's subsequent federal suit raising the same issues should not then be stayed.

\* *People v. Rockwell*, 275 App. Div. 568, 90 N.Y.S.2d 281 (1st Dep't 1949), *aff'd without opinion*, 300 N.Y. 557, 89 N.E.2d 521 (1949).

1. The extent to which creditors rely on information furnished by others is indicated by the activities of credit rating agencies. Dun & Bradstreet made 7,537,283 investigations in 1948; 2,904,200 inquiries were answered with "analytical" or "specialized" reports. *DUN & BRADSTREET, ANNUAL REPORT 1948*. See *PROCHNOW & FOULKE, PRACTICAL BANK CREDIT* 68 (1939). The Credit Bureau of Greater New York has over 5,000,000 names on file, and in normal times receives 3,000 inquiries daily. Green, *They Get All the Credit*, *Nation's Business*, March, 1945, p. 62, 65. For a description of credit agencies, see *PROCHNOW & FOULKE, op. cit. supra*, cc. III-VI.

According to J. M. Chapman, 141 banks have reported that "the most important source of credit information concerning applicants for personal loans is the bank's own commercial credit department; the outside sources were ranked . . . in the following order of importance: retail credit exchange agencies, the applicant's employer, his bank, his creditors, mercantile credit agencies, and bank and other personal loan credit exchange bureaus."

the future debtor's financial position, may therefore cause the creditor considerable harm. While a sense of business morality and civil remedies in tort tends to curb such abuses of trust, criminal sanctions may also be desirable if accurate credit information is to be assured.<sup>2</sup>

In *People v. Rockwell*,<sup>3</sup> however, the Appellate Division of the New York Supreme Court refused to apply a criminal sanction against a party who knowingly made a false statement of fact regarding a prospective debtor's financial responsibility. Title Guarantee and Trust Co., under its program of accounts receivable financing, maintained a running account for one Benjamin, president of Metropolitan Machine Shops, Inc.<sup>4</sup> Early in 1946, TG&T, fearing that Metropolitan's accounts receivable were not sound, conducted an investigation which seemed to confirm their suspicions. Before full repayment could be obtained, four lending institutions asked TG&T for information concerning Benjamin's credit standing.<sup>5</sup> TG&T replied to each that the account was "satisfactory."<sup>6</sup> One of the inquiring firms thereupon made a loan to Benjamin who then repaid the TG&T loan in full. Shortly thereafter, the new creditor discovered that Metropolitan's accounts receivable were fictitious. Metropolitan was put into involuntary bankruptcy, and Benjamin was sentenced to from ten to twenty years after pleading guilty to charges of grand larceny and forgery.<sup>7</sup>

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CHAPMAN, COMMERCIAL BANKS AND CONSUMER INSTALMENT CREDIT 92 (1940). For the sources used in other lending fields in appraising the financial condition of the prospective debtor see PHELPS, IMPORTANT STEPS IN RETAIL CREDIT OPERATION cc. 3,12 (1947); SAULNIER & JACOBY, ACCOUNTS RECEIVABLE FINANCING 109-117 (1943); SAULNIER, INDUSTRIAL BANKING COMPANIES AND THEIR CREDIT PRACTICES 102-103, 119-145 (1940); YOUNG, PERSONAL FINANCE COMPANIES AND THEIR CREDIT PRACTICES 89-106 (1940). See also JACOBY & SAULNER, TERM LENDING TO BUSINESS 89-91 (1942) (Federal Reserve Banks and RFC methods are, in broad outline, the same as commercial banks. *Id.* at 90).

2. See pages 994-7 *infra*.

False statements made without knowledge of their falsity have been made criminal in some jurisdictions, e.g., IOWA CODE ANN. § 502.26 (1949) (statements made to State Securities Commissioner), *State v. Dobry*, 217 Iowa 858, 250 N.W. 702 (1933), *appeal dismissed*, 293 U.S. 519 (1934); N.J. STAT. ANN. § 2:107-1 (1939) (false advertising), *State v. Silverman*, 116 N.J.L. 242, 183 Atl. 178 (1936).

