

MISREPRESENTATION — PART I

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The modern law of misrepresentation stems from three doctrinal streams which have recently begun to converge. It has evolved principally from the action on the case for deceit. It has also been influenced by negligence, with which it overlaps and into which it merges, particularly in connection with the conduct of professions. And it is affected by developments in the law of products liability as well as, more generally, the field of consumer protection law, which tend to condition expectations about the effect of representations in commercial transactions.

§ 1. DECEIT AS A SEPARATE TORT

Originally allied to the action for breach of warranty, it was not until 1789 that an action for deceit was available to one other than a party to a business transaction with his deceiver. In *Pasley v. Freeman*,¹ it was held by a divided court that one who fraudulently induced another to extend credit to a person known to be untrustworthy could be held liable to the person thereby defrauded. After *Pasley*, deceit, as a distinct tort, was definitely disassociated from actions for breach of warranty² and the basis for the legal duty was perceived to be independent of contractual relations between the parties. The source of the duty is the law and the basis is the relationship of the parties which usually, but not necessarily, involves a business transaction between them.

The type of interest protected by the law of deceit is the interest in formulating business judgments without being misled by others — in short, in not being cheated. Generally, the law of deceit is limited

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This article is based upon a draft chapter for a forthcoming revision of F. HARPER & F. JAMES, JR., *THE LAW OF TORTS* (1956). It follows the organization of and incorporates some language from Chapter 7 of the original work, which chapter was written principally by the late Professor Fowler V. Harper. The revision constitutes, however, a substantially complete reformulation.

1. 100 Eng. Rep. 450 (K.B. 1789).

2. For the earlier point of view, see *Leakins v. Clissel*, 82 Eng. Rep. 1022 (K.B. 1663); *Roswel v. Vaughan*, 79 Eng. Rep. 171 (K.B. 1607).

to misrepresentations which mislead another into an unwise judgment in some business enterprise resulting in financial loss.³

It is for this reason that this phase of the law has traditionally been closely associated with the mores of the commercial world. As recently as 1938 the following statements were made in the Scope Note to the chapter on misrepresentation and nondisclosure in business transactions of the *Restatement of Torts*:

Courts have recognized that parties to a bargain deal at arm's length and have made but little effort to care for those whose acumen and sagacity are inferior to those of their adversaries. In some particulars the recent tendency of the courts has been to relax the requirement of vigilance against deception but there is no tendency to require commercial or financial adversaries to lay all their cards on the table face upward when dealing with one another.⁴

In recent years, however, there has been increasing social discomfort with this notion about the relationship between parties to commercial transactions. There has been a matching awareness that the common law action of deceit, permeated by the ancient tradition of caveat emptor, provides only feeble and inadequate protection for large classes of consumers who are today victimized by fraudulent and deceitful practices, often pursued by sellers of securities or goods or real estate and by persons who lend money or furnish credit.⁵ The harmful incidence of these practices upon poor persons is the most severe and fraught with the most serious consequences, but the poor are by no means the only victims. Recognition of this problem has led to a number of statutes which relax and modify some of the

3. Cf. Bohlen, *Misrepresentation as Deceit, Negligence or Warranty*, 42 HARV. L. REV. 733, 734-37 (1929) (commercial, financial or other economic matters); Green, *Deceit*, 16 VA. L. REV. 749 (1930) (property interests, particularly as affected by sales and commercial transactions); Weisiger, *Bases of Liability for Misrepresentation*, 24 ILL. L. REV. 866, 869-70 (1930) (commercial transactions).

4. RESTATEMENT OF TORTS, Scope Notes, at 58 (1938).

5. For a sampling of fairly current critical comment, see Coffey & Welch, *Federal Regulation of Land Sales: Full Disclosure Comes Down to Earth*, 21 CASE W. RES. L. REV. 5 (1969); *Consumer Protection Symposium*, 14 SANTA CLARA LAW. 447 (1974); Hester, *Deceptive Sales Practices and Form Contracts — Does the Consumer Have a Private Remedy?*, 1968 DUKE L.J. 831; Robertson, *Consumer Protections Under the Uniform Consumer Credit Code*, 41 MISS. L.J. 36 (1969); *Symposium on Consumer Protection*, 64 MICH. L. REV. 1197 (1966); *Symposium — The Developing Law of Consumer Protection*, 10 GONZ. L. REV. 319 (1975); Tydings, *Fair Play for Consumers*, 6 TRIAL 37 (Feb./Mar. 1970); *Developments in the Law — Deceptive Advertising*, 80 HARV. L. REV. 1005 (1967); Comment, *Condominium Regulation: Beyond Disclosure*, 123 U. PA. L. REV. 639 (1975); Comment, *Translating Sympathy for Deceived Consumers into Effective Programs for Protection*, 114 U. PA. L. REV. 395 (1966).

common law restrictions on the traditional damage action or on the equitable remedy of rescission. The pioneer legislation in this field dealt with the sale of securities.⁶ More recent statutes and proposals deal with consumers,⁷ debtors,⁸ and home-buyers.⁹ Moreover, increasing social concern with these problems has led to some rather modest changes in the judicial rules governing the action.

It would be out of place in a general torts discussion to treat the recent legislation in depth. The attempt here will be, rather, to outline the traditional rules and the judicial developments in them and then to indicate typical ways in which modern legislation does or may modify the common law rules. This should afford a basis for understanding the remedial aspects of the legislation and also for

6. Securities Act of 1933, ch. 38, §§ 1-26, 48 Stat. 74-92 (1933) (current version at 15 U.S.C. §§ 77a-77aa (1970 & Supp. V 1975)); Securities Exchange Act of 1934, ch. 404, §§ 1-211, 48 Stat. 881-909 (1934) (current version at 15 U.S.C. §§ 78a-78jj (1970 & Supp. V 1975)); 3 L. LOSS, SECURITIES REGULATION 1746-54 (2d ed. 1961). For an exhaustive treatment of civil liabilities under these statutes, see 3 L. LOSS, *supra* at 1623-876; 6 L. LOSS, *supra* at 3780-4007 (Supp. 1969).

7. See, e.g., Motor Vehicle Information and Cost Savings Act, 15 U.S.C. §§ 1981-1991 (Supp. V 1975), *discussed in* Yates v. Tindall & Son Pontiac, 531 F.2d 293 (5th Cir. 1975), Duval v. Midwest Motors, Inc., 425 F. Supp. 1381 (D. Neb. 1977), Rider Oldsmobile, Inc. v. Wright, 415 F. Supp. 258 (M.D. Pa. 1976), Mataya v. Behm Motors, Inc., 409 F. Supp. 65 (E.D. Wis. 1976), Birdwell v. Hartsville Motors, Inc., 404 F. Supp. 625 (M.D. Tenn. 1975); Federal Trade Commission Improvement (Magnuson-Moss Warranty) Act § 1, 15 U.S.C. §§ 2301-2312 (Supp. V 1975); Illinois Consumer Fraud and Deceptive Business Practices Act § 1, ILL. REV. STAT. ch. 121½, § 261 (1973) (amending ILL. REV. STAT. ch. 121½, §§ 261 *et seq.* (1971)), *discussed in* Brooks v. Midas Int'l Corp., 47 Ill. App. 3d 266, 361 N.E.2d 815 (1977), Rice v. Snarlin, Inc., 131 Ill. App. 2d 434, 266 N.E.2d 183 (1970) (statute prior to amendment); MASS. GEN. LAWS ANN. ch. 93A, § 9 (West 1972 & West Supp. 1977-78), *discussed in* York v. Sullivan, 75 Mass. Adv. Sh. 3379, 338 N.E.2d 341 (1975), Rice, *New Private Remedies for Consumers: The Amendment of Chapter 93A*, 54 MASS. L.Q. 307 (1969); New Jersey Consumer Fraud Act § 1, N.J. STAT. ANN. §§ 56:8-1 *et seq.* (West 1964 & West Supp. 1977-78), *discussed in* Neveroski v. Blair, 141 N.J. Super. 365, 358 A.2d 473 (1976); Consumer Protection Act, WASH. REV. CODE ANN. §§ 19.86 *et seq.* (Supp. 1976), *discussed in* Fisher v. World-Wide Trophy Outfitters, Ltd., 15 Wash. App. 742, 551 P.2d 1398 (1976); Leete, *A Look at the Consumer Warranty Problem — The Federal Solution*, 6 U. TOL. L. REV. 351 (1975); Robertson, *Consumer Protection Under the Uniform Consumer Credit Code*, 41 MISS. L.J. 36 (1969); Tydings, *Fair Play for Consumers*, 6 TRIAL 37 (Feb./Mar. 1970).

8. E.g., Truth in Lending Act of 1968, 15 U.S.C. §§ 1601-1677 (1970 & Supp. V 1975); NATIONAL CONFERENCE OF COMMISSIONERS ON UNIFORM STATE LAWS, UNIFORM CONSUMER CREDIT CODE (rev. final draft 1969). See Robertson, *Consumer Protection Under the Uniform Consumer Credit Code*, 41 MISS. L.J. 36 (1969).