3. 275 App. Div. 568, 90 N.Y.S.2d 281 (1st Dep't 1949), *aff'd without opinion*, 300 N.Y. 557, 89 N.E.2d 521 (1949).

4. The accounts were assigned on a non-notification basis.

5. It is standard practice for banks to release credit information to responsible inquirers and ask for the same service in return. Many banks in large cities maintain separate departments which do nothing but collect and disseminate such information. See Brief for Appellants, pp. 11, 12, *People v. Rockwell*, 275 App. Div. 568, 90 N.Y.S. 2d 281 (1st Dep't 1949); Brief for Appellants, p. 3, *People v. Rockwell*, 300 N.Y. 557, 89 N.E.2d 521 (1949). See also note 1 *supra*.

6. Brief for Respondent, pp. 6,7, *People v. Rockwell*, 275 App. Div. 568, 90 N.Y.S.2d 281 (1st Dep't 1949). Defendants also stated that they would hate to lose Benjamin's account, that they regarded him "very highly" and considered him a good "moral risk." Brief for Appellant, pp. 8,9, *People v. Rockwell*, 300 N.Y. 557, 89 N.E.2d 521 (1949).

7. For a more detailed account of Benjamin's activities, see Kurtz, *I Get 'Em When They're Broke*, Sat. Eve. Post, Jan. 21, 1950, pp. 24, 73-4.

The District Attorney then initiated criminal proceedings against TG&T and its employees who had participated in the misrepresentation.<sup>8</sup> The indictment was based on Section 926-a of the New York Penal Law which broadly prohibits the circulation of false statements of fact knowingly made about the financial responsibility of any person, firm or corporation with intent that the information be relied upon.<sup>9</sup> A jury found the defendants guilty,<sup>10</sup> but the Appellate Division reversed on two alternative grounds: first, that knowledge of the falsity had not been proved beyond a reasonable doubt; and second, that the legislature intended to prohibit only false derogatory statements—since the defendant's statements were "laudatory" Section 926-a did not apply. The Court of Appeals affirmed the Appellate Division without opinion.<sup>11</sup>

The Appellate Division reached its second holding after examining the scanty and uninformative history of the statute. Although Section 926-a is not confined by its terms to derogatory statements only, it was placed under the Libel article of the Penal Law upon its passage in 1933.<sup>12</sup> Seven years later the Law Revision Commission removed the section from the Libel article and placed it under Frauds and Cheats "for logical arrangement."<sup>13</sup> The Appellate Division, inferring an initial legislative intent to confine the statute to derogatory statements, concluded that this locational change did not expand its terms to include laudatory statements as well. The contrary inference, however, would be more plausible. There would have been no reason to remove Section 926-a from the Libel article "for logical arrangement" if it were confined to derogatory statements.

There is, of course, a great practical difference between these two interpretations. The Appellate Division, by confining Section 926-a to deroga-

8. The individual defendants were the vice-president in charge of banking, an assistant vice-president, and a bank clerk, head of the credit department.

9. "Any person who knowingly and wilfully states, delivers or transmits by any means whatever to any person, firm or corporation, any false and untrue statements of a fact concerning the financial responsibility of any person, firm or corporation, with intent that the same shall be acted upon, is guilty of a misdemeanor." N.Y. PENAL LAW §926-a. Compare ME. REV. STAT. c.117, §35 (1944). *People v. Rockwell* is the first reported case brought under §926-a. The indictment also contained a count charging the individual defendants with conspiracy to violate the section.

10. The bank was fined \$2,500. Its vice-president received a suspended sentence, the assistant vice-president received six months in the workhouse, and the bank clerk received a six-months suspended sentence. Brief for Appellants, pp. 4,5, *People v. Rockwell*, 275 App. Div. 568, 90 N.Y.S.2d 281 (1st Dep't 1949).

11. 300 N.Y. 557, 89 N.E.2d 521 (1949).

12. N.Y. Laws 1933, c. 422, § 1354.

13. N.Y. Laws 1940, c. 561, § 4. See SEN. JOURNAL 1288 (N.Y. 1940): "Note: For logical arrangement this section is transferred from article 126 relating to Libel to article 86, relating to Frauds and Cheats." The change was accomplished by a Revision Bill, a term employed "to indicate those bills recommended by the Commission to make changes in the statutes merely in matters of form." LAW REV. COMM'N, REPORT, RECOMMENDATIONS AND STUDIES 407n. (1940). The wording of the statute was not changed.

tory statements,<sup>14</sup> protects only the person about whom a statement is made. Construction of the statute to include commendatory statements also protects the creditor who relies on the information.<sup>15</sup>

By refusing to extend criminal sanctions, the Appellate Division has left prospective creditors to rely on existing curbs on false laudatory statements—business morality and civil remedies in tort. Neither of these is adequate. Although unwritten codes of ethics undoubtedly govern the businessman's conduct in large part, honesty is still not regarded as the best policy in many varied business transactions.<sup>16</sup> Moreover, civil remedies penalizing the person who knowingly makes a false commendatory statement<sup>17</sup> are ineffective deterrents. The maker of the false statement may well consider the prize worth the gamble, for the injured party has the burden of showing that he relied on the false information and that this reliance was the cause of his loss.<sup>18</sup>

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14. So confined, § 926-a is still an extension over previous criminal statutes. N.Y. PENAL LAW § 1340 already prohibits *written* "malicious" statements having a tendency to injure any person in his business or occupation, and N.Y. PENAL LAW §§ 303, 1204 prohibit oral derogatory statements against banks and insurance companies, see *State v. Kollar*, 93 Ohio St. 89, 112 N.E. 196 (1915), a protection which § 926-a gives to "any person, firm or corporation."

15. Present false pretenses statutes are not flexible enough to include this situation. See note 23 *infra*.

16. See, e.g., SUTHERLAND, *WHITE COLLAR CRIME* (1949) *passim*, and BARNES & TEETERS, *NEW HORIZONS IN CRIMINOLOGY* 41-55 (1943), which indicate that the facts of the *Rockwell* case are not completely aberrational.

17. See generally PROSSER, *TORTS* c. 16 (1941). When a false statement concerns financial responsibility, the most widely used form of recovery is the action of deceit. The injured party can recover where the falsifier misrepresented another's financial position, *Pasley v. Freeman*, 3 D. & E. 51, 100 Eng. Rep. 450 (1789); *H. D. Sojourner & Co. v. Joseph*, 186 Miss. 755, 191 So. 418 (1939), as well as his own, whether made directly to the injured party, *First State Sav. Bank v. Dake*, 250 Mich. 525, 231 N.W. 135 (1930), or through a third party—usually a mercantile agency. *Davis v. Louisville Trust Co.*, 181 Fed. 10 (6th Cir. 1910); *Penn Anthracite Mining Co. v. Clarkson Securities Co.*, 205 Minn. 517, 287 N.W. 15 (1939); *Jamestown Iron & Metal Co. v. Knofsky*, 291 Pa. 60, 139 Atl. 611 (1927).

The expansion of remedies for false statements is discussed in Harper & McNecly, *A Synthesis of the Law of Misrepresentation*, 22 MINN. L. REV. 939 (1938); Green, *Deceit*, 16 VA. L. REV. 749 (1930).

18. E.g., *Standard Surety & Casualty Co. v. Plantsville Nat. Bank*, 158 F.2d 422 (2d Cir. 1946), *cert. denied*, 331 U.S. 812 (1947); *Hindman v. First Nat. Bank of Louisville*, 112 Fed. 931 (6th Cir. 1902), *cert. denied*, 186 U.S. 483 (1902); *Farmer's Savings Bank v. Jameson*, 175 Iowa 676, 157 N.W. 460 (1916); cf. *Masche v. Nichols*, 188 Va. 857, 51 S.E.2d 144 (1949).

Other difficult problems of proof may discourage the injured party from bringing suit. The falsity of the statement must be proved by the plaintiff. *Shriver v. Fourth Nat. Bank*, 121 Kan. 388, 247 Pac. 443 (1926); *Park & Tilford Import Corp. v. Passaic Nat. Bank & Trust Co.*, 129 N.J.L. 436, 30 A.2d 24 (1943). In addition, the plaintiff must usually show that the statement was knowingly made. *Jorgensen v. Albertson*, 129 Wash. 686, 225 Pac. 639 (1924). *But see Ultramares Corp. v. Touche*, 255 N.Y. 170, 174 N.E. 441 (1931).