9. E.g., Interstate Land Sales Full Disclosure Act, 15 U.S.C. §§ 1701-1720 (1970 & Supp. V 1975). For a critical review of this Act's provisions and a brief summary of existing state laws, see Case & Jester, *Securities Regulation of Interstate Land Sales and Real Estate Development — A Blue Sky Administrator's Viewpoint* (pts. 1 & 2), 7 URB. LAW. 215, 385 (1975); Coffey & Welch, *Federal Regulation of Land Sales: Full Disclosure Comes Down to Earth*, 21 CASE W. RES. L. REV. 5 (1969). In addition to civil liability there can be criminal penalties for violation of this Act. See, e.g., United States v. Goldberg, 527 F.2d 165 (2d Cir. 1975), *cert. denied*, 425 U.S. 971 (1976).

handling problems in that area — still large — to which the legislation does not yet extend.¹⁰

Under the traditional common law rule, the type of conduct which subjects one to liability for deceit consists of (1) false representations (2) fraudulently made (3) with the intention of inducing another to rely thereon. If such misrepresentations (4) induce reliance and (5) the reliance is justified and (6) causes damage, the defendant is liable.¹¹ The older law also afforded remedies for misrepresentation by way of rescission (of the transaction induced thereby), and, as we shall see, the requirements for rescission were less strict in one or two particulars than those just listed for damage actions, but beyond that they were pretty much the same. We shall also see that a defrauded party may in some situations have other remedies, *e.g.*, by way of defense to an action for the purchase price of goods sold to him through fraud. But, in such situations as well, the availability of the remedy is tested largely by the rules which are applied in a damage action or a suit for rescission, so that from this point of view also it is convenient to start with a consideration of those rules.

§ 2. SCOPE OF LIABILITY IN DECEIT

The scope of the law's protection afforded by the damage action was originally very narrow. It extended only (1) to the person (or persons) to whom the defendant made the misrepresentation with the intent to cause him to act in reliance upon it, and to such person only (2) for the pecuniary harm, through such reliance in the transaction or type of transaction in which the maker intended to influence his conduct.¹

Under this rule a person who was not one of those whom the maker of the statement intended to influence by it could not recover for loss suffered in reliance on the statement even where such

10. Even in the fields affected by legislation, coverage is sometimes far from complete. The Federal Interstate Land Sales Full Disclosure Act, 15 U.S.C. §§ 1701-1720 (1970 & Supp. V 1975), for instance, has basic application only to sales of lots in subdivisions defined as "land which is divided or proposed to be divided into fifty or more lots . . ." 15 U.S.C. § 1701(3) (1970).

11. As the *Restatement of Torts* summarizes it,
One who fraudulently makes a misrepresentation of fact, opinion, intention or law for the purpose of inducing another to act or to refrain from action in reliance upon it, is subject to liability to the other in deceit for pecuniary loss caused to him by his justifiable reliance upon the misrepresentation.

RESTATEMENT (SECOND) OF TORTS § 525 (1977).

1. RESTATEMENT OF TORTS § 531 (1938).

reliance and loss were reasonably foreseeable.² For instance, in *Wells v. Cook*,³ defendant sold sheep to the plaintiff's principal through plaintiff (the principal's brother) as agent, defendant falsely representing to plaintiff that the sheep were healthy. Plaintiff later bought his brother's flock relying on the statements made to him as agent, and the whole flock was lost because of the diseased condition of the sheep originally sold by defendant. Recovery was denied because the statement was not "intended to be acted on" by plaintiff "in a matter affecting himself."⁴ Similarly, a number of cases held that persons who bought shares of stock on the market could not take advantage of statements in a prospectus intended to induce the original purchase of stock from the issuing corporation.⁵ Moreover, defendant would not be liable for a loss suffered from conduct in reliance on the misrepresentation which was of a different kind from that which he intended to induce. Thus, one who purchased land in reliance on false statements concerning title, made in a circular issued to induce the public to buy bonds secured by a mortgage on the land, could not sustain an action for deceit based upon those statements.⁶

Even under this rule, defendant need not have the particular plaintiff in mind or even know of his existence. It is enough that plaintiff is one of a class whom defendant intends to influence by his

2. This was emphasized by RESTATEMENT OF TORTS § 533, Comment b at 77-78 (1938), which read in part:

Probability of repetition to third persons. It is not enough to make the rule stated in this Section applicable that the maker of the misrepresentation knows that its recipient may probably, or will to a substantial certainty, repeat it to a third person for the purpose of influencing his conduct in transactions with him. The misrepresentation must be made for the purpose of having it repeated in terms or communicated in substance to the third person.

This language was applied quite literally in *Metric Inv., Inc. v. Patterson*, 101 N.J. Super. 301, 244 A.2d 311 (1968), where a homeowner made false statements in a credit application to a contractor for financing home improvements on an installment plan. The contractor transferred the homeowner's note to plaintiff who was then induced to discount it by the statements in the credit application, a practice which the court found prevalent. The court held the plaintiff could not take advantage of these misrepresentations, quoting the above language. *Id.* at 309, 244 A.2d at 315.

3. 16 Ohio St. 67, 88 Am. Dec. 436 (1865).

4. *Id.* at 74, 88 Am. Dec. at 441.

5. See, e.g., *Cheney v. Dickinson*, 172 F. 109 (7th Cir. 1909); *Peek v. Gurney*, L.R. 6 H.L. 377 (1873); *Shulman, Civil Liability and the Securities Act*, 43 YALE L.J. 227, 239 (1933). Cf. *Hindman v. First Nat'l Bank*, 112 F. 931 (6th Cir. 1902), cert. denied, 186 U.S. 483 (1902) (statements in bank certificate); *Hunnewell v. Duxbury*, 154 Mass. 286, 28 N.E. 267 (1891) (statements in certificate of solvency).

6. *Wollenberger v. Hoover*, 346 Ill. 511, 179 N.E. 42 (1931); RESTATEMENT OF TORTS § 531, Comment c (1938); RESTATEMENT (SECOND) OF TORTS § 531, Comment g (1977).

statement.⁷ Thus, if defendant makes false statements about his credit to a commercial credit agency, such statements will be taken as intended to be acted upon at least by the agency's subscribers in transactions involving defendant's credit.⁸ And a public circular or prospectus will be taken as addressed to any member of the public who accepts the invitation which the circular or prospectus extends.⁹

Moreover, there came to be recognized exceptions to this rule. If the statement is embodied "in an article of commerce, a muniment of title, a negotiable instrument or a similar commercial document," the maker is subject to liability to another who relies on the statement in the course of a business transaction in dealing with the maker of the statement or with a third person.¹⁰ And where misrepresentations occur in reports required by statute, the class of persons who may take advantage of them is defined by the intent or purpose of the legislature rather than that of the person who makes the report.¹¹ This latter notion seems destined to assume growing importance in a time when legislatures are increasingly concerned with according broad protection to classes of persons frequently

7. RESTATEMENT OF TORTS § 531, Comment d (1938).

8. *Hulsey v. M.C. Kiser Co.*, 21 Ala. App. 123, 105 So. 913 (1925); *Tindle v. Birkett*, 183 N.Y. 267, 76 N.E. 25 (1905); RESTATEMENT (SECOND) OF TORTS § 531, Comment e (1977).

9. *See, e.g., Prescott v. Haughey*, 65 F. 653 (C.C.D. Ind. 1895).

10. RESTATEMENT OF TORTS § 582, Comments (1938); RESTATEMENT (SECOND) OF TORTS § 532, Comments (1977). *See, e.g., National Bank v. Kershaw Oil Mill*, 202 F. 90 (4th Cir. 1912) (bill of lading); *Baker v. Hallam*, 103 Iowa 43, 72 N.W. 419 (1897) (forged abstract of title); *Bruff v. Mali*, 36 N.Y. 200, 11 Abb. Pr. 129 (1867) (stock certificates representing overissue); *Stickel v. Atwood*, 25 R.I. 456, 56 A. 687 (1903) (statement on corporate bond).

11. RESTATEMENT (SECOND) OF TORTS § 536, Comment d (1977). *See also id.* § 552(3). There may often be room for either a broad or a narrow judicial interpretation of the scope of the legislative purpose. For example, *compare Merchants' Nat'l Bank v. Armstrong*, 65 F. 932 (C.C.S.D. Ohio 1895) *with Gerner v. Mosher*, 58 Neb. 135, 78 N.W. 384 (1899). Both cases dealt with false statements furnished to the Comptroller of the Currency of the United States under the same section of the National Bank Act, ch. 106, § 34, 13 Stat. 109 (1864) (current version at 12 U.S.C. § 161 (1970)). The *Armstrong* court held that these reports were not intended for the protection of a person who, after relying upon them, accepted shares of stock in the bank as collateral for a loan. The *Gerner* court held that the reports were intended, *inter alia*, for the protection of persons who bought shares in the bank, saying, "We think the object is to afford public information to all persons having or contemplating business transactions into which the condition of the bank enters as a material factor." 58 Neb. at 146, 78 N.W. at 387.

Compare also Merchants' Nat'l Bank with Warfield v. Clark, 118 Iowa 69, 91 N.W. 833 (1902) (involving state statutory provisions requiring reports by insurance companies). For a discussion of other state reporting statutes, see *Hunnewell v. Duxbury*, 154 Mass. 286, 28 N.E. 267 (1891); *Dime Sav. Bank v. Fletcher*, 158 Mich. 162, 122 N.W. 540 (1909); *Webb v. Rockefeller*, 195 Mo. 57, 93 S.W. 772 (1906); RESTATEMENT (SECOND) OF TORTS, Explanatory Notes § 536, at 107-11 (Tent. Draft No. 10, 1964).

victimized by fraud.¹² Thus under the federal securities statutes the liability for misstatements and omissions in the required registration statement is extended to the ultimate investor and "even to a buyer in the open market, all without the plaintiff's proving that the misrepresentation was addressed to or intended to influence *him*."¹³

In addition to legislative expansion of the scope of defendant's duty in fraud, there has been some judicial tendency, reflected in the *Restatement (Second) of Torts*, to relax the rigidity of the original rule.¹⁴ These authorities would extend the class of persons who may take advantage of a fraudulent misrepresentation to include those who the defendant has reason to expect¹⁵ will act in reliance on the statement although such persons are beyond the range of his actual intent. Thus, where a member of an auto theft ring sold a stolen auto to W whom he knew to be in the business of repairing and selling autos, with representation of good title, he was held liable to a purchaser from W who relied on this representation.¹⁶ Adoption of the *Restatement (Second)*'s broader test will include cases hereto-

12. See §1 at notes 5 to 9 and accompanying text *supra*.

13. 3 L. LOSS, *SECURITIES REGULATION* 1731 (2d ed. 1961) (emphasis in original). See 6 *id.* at 3850-51 (Supp. 1969); Shulman, *Civil Liabilities and the Securities Act*, 43 *YALE L.J.* 227, 248-50 (1933). Cf. *Miller v. Bargain City, U.S.A., Inc.*, 229 F. Supp. 33 (E.D. Pa. 1964) (filing false report, where such report was required by securities legislation, deemed sufficient to create common law liability for misrepresentation).

14. *RESTATEMENT (SECOND) OF TORTS* §531(h) (1977).

15. "One has reason to expect a result if he has information from which a reasonable man would conclude that the result will follow or would govern his conduct upon the assumption that it will do so." *Id.* Comment d. It is not enough that there be a foreseeable likelihood which would suffice to make conduct negligent under prevailing rules of tort liability. There must be "an especial likelihood that it will reach those persons and will influence their conduct." *Id.* For a similar distinction between "reason to know" and "should know," see *RESTATEMENT (SECOND) OF TORTS* §12 (1965).

16. *Oppenhuizen v. Wennersten*, 2 Mich. App. 288, 139 N.W.2d 765 (1966). Other earlier cases looking in the same direction include *Davis v. Louisville Trust Co.*, 181 F. 10 (6th Cir. 1910) (false statement given to credit agency by defendant relied upon by one not a subscriber to agency who procured report through business associate who was such a subscriber; excellent discussion by Warrington, J.); *Southern States Fire & Cas. Ins. Co. v. Cromartie*, 181 Ala. 295, 61 So. 907 (1913) (like *Wells v. Cook*, 16 Ohio St. 67, 88 Am. Dec. 436 (1865), at note 3 and accompanying text *supra*, but with specific reason to think that plaintiff would be purchaser); *Highland Motor Transfer Co. v. Heyburn Bldg. Co.*, 237 Ky. 337, 35 S.W.2d 521 (1931) (subcontractor's reliance on fraudulent nondisclosure by landowner to architect whose specifications resulted in bids which were far lower than was actual cost to subcontractor); *Dime Sav. Bank v. Fletcher*, 158 Mich. 162, 122 N.W. 540 (1909) (creditor's reliance on information furnished him by credit agency which, in turn, took information from reports furnished by defendant to secretary of state pursuant to statute); *Ultramares Corp. v. Touche, Niven & Co.*, 255 N.Y. 170, 174 N.E. 441 (1931) (accountant liable for fraudulent misstatement in balance sheet to creditor of customer for whom balance sheet prepared). See also *Countryside Cas. Co. v. Orr*, 523 F.2d 870 (8th Cir. 1975) (subsidiary auto insurance company's reliance upon fraudulent statements in a policy

fore treated as exceptions to the older narrow rule described in the preceding paragraph.¹⁷

application to parent company); *Nationwide Motorist Ass'n v. Freeman*, 405 F.2d 699 (6th Cir. 1969); *Schoefield Gear & Pulley Co. v. Schoefield*, 71 Conn. 1, 40 A. 1046 (1898) (corporation's reliance upon statements made before incorporation to individuals who formed the corporation); *Houston v. Thornton*, 122 N.C. 365, 29 S.E. 827 (1898) (bank directors liable to purchasers of bank stock who relied on probably dishonest, false published statements as to the condition of the bank).

In some of these cases the reasoning is couched in terms of intent, but the context makes it reasonably clear that the intent (if that is to be equated with desire or purpose) is being presumed without inquiry into the specific facts of the case, "intent" being treated as coterminous with what should have been expected. *See, e.g.*, *Dime Sav. Bank v. Fletcher*, 158 Mich. at 167-68, 122 N.W. at 542: "Representations made by a person in business to a commercial agency are presumed to have been made for the purpose of obtaining credit, and we are of opinion that the fact that the representations in the case at bar were made in the report to the Secretary of State, and thus indirectly to the commercial agency, is of no consequence." For a perceptive analysis of the ambiguity lurking in the word "intent," see P. Keeton, *The Ambit of a Fraudulent Representor's Responsibility*, 17 TEX. L. REV. 1, 9-10 (1938); RESTATEMENT (SECOND) OF TORTS § 13, Comment on clause (a) (1934).

The Second Circuit has recently discussed the rule concerning liability to persons other than those to whom the fraudulent misrepresentation was made in terms which suggest, albeit inconclusively, adherence to the older version of the rule; see notes 1 & 2 and accompanying text *supra*. *Peerless Mills Inc. v. American Tel. & Tel. Co.*, 527 F.2d 445 (2d Cir. 1975). Plaintiffs had lent securities to their son-in-law to facilitate his purchase of a partnership in defendant brokerage firm, whose partners had fraudulently misled the applicant as to the firm's financial condition and had known that the in-laws would be the source of his contribution. Judgment for defendants was affirmed principally because of lack of reliance, *i.e.*, the fond and trusting plaintiffs were not in fact misled, as they did not inquire, and were not informed by the son-in-law, about the firm's supposed condition. In extensive dicta, however, the court emphasized that "there is no showing that the appellees intended that [the son-in-law] convey their representations to [the plaintiffs]." 527 F.2d at 451. The court cited RESTATEMENT (SECOND) OF TORTS § 531 (Tent. Draft No. 10, 1964) as authority for "the need for the defendant to have intended his misrepresentation to reach and influence the third party," 527 F.2d at 450 n.2, but did not refer to the new language contained therein which broadens the rule to "intends or has reason to expect." The court also cited *Ultramares Corp. v. Touche, Niven & Co.*, 255 N.Y. 170, 174 N.E. 441 (1931), for the same proposition, and even quoted the language in that opinion which provides for liability for fraud to third persons without regard to whether disclosure was actually intended by the misrepresenter (because of "notice in the circumstances" that defendant accountant's client "did not intend to keep . . . to himself" the fraudulent financial statement which was disclosed to injured creditors and investors. 255 N.Y. at 179, 174 N.E. at 444). 527 F.2d at 450 n.2. Nevertheless, the Second Circuit confined its discussion on this issue to the lack of evidence that defendants intended their misrepresentations to be conveyed to plaintiffs, with no reference to whether, if there had been reliance, defendants could have been liable on the basis of having had "reason to expect" such a disclosure, *i.e.*, whether there was "notice in the circumstances." The apparent insistence on actual intent for purposes of § 531 seems to be reinforced by a discussion of the inapplicability of RESTATEMENT (SECOND) OF TORTS § 533 (1976), which, while distinguishable, serves to emphasize the need for more than knowledge by defendant that the misrepresentation "may probably, or will to a substantial certainty" be repeated to a third person. 527 F.2d at 451.

Up to the present time the cases have not gone so far as to extend protection to a plaintiff whose reliance on a fraudulent statement was merely within the foresight of reasonable men¹⁸ (an extension which would make the scope of duty in fraud parallel that in cases where physical damage is caused by negligence).¹⁹ Perhaps this will be the future course of common law development, but this is far from clear.

Conversely, a court will occasionally uphold the right of a defendant who is clearly entitled to prevail under even the new version of the § 531 rule, because there was no "reason to expect" that a specific misrepresentation made to another would be repeated to plaintiff, stating instead that defendant "could not have reasonably foreseen" that the statement would be repeated to plaintiff. *See, e.g., Trigo Hnos., Inc. v. Premium Wholesale Groc., Inc.*, 424 F. Supp. 1125, 1132 (1976) (however, quoted statement made in context of an assumed requirement, like that of older version of § 531 rule, that statement be made "with intent to be communicated" to plaintiff).

17. *See* notes 10 to 13 *supra*.

18. *See* note 15 *supra*. *See, e.g., Nader v. Allegheny Airlines, Inc.*, 512 F.2d 527, 547-49 (1975), *rev'd on other grounds*, 426 U.S. 290 (1976).