A criminal sanction such as Section 926-a, on the other hand, is likely to be a more persuasive deterrent. To be sure, it requires that knowledge of the falsity be proved beyond reasonable doubt, a requirement that proved a stumbling block in the *Rockwell* case.<sup>19</sup> But it does not require proof of loss or proof that the false statement caused the loss. Moreover, the possibility of a criminal trial, whether or not a conviction results, is something to reckon with in the credit rating field.<sup>20</sup> A charge of misrepresentation not only subjects a person to the general stigma of being involved in criminal proceedings,<sup>21</sup> but also damages the very reputation for honesty and

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Relief has been granted, however, for reckless or negligent statements under special circumstances. *Sovereign Pocohontas Co. v. Bond*, 120 F.2d 39 (D.C. Cir. 1941); see also *Harper & McNeely*, *supra* note 17 at 955-90. Moreover, the false statement must have been one of fact, not opinion. *Shine v. Dodge*, 130 Me. 440, 157 Atl. 318 (1931). Furthermore, an injured party who seeks to recover from a bank or other employer must show that the falsifying employee was acting within the scope of his employment, *e.g.*, *Oppenheimer v. Harriman Nat. Bank & Trust Co.*, 301 U.S. 206, 212 (1937); *Standard Surety & Casualty Co. v. Plantsville Nat. Bank*, 158 F.2d 422 (2d Cir. 1946), *cert. denied*, 331 U.S. 812 (1947), or that benefit was received by the employer, *e.g.*, *Martin v. Gotham Nat. Bank*, 248 N.Y. 313, 162 N.E. 91 (1928).

The deterrent effect of the civil remedy is further lessened by the ever-present possibility that a suit can be settled out of court. Such a settlement entails little or no adverse publicity, and may in fact result in the falsifier gaining more than he has lost in the affair.

19. Section 926-a requires not only that the false statement be knowingly made, but also that it be made with intent that it be relied upon. The latter requirement would seem to be an undesirable addition to a prosecutor's burden of proof. But practically speaking it should make no difference in credit-information cases. A prospective creditor almost invariably seeks information for the purposes of relying on it, and every supplier is well aware of this fact. Thus in most cases intent may be conclusively presumed.

20. Although the effectiveness of criminal sanctions as a deterrent has been questioned, careful writers have distinguished between professional and non-professional law-breakers. See HALL, *THEFT, LAW AND SOCIETY* 293-4 (1935): "[R]eduction of criminality by deterrence through fear of punishment has never been demonstrated, but if coupled with otherwise effective administration, is a common-sense probability among non-professionals." (author's emphasis).

Moreover, the *Rockwell* situation should be distinguished from the situations where criminal sanctions have not worked well against businessmen, *e.g.*, where the crime is committed against a vague entity such as "the stockholders," "the general public," or "consumers," or where businessmen violate laws with which a substantial majority of the business community do not agree politically or economically. See SUTHERLAND, *WHITE COLLAR CRIME* (1949). In contrast, a businessman who disseminates false credit information to other businessmen directly injures a member of his own group whose approval he especially desires and needs. A criminal sanction here has the great advantage of publicizing the falsifier's conduct in the most adverse way. See SUTHERLAND, *WHITE COLLAR CRIME* 219-20 (1949): "[A] violation of the legal code is not necessarily a violation of the business code. Prestige is lost by violation of the business code but not by violation of the legal code except when the legal code coincides with the business code." See also HALL, *THEFT, LAW AND SOCIETY* 294 (1935).

21. See Berge, *Remedies Available to the Government Under the Sherman Act*, 7 *LAW & CONTEMP. PROB.* 104, 111 (1940); M. Cohen, *Moral Aspects of the Criminal Law*, 49

accuracy on which his business success depends.<sup>22</sup>

The appropriateness of criminal sanctions has been recognized by legislatures in situations analogous to the *Rockwell* case. The Federal Securities Act<sup>23</sup> and many state blue sky laws<sup>24</sup> make the misrepresentation of a corporation's financial condition criminal. In the field of credit rating many states, including New York, have false financial statement statutes<sup>25</sup> which

YALE L.J. 987, 1019, 1022 (1940); SUTHERLAND, *WHITE COLLAR CRIME* 225 (1949).