At least one court has, however, purported to go the full distance in extending liability of a merely negligent title abstractor to a remote purchaser of realty on the express theory that liability for such a "negligent misrepresentation" (not intentional) "runs to those persons an abstractor could reasonably foresee as relying on the accuracy of the abstract put into motion . . . which would obviously include grantees where his . . . grantor or any predecessor in title of the grantor has initiated the contract for abstracting services. . . ." *Williams v. Polgar*, 391 Mich. 6, 23, 215 N.W.2d 149, 157 (1974). The court did not discuss whether it could have based its judgment on narrower grounds, *i.e.*, that the same reasoning which led to the conclusion that plaintiff was foreseeable could also have led to the conclusion that there was "reason to expect" the disclosure of the title abstract to realty purchasers, both immediate and in subsequent transactions, as a class. For an explanation, on somewhat narrower grounds than those expressed in *Williams*, of abstractor liability to a remote purchaser, see *Rozny v. Marnul*, 43 Ill. 2d 54, 250 N.E.2d 656 (1969). *Cf. Rusch Factors, Inc. v. Levin*, 284 F. Supp. 85, 90-92 (D.R.I. 1968) (*dicta*) (suggesting desirability of "a rule of foreseeability"); *Fischer v. Kletz*, 266 F. Supp. 180, 184-89 (S.D.N.Y. 1967) (declining to define scope of duty on motion to dismiss, but quoting SEC to the effect that accountant's responsibility is to "investors, creditors and others who may rely on the financial statements which he certifies").

19. *Palsgraf v. Long Island R.R.*, 248 N.Y. 339, 162 N.E. 99 (1928). *See* F. HARPER & F. JAMES, *THE LAW OF TORTS* § 20.5 (1956 & Supp. 1968); *RESTATEMENT (SECOND) OF TORTS* § 281 (1965).

A reason often given for restricting the scope of duty more narrowly in these cases than in those when physical injury results is the far wider possibility of economic harm from a misstatement once released than of physical harm from a wrongful act — the exposure of defendant in the former case "to a liability in an indeterminate amount for an indeterminate time to an indeterminate class." *Ultramares Corp. v. Touche, Niven & Co.*, 255 N.Y. 170, 179, 174 N.E. 441, 444 (1931) (Cardozo, C.J.). The words were spoken in a discussion of negligent misstatements but they just as aptly describe the breadth of exposure to liability for fraudulent misstatements. The question remains, however, whether the conscious liar deserves protection against wide foreseeable harm from his deception and, if so, to what extent. *See* P. Keeton, *The Ambit of a Fraudulent Representor's Responsibility*, 17 *TEX. L. REV.* 1 (1938); Seavey, *Mr. Justice Cardozo and the Law of Torts*, 39 *COLUM. L. REV.* 20, 46-52, 52 *HARV. L. REV.* 372, 398-404, 48 *YALE L.J.* 390, 416-22 (1939). For the

For completeness it should be noted that even under the stricter rule the intent required did not include an intent to harm or cause loss to plaintiff. A plaintiff is within the scope of the duty not to deceive where defendant intended him to act upon the misrepresentation whether or not defendant's motives were benign or altruistic.²⁰

proposition, furthermore, that even in the case of negligent misrepresentation no distinction should be drawn between losses caused by physical injury and those not so caused, see Lord Devlin's speech in *Hedley Byrne & Co. v. Heller & Partners Ltd.*, [1964] A.C. 465, 517 (1963).

20. *Cf. Boyd's Ex'rs v. Browne*, 6 Pa. 310, 316 (1847) (fraudulent credit reference; dictum that there is no need to prove intent to cheat or defraud); *Brown Jenkinson & Co. v. Percy Dalton (London) Ltd.*, [1957] 2 Q.B. 621 (C.A.) (apparently bona fide belief that issuance of false clean bill of lading was in furtherance of commercial convenience, with no chance in the circumstances of harming recipients); *Polhill v. Walter*, 110 Eng. Rep. 43 (K.B. 1832) (untrue representation that defendant was authorized to accept a bill on behalf of absent friend, made in mistaken belief that drawee would honor); *Edgington v. Fitzmaurice*, 29 Ch. D. 459, 482 (C.A. 1885) (misrepresentation concerning purpose for which debentures were sold; dictum that the object of the lie is wholly immaterial); *Derry v. Peek*, 14 App. Cas. 337, 365, 374 (1889) (dictum per Lord Herschell, that "wilfully to tell a falsehood, intending that another shall be led to act upon it as if it were the truth, may well be termed fraudulent, whatever the motive which induces it, though it be neither gain to the person making the assertion nor injury to the person to whom it was made. . . . [I]f fraud be proved, the motive of the person guilty of it is immaterial."). See also RESTATEMENT OF TORTS § 531, Comment b (1938) (omitted from the comments to RESTATEMENT (SECOND) OF TORTS § 531 (1977)).

Apparently, contrary statements — to the effect that there must be an intent to injure the victim of the misrepresentation in order to sustain an action for deceit — abound, but they appear typically in general descriptions of the elements of the cause of action, in cases where defendant's motive is not determinative (*i.e.*, where plaintiff does not lose because of his failure to prove a malign motive, but instead either the motive is clearly malign and defendant loses, as he would under either rule, or the case turns on other considerations which would control even if defendant's motive were benign or disinterested). See, *e.g.*, *West Virginia Hous. Dev. Fund v. Sroka*, 415 F. Supp. 1107, 1114 (W.D. Pa. 1976) (in applying "traditional elements of common law fraud" to definition of "fraud" for purposes of U.C.C. § 5-114(2)(b), relating to grounds for dishonor of a draft or demand for payment under an irrevocable letter of credit, the court refers to "an element of intentional misrepresentation in order to profit from another"; decision based, however, on principle unrelated to misrepresenter's motive); *Trigo Hnos., Inc. v. Premium Wholesale Groc., Inc.*, 424 F. Supp. 1125, 1132 (S.D.N.Y. 1976) (dictum that intent "to deprive the plaintiff of a benefit" and "intent to defraud the plaintiff" is necessary, but holding based on absence of responsibility for repetition of misrepresentation to plaintiff by third party); *Lustine Chevrolet v. Cadeaux*, 19 Md. App. 30, 34, 308 A.2d 747, 750 (1973) ("plaintiff must show that . . . the misrepresentation . . . was made for the purpose of defrauding the person claiming to be injured thereby"; case turns, however, on causation issue); *Abbey v. Heins*, 546 S.W.2d 553, 557 (Mo. App. 1977) (fraud defined as "wilful, malevolent act directed toward perpetrating a wrong"; defendant clearly reprehensible, loses as he would under either rule); *Reno v. Bull*, 226 N.Y. 546, 551, 124 N.E. 144, 145 (1919) (directors held not liable to purchasers of stock for negligent misrepresentations in prospectus; dictum that "fraud presupposes a wilful purpose to deprive another of his legal rights"; this quote is misleading except in the sense that the "legal rights" of the recipient of a misrepresentation are understood to include the right not to be lied to;

The law here seeks to protect an individual from being tricked by deceit into making a choice even for his own good.

§ 3. SCIENTER

The fraud action is traditionally associated with a requirement that defendant¹ *knew* the falsity of his statement — often termed a requirement of scienter.² On the other hand the law does in some cases afford a remedy for merely negligent or even innocent misrepresentations, in the absence of scienter in any meaningful sense. Thus, questions are raised as to where the line is to be drawn between situations in which the requirement obtains and those in which it does not, and also of what the test of scienter is.

In the common case where defendant knew his statement to be false, questions concerning the meaning of scienter are not presented. Nor are such questions presented where defendant had no

case turns on lack of scienter, not on motive; if scienter had been present the motive in the circumstances could hardly have been benign); *Beavers v. Lamplighters Realty, Inc.*, 556 P.2d 1328, 1331 (Okla. App. 1976) (“intent to deceive and defraud”; defendant, whose purpose was clearly neither benign nor disinterested, would have lost under either rule); *Goerke v. Vojvodich*, 67 Wis. 2d 102, 226 N.W.2d 211, 214 (1975) (statement that misrepresentation “must be made with intent to defraud”; actual holding turns on lack of intent to mislead); *Miles v. Mackle Bros.*, 73 Wis. 2d 84, 89, 242 N.W.2d 247, 251 (1976) (quotes *Goerke*, but case turns on failure to allege fraud as a cause of action). Accordingly, despite the frequency of such loose assertions that fraud involves an intention to injure plaintiff, they should probably be regarded as rhetorical excesses, easy to associate with the pejorative overtones of fraud, particularly where dishonesty and an intent to deceive are assumed to have been established. Where the latter elements are proven it should not be anticipated that the victim who suffers damage from justifiable reliance on a misrepresentation will lose because of failure to prove malign purpose. Of course, if dishonesty need not be proven, intent to injure is clearly irrelevant. *See, e.g.*, *Snyder v. Sperry & Hutchinson Co.*, 75 Mass. Adv. Sh. 2463, 333 N.E.2d 421 (1975); *Griffin v. Phillips*, 542 S.W.2d 432 (Tex. Civ. App. 1976); *Alexander Myers & Co. v. Hopke*, 14 Wash. App. 354, 541 P.2d 713 (1975).

1. An action for damages for fraud is brought against the person who made the false statement by the one who acted in reliance on it. The words “defendant” and “plaintiff” in the text are to be understood in this context. It should be noted, however, that the maker of the statement may sometimes appear as a plaintiff where the maker of the false statement brings an action for the purchase price of the goods sold and the buyer sets up the fraud as a defense to the action. *See, e.g.*, *Colorado Kenworth, Inc. v. Huntley*, 537 P.2d 1087 (Colo. App. 1975).

2. Scienter is typically listed as a required element in an action for damages for fraud. *See, e.g.*, F. HARPER & F. JAMES, *LAW OF TORTS* § 7.3 (1956); W. PROSSER, *HANDBOOK OF THE LAW OF TORTS* 685-86 (4th ed. 1971); *RESTATEMENT (SECOND) OF TORTS* § 526 (1977); 37 *AM. JUR. 2d Fraud and Deceit* § 12 n.10 (1968); 37 *C.J.S. Fraud* § 3 n.37 (1943).

belief in the truth of his statement, though he did not positively know it to be false³ (as by hypothesis it was); nor in the similar situation where defendant was recklessly indifferent to the statement's truth or falsity.⁴

Problems are presented, however, where defendant does not have reasonable grounds to believe in the truth of his statement, even though he does so in fact. In the leading case of *Derry v. Peek*,⁵ the House of Lords held that such a state of mind was inconsistent with fraud. In his speech Lord Herschell said: "First, in order to sustain an action of deceit, there must be proof of fraud, and nothing short of that will suffice. Secondly, fraud is proved when it is shown that a false representation has been made (1) knowingly, or (2) without belief in its truth, or (3) recklessly, careless whether it be true or false."⁶ Many courts and commentators would accept this as the point at which negligence begins and fraud has ended.⁷ But several things need to be noted in this connection:

—If the case is one where negligence would be an adequate basis for the remedy sought by plaintiff, or where liability is strict, nothing should turn on the absence of scienter under modern

3. "A person who suspects his statement is false does not entertain an honest belief it is true, or is consciously and wickedly indifferent to its truth or falsity." *Navison Shoe Co. v. Lane Shoe Co.*, 36 F.2d 454, 459 (1st. Cir. 1929). *Accord*, *Luikart v. Miller*, 48 S.W.2d 867 (Mo. 1932); *Miller v. Rankin*, 136 Mo. App. 426, 117 S.W. 641 (1909); *Shackett v. Bickford*, 74 N.H. 57, 65 A. 252 (1906); RESTATEMENT (SECOND) OF TORTS § 526, Comment e (1977).

Note that the quotations from Lord Herschell set out in the text at note 6 *infra* include this as an instance of scienter.

4. Authorities cited in note 3 *supra*. See also RESTATEMENT (SECOND) OF TORTS § 526, Comment e (1977).

5. 14 App. Cas. 337 (1889).

6. *Id.* at 374.

7. See, e.g., *Kimber v. Young*, 137 F. 744, 748 (8th Cir. 1905); *Nash v. Minnesota Title Ins. & Trust Co.*, 163 Mass. 574, 577-80, 40 N.E. 1039, 1040 (1895); *Ultramares Corp. v. Touche, Niven & Co.*, 255 N.Y. 170, 179-80, 174 N.E. 441, 444-45 (1931).

For comment, see F. HARPER, LAW OF TORTS § 221 (1933); C. MORRIS, TORTS 258-68 (1953); W. PROSSER, HANDBOOK OF THE LAW OF TORTS § 107 (4th ed. 1971); Bohlen, *Misrepresentation as Deceit, Negligence, or Warranty*, 42 HARV. L. REV. 733 (1929); Carpenter, *Responsibility for Intentional, Negligent and Innocent Misrepresentation*, 24 ILL. L. REV. 749 (1930); Green, *Deceit*, 16 VA. L. REV. 749 (1930); Harper & McNeely, *A Synthesis of the Law of Misrepresentation*, 22 MINN. L. REV. 939 (1938); P. Keeton, *Fraud: The Necessity for an Intent to Deceive*, 5 U.C.L.A. L. REV. 583 (1958). *But cf.* Smith, *Liability for Negligent Language*, 14 HARV. L. REV. 184 (1900) (imposition of legal duty to refrain from making erroneous statements, regardless of honest belief in truth of statement by the defendant); Williston, *Liability for Honest Misrepresentation*, 24 HARV. L. REV. 415 (1911) (liability for misrepresentation based on a form of absolute liability such as the form which obtains in the law relating to warranty rather than a basis of negligence or fraud).

procedures which do not observe the distinctions between the ancient forms of action.⁸

—If defendant had no adequate grounds for believing his statement to be true this may afford a rational inference that he did not in fact believe it to be true (so that there was scienter). This must be treated as a permissible inference of fact, however, and not a presumption of law, or else the distinction between fraud and negligence will be largely obliterated. If the trier of fact does not draw the inference under the facts in the case before it — if it finds that defendant was “dumb but honest” — then the test of scienter is not met, and a charge to the jury should make this clear.⁹

—There is a shading of this test made by many American courts which tends in its outer reaches to blur the distinction between fraud and warranty and presents subtleties which call for treatment in a fuller discussion (which follows).

If defendant was apparently in a position to know the factual truth or falsity of his statement and if he made the statement as one of positive fact (as though he knew it), then he will be held knowingly to have made a false statement if he realized he did not know the truth of his statement, even though he honestly believed its truth.¹⁰ A case wherein all these conditions are clearly met falls fairly within the concept of conscious deception. Defendant has lied about the extent of his knowledge of the facts in question; he has in effect represented that he *knew* a thing to be true when he knew that he only believed or surmised it to be true. As the Supreme Judicial Court of Massachusetts put it: “The fraud consists in stating that

8. See F. JAMES & G. HAZARD, CIVIL PROCEDURE § 3.11 (2d ed. 1977) (greater specificity required at common law and under the codes when pleading a charge of fraud, including knowledge by defendant of falsity of statement).

9. “A consideration of the grounds of belief is no doubt an important aid in ascertaining whether the belief was really entertained. A man’s mere assertion that he believed the statement he made to be true is not accepted as conclusive proof that he did so. There may be such an absence of reasonable ground for his belief as, in spite of his assertion, to carry conviction to the mind that he had not really the belief which he alleges.” *Derry v. Peek*, 14 App. Cas. 337, 369 (1889) (Herschell, L.). See also *Ultramares Corp. v. Touche, Niven & Co.*, 255 N.Y. 170, 190–92, 174 N.E. 441, 448–49 (1931); RESTATEMENT (SECOND) OF TORTS § 526, Comment d (1977).

10. See, e.g., *Kirkpatrick v. Reeves*, 121 Ind. 280, 22 N.E. 139 (1889); *Knappen v. Freeman*, 47 Minn. 491, 494–95, 50 N.W. 533, 534 (1891); *Hadcock v. Osmer*, 153 N.Y. 604, 608, 47 N.E. 923, 923–24 (1897); *Cabot v. Christie*, 42 Vt. 121, 126–27, 1 Am. Rep. 313, 315 (1869); *Holland Furnace Co. v. Korth*, 43 Wash. 2d 618, 622–23, 262 P.2d 772, 776 (1953); *Osborne v. Holt*, 92 W. Va. 410, 415–16, 114 S.E. 801, 803 (1922).

If the representation concerned a matter which was apparently not susceptible of accurate knowledge, this notion is inapplicable. *Harris v. Delco Prods., Inc.*, 305 Mass. 362, 365–67, 25 N.E.2d 740, 742–43 (1940).

the party knows the thing to exist when he does not know it to exist."¹¹

If this formula is carried beyond this clear case, however, it tends to obliterate the distinctions between fraud and strict liability. Thus, in *Chatham Furnace Co. v. Moffatt*,¹² the words just quoted were immediately followed by these (after a semicolon, in the same sentence): "and, if he does not know it to exist, he must ordinarily be deemed to know that he does not." The court proceeded to elaborate: "Forgetfulness of its existence after a former knowledge, or a mere belief of its existence, will not warrant or excuse a statement of actual knowledge."¹³ Taken literally, this phrasing of the test ignores the possibility that defendant may have had a sincere belief that he knew something which did not in fact exist, a phenomenon one meets in everyday life and very nearly parallel to the situation which the House of Lords found inconsistent with fraud.¹⁴ If the distinctions between fraud and strict liability or between fraud and negligence deserve to be preserved — if there is any place for imposing a liability on the conscious deceiver which is not imposed on an innocent or merely negligent misrepresenter — then defendant should escape liability for fraud if he can show that his statement (including any implied assertion of knowledge) was in full accord with his sincere belief.¹⁵ If the circumstances make the sincerity of that belief doubtful, an inference of scienter may be warranted;¹⁶ and perhaps a finding of sincerity should not be allowed as a mere conjecture in the absence of positive evidence.¹⁷ But unless the road to showing sincerity is left open, the *Chatham Furnace* formula will turn representations of facts susceptible of knowledge into warranties wearing the guise of fraudulent misstatements.¹⁸ In a case where

11. *Chatham Furnace Co. v. Moffatt*, 147 Mass. 403, 404, 18 N.E. 168, 169 (1888). See, similarly, *Coleco Indus., Inc. v. Berman*, 423 F. Supp. 275, 297 (E.D. Pa. 1976); *Lee v. Brodbeck*, 196 Neb. 393, 397, 243 N.W.2d 331, 334 (1976).