22. A criminal sanction seems potentially more damaging than a civil sanction for two reasons. First, most civil suits can be kept from ever seeing the light of day by out-of-court settlement before a complaint is brought. Unless he feels in a vindictive mood, the prospective plaintiff will be only too happy to avoid the time and trouble—and risk—of a formal court action. On the other hand, the public prosecutor with ample evidence has no similar reason for dropping his case. Second, a civil suit even though instituted is not likely to prove as damaging as a criminal charge. Many civil suits are brought without any real prospect of success. In contrast, criminal proceedings are rarely instituted without a comfortable accumulation of evidence. Thus the public at large will ordinarily give much more credence to the latter than to the former. Cf. Berge, *Remedies Available Under the Sherman Act*, 7 LAW & CONTEMP. PROB. 104, 111 (1940): "While civil penalties may be as severe in their financial effect as criminal penalties, yet they do not involve the stigma that attends indictment and conviction." And see note 20 *supra*.

23. 48 STAT. 87 (1933), 15 U.S.C. § 77x (1946), and 48 STAT. 904 (1934), as amended, 15 U.S.C. § 78ff (1946). See *Crooker v. SEC*, 161 F.2d 944 (1st Cir. 1947); *Bank of America v. Douglas*, 105 F.2d 100 (D.C. Cir. 1939). For a discussion of these statutes see Herlands, *Criminal Law Aspects of the Securities Exchange Act of 1934*, 21 VA. L. REV. 139 (1934); MacIntyre, *Criminal Provisions of the Securities Act and Analogies to Similar Criminal Statutes*, 43 YALE L.J. 254 (1933). The English courts likewise punish such misrepresentations, *Rex v. Kyslant*, [1932] 1 K.B. 442 (1931).

For similar criminal penalties in related fields where accurate information is also vital and difficult to obtain, see 53 STAT. 1176-7, (1939), 15 U.S.C. §§ 77www-yyy (1946) (Trust Indenture Act) and 54 STAT. 846, 853, 857 (1940), 15 U.S.C. §§ 80a-48, 80b-7, 8, 17 (1946) (Investment Companies and Advisors Act).

24. See, e.g., FLA. STAT. ANN. c. 817, § 817.34 (1944); ILL. ANN. STAT. c. 121½, § 127 (Smith-Hurd, 1936); N.Y. PENAL LAW §§ 421, 926, 952; PA. STAT. ANN. tit. 70, § 52 (Purdon, 1931); TEX. REV. PENAL CODE art. 1083a (Vernon, 1948). See generally CCH, *BLUE SKY LAW REP.* (1946). See note 2 *supra*.

25. A model statute, formulated by the National Association of Credit Men, has been widely adopted. See, e.g., N.Y. PENAL LAW § 1293-b which punishes any person (1) who knowingly makes a false written statement of financial condition, intending it to be relied upon, for the purpose of procuring personal property, cash or credit, or (2) who knowingly procures the designated property on the faith of another's false written statement, or (3) procures property on the faith of a false statement to the effect that a previous statement continues to be true.

This statute does away with many of the difficulties of prosecuting under false pretenses statutes, formerly the only sanction against such conduct. See NATIONAL ASS'N OF CREDIT MEN, *CREDIT MANUAL OF COMMERCIAL LAWS* 1949 344-7 (1948). Under these statutes it is often difficult to prove that the accused obtained the property as a result of the false statement. *Treadwell v. State*, 99 Ga. 779, 27 S.E. 785 (1896); *Commonwealth v. Randle*, 180 Atl. 720 (Pa. Super. Ct. 1935), 36 COL. L. REV. 838 (1936). In addition, some states have held that obtaining credit by false pretenses is not punishable because "credit" is not "property" within the meaning of the statutes. *Lochner v. State*, 218 Wis. 472, 261