12. 147 Mass. 403, 18 N.E. 168 (1888).

13. *Id.* at 404, 18 N.E. at 169 (emphasis supplied). See also *Snyder v. Sperry & Hutchinson Co.*, 75 Mass. Adv. Sh. 2463, 2480-81, 333 N.E.2d 421, 428 (1975).

14. See text accompanying notes 5 & 6 *supra*.

15. See the excellent analysis in P. Keeton, *Fraud: The Necessity for an Intent to Deceive*, 5 U.C.L.A. L. REV. 583 (1958).

16. Cf. note 10 and accompanying text *supra* (where defendant is in a position to know the factual truth or falsity of the statement).

17. This is Keeton's position, and it would probably be a sufficient basis for explaining the *holdings* of most cases (including *Chatham Furnace Co. v. Moffatt*, 147 Mass. 403, 18 N.E. 168 (1888)). P. Keeton, *Fraud: The Necessity for an Intent to Deceive*, 5 U.C.L.A. L. REV. 583, 592-96 (1958).

18. This would occur in very much the same way that a compulsory presumption of scienter from lack of reasonable grounds to support belief would tend to obliterate the distinction between fraud and negligence. See Note, *Fraud — Negligence — Liability for Innocent Misrepresentation*, 21 MINN. L. REV. 434, 439 (1937).

policy calls for strict liability this process may lead to a proper result, but it leads to conceptual confusion which may cause trouble in other cases where liability should not be imposed on the innocent representor.

§ 4. DECEIT, NEGLIGENCE AND LIABILITY WITHOUT FAULT

As Bohlen pointed out in a leading article,¹ the three types of liability for misrepresentation represent instances of the three general fields of tort law — liability for intended wrongs, liability for negligent wrongs, and strict liability imposed without fault. The question then arises whether the application of these variant liability formulas in this field reflects valid differences between situations which call for different treatment. It is submitted that by and large this is the case, though it must be conceded that in some instances the decisions seem to defy attempts to bring consistency and clarification to this branch of the law.² Moreover, changing times and needs may call for shifts in drawing the line, and extension of the areas in which liability may be based on negligence or warranty. But reasons for differences remain.

In the first place, people's reasonable expectations are not the same in all situations, nor the same with respect to persons standing in diverse relationships toward them. As noted at the outset,³ the law governing misrepresentation is largely business law and reflects the mores of the market place, though it is being tinged increasingly by notions once thought paternalistic. When a man has relied to his loss on another's statements in a business transaction and seeks a legal remedy, then the law is faced with deciding whether he was justified as a practical matter in such reliance. To some extent — a diminishing extent — this will vary inversely with his own self-protective care.

The traditional view, reflecting the business ethics and mores of a former generation, which are by no means entirely superseded, divided situations into four kinds. In arm's length dealings between open antagonists, people do not even expect honesty in some types of statements, such as those of pure opinion. Here was an area in

1. Bohlen, *Misrepresentation as Deceit, Negligence, or Warranty*, 42 HARV. L. REV. 733, 735-39 (1929).

2. For examples in one jurisdiction, see, e.g., the decisions cited in Note, *Deceit and Negligent Misrepresentation in Maryland*, 35 MD. L. REV. 651 (1976).

3. § 1 at notes 3 & 4 *supra*.

which the conscious lie was privileged — the area of “trade talk” or “puffing.”⁴ This area has shrunk in recent years but has not entirely disappeared.

There are other situations where honesty will be generally expected, but not care and certainly not a guaranty.

In still other situations, the relationship of the parties is generally accepted in the community as carrying obligations on the part of the one to employ reasonable care to avoid misleading the other. In such cases, the latter may properly assume that the former will not make representations which he has no reasonable ground to believe to be true. These assumptions are justifiable because they conform to the ethics of business practice. Here the law requires the parties to make good the tacit assumptions upon which they deal.

Finally, there are situations in which action is commonly taken in business negotiations in reliance upon the assumed existence of certain facts. Business proceeds upon the assumption that representations are true. These are usually cases in which the party making the representations is in a position which gives him exclusive access to the facts, or the manner of giving the information constitutes such an assumption of complete knowledge that the psychological effect upon the other is calculated to divert that self-protective investigation which might otherwise be made. Business would be greatly hampered, and human nature ignored, were the law not to lend its sanction to enforce the prevailing assumptions of accuracy thus made. “[W]ith the acceleration of business generally,” says Dean Green,⁵ “as well as the standardization of the various types of transactions, the factors which control judgment demand more and more certainty and precision in sales and credit transactions”

Another consideration which may call for differences in the formula of liability to be applied is that the effect of imposing it on a defendant may vary from one situation to another. Where defendant is a stranger to the transaction (or even a servant or agent of a participant), he may stand to gain little or nothing from its consummation so that an award of damages against him must be met out of his own unaided resources.⁶ In other cases the remedy may simply restore the parties to the transaction (*e.g.*, buyer and seller) to the status quo ante, as by rescission, or prevent one party from reaping unjust enrichment from the transaction.⁷ In the latter

4. See § 8 at note 10 *infra*.

5. L. GREEN, JUDGE AND JURY 280 (1930); Green, *Deceit*, 16 VA. L. REV. 749, 757 (1930).

6. See § 5 at notes 3 & 4 and accompanying text *infra*.

7. See § 7 at notes 9 to 17, 20 to 24 and accompanying text *infra*.

cases, imposing liability upon an innocent misrepresenter is not as harsh as where damages against a stranger must come out of his own pocket.

A quite different kind of consideration also may come into play. The law has occasionally developed what may be called prophylactic rules which limit or impede liability in the interest of safeguarding against some real or supposed evil. Thus the statute of frauds requires certain kinds of agreements to be in writing in order to be legally enforceable, and the parol evidence rule excludes evidence which might otherwise enlarge or restrict liability where preliminary negotiations have become merged or integrated in a formal contract. Neither rule will preclude the showing of fraud.⁸ And if the notion of fraud is extended beyond conscious deception to include other kinds of misstatements the policy embodied in these prophylactic rules might be seriously undermined. A similar set of considerations will come into play where plaintiff seeks a remedy which is not ordinarily available to him except on a showing of fraud, *e.g.*, a

8. See *Nelson Realty Co. v. Darling Shop of Birmingham*, 267 Ala. 301, 309, 101 So. 2d 78, 84-85 (1958); *Cobbledick-Kibbe Glass Co. v. Pugh*, 161 Cal. App. 2d 123, 127, 326 P.2d 197, 200 (1958); *Bloomberg v. Pugh Bros. Co.*, 45 R.I. 360, 121 A. 430 (1923); *Texas & Pac. Ry. v. Presley*, 137 Tex. 232, 238, 152 S.W.2d 1105, 1107 (1941); *Mawhinney v. Jensen*, 120 Utah 142, 152-53, 232 P.2d 769, 775 (1951); *Cabot v. Christie*, 42 Vt. 121, 1 Am. Rep. 313 (1869); 3 A. CORBIN, *CONTRACTS* §§ 573, 580 (1960). *But cf.* *Apolito v. Johnson*, 3 Ariz. App. 232, 236, 413 P.2d 291, 295 (1966) (dictum) (misrepresentations contradictory to unambiguous express terms of contract disallowed as violative of parol evidence rule); *Newmark v. H.&H. Prods. Mfg. Co.*, 128 Cal. App. 2d 35, 274 P.2d 702 (1954) (representations which were inconsistent with written instrument properly excluded). See also P. Keeton, *Fraud — Statements of Intention*, 15 TEX. L. REV. 185, 200-09 (1937); § 10 at notes 19 to 24 and accompanying text *infra*.

The parol evidence problem may be complicated by a clause specifically reciting that "no statements or representations of any kind or nature . . . not contained herein shall be binding" upon the party whose agents made such statements. *Sharkey v. Burlingame Co.*, 131 Or. 185, 282 P. 546 (1929) (admitting the parol evidence and citing cases holding both ways). See, *e.g.*, *Bloomberg v. Pugh Bros. Co.*, 45 R.I. 360, 121 A. 430 (1923); *Texas & Pac. Ry. v. Presley*, 137 Tex. 232, 152 S.W.2d 1105 (1941) (both admitting parol evidence; where fraud initiates the contract, and the restrictive clause itself falls within such, the entire contract is voidable). See Hester, *Deceptive Sales Practices and Form Contracts — Does the Consumer Have a Private Remedy?*, 1968 DUKE L.J. 831, 836-40.

Such clauses and other integration clauses should not be allowed to close the door to showing actual fraud. A principal purpose of the parol evidence rule is to guard writings against too easy fabrication of oral testimony. The rule does this by drawing a more or less hard and fast line which will exclude honest as well as fraudulent testimony. Because it does so it can be used as a vehicle for fraud and oppression — particularly of the legally unsophisticated. And a rule which would prevent the showing of actual dishonesty would allow the drafter of the instrument to create a built-in protection for his own fraudulent overreaching. See *Sharkey v. Burlingame Co.*, 131 Or. 185, 205-06, 282 P. 546, 552 (1929) (clause having such effect would be void).

judgment not dischargeable in bankruptcy,⁹ body attachment or execution, or punitive damages.¹⁰ If the policies which protect defendants against such remedies in actions based on ordinary negligence or contract are to be served, then the action of fraud (in which these remedies would be available) should be saved for conscious deception, and the distinction between fraud on the one hand and negligence or warranty on the other should be kept meaningful.¹¹ Still another occasion for making the distinction is presented when the defense of contributory negligence is interposed since this will probably defeat an action based on negligence but not one for deceit.

§ 5. LIABILITY BASED ON SCIENTER

The real question here is when is a showing of intentional deceit *required* for liability. In all cases where liability may be predicated on some lesser showing, *i.e.*, negligence or warranty, a showing of intentional deceit will a fortiori suffice for liability. Judicial statements about the need for scienter in cases where it is shown should be carefully weighed with this in mind.¹ It is only where liability is denied for want of scienter, but where negligence or a

9. See, *e.g.*, *In re Romero*, 535 F.2d 618 (10th Cir. 1976); *Abbott v. Regents of the Univ. of Cal.*, 516 F.2d 830 (9th Cir. 1975).

10. See *Walker v. Sheldon*, 10 N.Y.2d 401, 405-06, 179 N.E.2d 497, 499, 223 N.Y.S.2d 488, 491 (1961) (punitive damages allowable where fraud is gross and involves a high moral culpability). Cf. *Globus v. Law Research Serv., Inc.*, 418 F.2d 1276, 1283 (2d Cir. 1969), *cert. denied*, 397 U.S. 913 (1970) (punitive damages not allowable for violations of § 17a of the Securities Act of 1933); § 15 at note 8 *infra*.

11. Cf. *Brown v. Underwriters at Lloyd's*, 53 Wash. 2d 142, 332 P.2d 228 (1958) (where a real estate broker who had been held liable for a misstatement to a purchaser sought indemnity from his insurer under a policy which covered liability for negligence but excluded liability for dishonest or fraudulent acts of the insured, the court properly found it necessary to determine whether the insured's misstatement was fraudulent in the sense which involves conscious deception).

1. See, *e.g.*, *C.W. Denning & Co. v. Suncrest Lumber Co.*, 51 F.2d 945 (4th Cir. 1931) (withdrawal of fraud issue from jury upheld where verdict gave credit for shortages in amount of lumber represented); *Tremaine Alfalfa Ranch & Milling Co. v. Carmichael*, 32 Ariz. 457, 259 P. 884 (1927) (actual fraud required but found proven).

At common law a plaintiff could recover only if he could establish the elements of the cause or form of action he had chosen. Under this system a ruling that scienter was needed to establish an action for deceit would not necessarily mean that plaintiff was without remedy in some other form of action. See, *e.g.*, *Cantwell v. Harding*, 249 Ill. 354, 94 N.E. 488 (1911); *Hedley Byrne & Co. v. Heller & Partners Ltd.*, [1964] A.C. 465, 484-89 (1963) (Reid, L.) (distinguishing *Derry v. Peek*, 14 App. Cas. 337 (1889)).

warranty-like statement is shown, that such statements represent the actual holding or decision in the case.²

Conscious fraud, involving scienter as we have defined it, is required by the weight of authority where the misrepresentation induces plaintiff to enter into a transaction to which defendant is a stranger.³ Thus, in *Pasley v. Freeman*,⁴ defendant misrepresented the credit of a third person, Falch, and thereby induced plaintiff to extend credit to Falch. The same rule is sometimes applied where defendant is a broker or agent whose misrepresentation brings plaintiff into business relations with his principal.⁵ And in *Derry v. Peek*,⁶ defendant's statements induced plaintiff to buy shares in the

2. See, e.g., *Dwyer v. Redmond*, 103 Conn. 237, 130 A. 108 (1925); *Warfield v. Clark*, 118 Iowa 69, 91 N.W. 833 (1902); *Kountze v. Kennedy*, 147 N.Y. 124, 41 N.E. 414 (1895); *Derry v. Peek*, 14 App. Cas. 337 (1889). See also *In re Alodex Corp.*, 533 F.2d 372 (8th Cir. 1976), concerning which of two state statutes of limitations should apply, in the absence of a federal statute of limitations, to a federal securities misrepresentation claim under § 10 of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b) (1970) and Rule 10b-5 of the Securities and Exchange Commission, 17 C.F.R. § 240-10b-5 (1975). The two competing limitation periods were Iowa's five-year limitation for common law fraud, and the two-year period in that state's Blue Sky law. The Eighth Circuit chose the two-year period, not only because the subject of the Blue Sky law was the same as that of the federal rule, i.e., securities regulation, but also because the court concluded that the federal rule resembled the Blue Sky law more than common law fraud in terms of applicable defenses. It so held because it considered that the Blue Sky law did not require scienter; that common law fraud in Iowa does require scienter; and, according to precedent in that circuit, it then thought that scienter was not required for a Rule 10b-5 action. *But see Ernst & Ernst v. Hochfelder*, 425 U.S. 185 (1976), where the Supreme Court, in an opinion rendered one week after the Eighth Circuit's *Alodex* decision, ruled that scienter is required for purposes of damage suits under SEC Rule 10b-5. As to the need for scienter in the case of other remedies under Rule 10b-5, see 90 HARV. L. REV. 1018 (1977).

3. *Vartan Garapedian, Inc. v. Anderson*, 92 N.H. 390, 31 A.2d 371 (1943); *Pasley v. Freeman*, 100 Eng. Rep. 450 (K.B. 1789). See *Rosenberg v. Cyrowski*, 227 Mich. 508, 512, 198 N.W. 905, 906 (1924) ("But when the person making the representations is not a party to the transaction, and in no way profits by the act of the party defrauded in reliance on the representations made by him, he is liable for damage only in case he knows the representations made by him to be false . . ."). *Cf. Bland v. Reed*, 261 Cal. App. 2d 231, 67 Cal. Rptr. 589 (1968) (injured employee unjustified in relying upon alleged representation of non-lawyer union representative where no confidential relationship is present). The significance of the *Garapedian* decision is pointed up by the fact that New Hampshire is in the vanguard of those states which accept negligence as a basis of liability for misrepresentation. See § 6 at note 7 *infra*.

4. 100 Eng. Rep. 450 (K.B. 1789).

5. *Kuehl v. Parmenter*, 195 Iowa 497, 192 N.W. 429 (1923); *Smith v. Badlam*, 112 Vt. 143, 22 A.2d 161 (1941); *Lasman v. Calhoun, Denny & Ewing*, 111 Wash. 467, 191 P. 409 (1920). *But cf.* § 7 note 28 and text accompanying notes 26 to 28 *infra* (possible strict liability for positive and unequivocal statement of fact by person in position to know the facts).

6. 14 App. Cas. 337 (1889).

corporation in which defendant was a director.⁷ In such cases, however, defendant is not a stranger to the transaction and indeed stands to gain directly or indirectly by it to a greater or lesser extent. It is not surprising therefore that some courts have imposed liability on such persons even where conscious deception is not shown.⁸ And the Federal Securities Acts⁹ impose civil liability on a wide group of persons including officers, directors, accountants and underwriters,¹⁰ for false statements and certain omissions in a registration statement without requiring scienter. The issuer's liability is strict, that of other classes of defendants defeasible if certain named defenses are affirmatively established, among which is that such person "had, after reasonable investigation, reasonable ground to believe and did believe" in the truth of the false statement.¹¹

The question whether scienter is required also arises in cases between buyer and seller where the misrepresenter gained by the transaction which his misrepresentation induced. Here there is usually an adequate basis for making even an innocent misrepresenter restore the loss he has caused the other, at least to the extent that he has gained by the misrepresentation, or for putting both parties back into the status quo ante.¹² Here the authorities that insist on actual scienter¹³ are believed to be too strict.

7. See also *Warfield v. Clark*, 118 Iowa 69, 91 N.W. 833 (1902); *Nash v. Minnesota Title Ins. & Trust Co.*, 163 Mass. 574, 40 N.E. 1039 (1875); *Reno v. Bull*, 226 N.Y. 546, 124 N.E. 144 (1919).

8. See, e.g., *Tischer v. Bardin*, 155 Minn. 361, 194 N.W. 3 (1923); *Osborne v. Holt*, 92 W. Va. 410, 114 S.E. 801 (1922); *Angell v. Loomis*, 97 Mich. 5, 55 N.W. 1008 (1893) (strict liability applied in all three cases). Cf. *Giddings v. Baker*, 80 Tex. 308, 16 S.W. 33 (1891) (liability for negligence). For further treatment of Michigan cases, see § 7 at note 28 *infra*.

9. Securities Act of 1933, § 1, 15 U.S.C. §§ 77a-77aa (1970); the Securities Exchange Act of 1934, § 1, 15 U.S.C. §§ 78a-78jj (1970).

10. Section 11 of the Securities Act of 1933 applies to every person who signed the registration statement; every director in the issuer at the time the statement was filed; every such director; every accountant, engineer, or appraiser named therein as having prepared or certified any part thereof; every underwriter with respect to such security. The Securities Act of 1933, § 1, 15 U.S.C. § 77k (1970); 3 L. LOSS, SECURITIES REGULATION 1721-42 (2d ed. 1961).

11. Securities Act of 1933, § 1, 15 U.S.C. § 77k (1970). See also 3 L. LOSS, SECURITIES REGULATION 1724-25 (2d ed. 1961). The quoted words apply to parts of the registration statement not purporting to be made on the authority of an expert. Different tests of care apply to parts of the statement made on expert authority. See *Escott v. Barchris Constr. Corp.*, 283 F. Supp. 643, 682-703 (S.D.N.Y. 1968). See also § 6 at notes 33 to 36 *infra*.

12. See § 7 at notes 9 to 11 *infra*.

13. See, e.g., *C.W. Denning & Co. v. Suncrest Lumber Co.*, 51 F.2d 945 (4th Cir. 1931); *Dwyer v. Redmond*, 103 Conn. 237, 130 A. 108 (1925); *Dunn v. White*, 63 Mo. 181 (1876); *McGinty v. McGinty*, 195 Neb. 281, 286-87, 237 N.W.2d 855, 858 (1976) (dicta). Contrast *Griswold v. Tucker*, 216 S.W.2d 276 (Tex. Civ. App. 1948) (recovery in action

When the question is not simply one of liability, however, but rather one where plaintiff seeks a remedy against which it is the policy of the law to protect the ordinary debtor, then, in order to get that remedy plaintiff generally is and should be required to prove actual fraud with scienter.¹⁴ And when liability, *e.g.*, in contract, is precluded by the operation of prophylactic rules such as the statute of frauds or the parol evidence rule, then the policy behind the prophylaxis would sometimes seem to require the same kind of showing.¹⁵

§ 6. LIABILITY FOR NEGLIGENT MISREPRESENTATIONS

Where misrepresentations entail the foreseeability of physical harm and such harm in fact results, the ordinary rules of negligence have for some time been applied.¹ Courts have been more reluctant,

for breach of warranty under contract of sale where seller represented truck to be of later make than it actually was; scienter requirement not discussed).

Sometimes a narrow holding can be explained as representing a procedural point of view toward forms or theories of action which should have no place in modern procedures (under which any appropriate legal theory should be applied to the facts pleaded and proved). *See, e.g.*, *Cantwell v. Harding*, 249 Ill. 354, 94 N.E. 488 (1911).

14. *See, e.g.*, *Swanson Petroleum Corp. v. Cumberland*, 184 Neb. 323, 167 N.W.2d 391 (1969) (judgment discharged in bankruptcy unless based on actual fraud); *Walker v. Sheldon*, 10 N.Y.2d 401, 179 N.E.2d 497, 223 N.Y.S.2d 488 (1961) (punitive damages); *Dezero v. Turner*, 112 Vt. 194, 22 A.2d 173 (1941) (presumably to obtain body attachment); *Household Fin. Corp. v. Williams*, 66 Wash. 2d 183, 401 P.2d 876 (1965).

15. If the contract, *e.g.*, of sale, is written, any *promissory* warranty which is not contained in the writing must meet the obstacle of the parol evidence rule. As we shall see, a promise may involve fraud if when it is made the promisor has no present intention of fulfilling it. A promise implies a representation that the one who makes it now has the intention to fulfill it; if this intention is lacking, then the implied representation is false. In such a case scienter would always exist; the promisor could not be innocently ignorant of his own present intentions. In such a case fraud exists in the fullest sense of the word and the parol evidence rule does not bar its proof.

Misstatements of existing fact may, of course, be innocently made. The question as to whether the parol evidence rule should bar their proof raises the additional question whether the policy of that rule should validly extend to nonpromissory warranties or assertions of fact. A good many authorities do exclude them. *See* P. Keeton, *Fraud — Statement of Intention*, 15 TEX. L. REV. 185, 207 (1937); 9 J. WIGMORE, EVIDENCE § 2439 (3d ed. 1940). Williston, on the other hand, argues persuasively that the obligation under warranties that are representations of fact is not a contractual one, so that the parol evidence rule should have no application. 2 A. SQUILLANTE & J. FONSECA, WILLISTON ON SALES § 15-10 (4th ed. 1974). If Williston is right, this would go a long way towards justifying decisions which dilute the scienter formula in actions between parties to the contract wherein other considerations, *see* § 7 at note 18 and accompanying text *infra*, call for strict liability. *See, e.g.*, *Cabot v. Christie*, 42 Vt. 121, 1 Am. Rep. 313 (1869).

1. *See, e.g.*, *Freeman v. United States*, 509 F.2d 626 (6th Cir. 1975) (air traffic controller negligently gave wrong information about location and direction to pilot of

however, to impose liability on this basis where a misrepresentation leads solely to economic loss.² The reason for the difference is that by and large the range of physical harm is more limited.³ In the field of economic harm, however, “[i]f liability for negligence exists, a thoughtless slip or blunder . . . may expose [defendants] to a liability in an indeterminate amount for an indeterminate time to an indeterminate class.”⁴

After *Derry v. Peek*⁵ made an action of deceit unavailable for merely negligent misrepresentations, the English courts for many years denied recovery in any form of action for economic loss caused by negligent misstatements.⁶ American courts and commentators, however, have been less inhospitable to recovery on this basis.⁷

plane carrying parachutists, who consequently jumped, to their death, over Lake Erie instead of target airfield; government liable); *Jones v. Stanko*, 118 Ohio St. 147, 160 N.E. 456 (1928); *Clay v. A.J. Crump & Sons Ltd.*, [1964] 1 Q.B. 533 (C.A. 1963).

2. This parallels a general reluctance to impose liability in negligence for economic loss which does not result from bodily harm to claimant or from physical damage to property in which he has a proprietary interest. See, e.g., James, *Limitations on Liability for Economic Loss Caused by Negligence: A Pragmatic Appraisal*, 25 VAND. L. REV. 43 (1972); note 23 *infra*. Where physical damage is threatened and caused, however, recovery for consequential economic loss is regularly allowed. See generally 2 F. HARPER & F. JAMES, *THE LAW OF TORTS* §§ 25.6-25.9 (1956 & Supp. 1968).

3. This is commonly stated and, presumably, widely supposed. Consider, however, the case of Mrs. O’Leary’s cow, the Texas City disaster, the case of thalylomide, or the possible holocaust attendant on a nuclear incident. But even in these cases of “mass tort” the physical consequences are far narrower than the indirect economic loss. See, e.g., *Stevenson v. East Ohio Gas Co.*, 73 N.E.2d 200 (Ohio Ct. App. 1946).

It is also true, on the other hand, that the economic harm likely to result from negligence is in some cases finite and easily predictable. See note 23 *infra*.

4. *Ultramares Corp. v. Touche, Niven & Co.*, 255 N.Y. 170, 179, 174 N.E. 441, 444 (1931) (Cardozo, C.J.). The opinion continues: “[t]he hazards of a business conducted on these terms are so extreme as to enkindle doubt whether a flaw may not exist in the implication of a duty that exposes to these consequences.” *Id.*

5. 14 App. Cas. 337 (1889).

6. *Candler v. Crane, Christmas & Co.*, [1951] 2 K.B. 164 (C.A.); *Le Lievre and Dennes v. Gould*, [1893] 1 Q.B. 491 (C.A.). See Goodhart, *Liability for Negligent Misstatements*, 78 L.Q. REV. 107 (1962); Morrison, *Liability in Negligence for False Statements*, 67 L.Q. REV. 466 (1951); Seavey, *Candler v. Crane, Christmas & Co.: Negligent Misrepresentation by Accountants*, 67 L.Q. REV. 466 (1951). But cf. *Nocton v. Lord Ashburton*, [1914] A.C. 932 (fraud not proved, but plaintiff not precluded from claiming relief on the basis of breach of duty arising from fiduciary relationship).

Liability for economic loss caused by negligence has been recognized since 1963. *Hedley Byrne & Co. v. Heller & Partners Ltd.*, [1964] A.C. 465 (1963). See Stevens, *Hedley Byrne & Co. v. Heller: Judicial Creativity and Doctrinal Possibility*, 27 MOD. L. REV. 121 (1964). Compare *Hedley Byrne with Mutual Life & Citizens’ Assur. Co. v. Evatt*, [1971] A.C. 793 (P.C. 1970) (Austl.).

7. See, e.g., *Mulroy v. Wright*, 185 Minn. 84, 240 N.W. 116 (1931); *Weston v. Brown*, 82 N.H. 157, 131 A. 141 (1925); *Glanzer v. Shepard*, 233 N.Y. 236, 135 N.E. 275 (1922); *Houston v. Thornton*, 122 N.C. 365, 29 S.E. 827 (1898); *Brown v. Underwriters at Lloyd’s*, 53 Wash. 2d 142, 332 P.2d 228 (1958); Bohlen, *Misrepresentation as Deceit*,

Some relationships between the parties are generally deemed to require care on the part of one of them in ascertaining and communicating facts to the other. An agent may owe this duty to his principal, a trustee to his beneficiary, or a professional man to his client.⁸ Persons who go into the business of getting information may come under this duty to their subscribers or customers.⁹ And where a failure to use care in performing the duties incident to such a relationship results in economic loss to the other party to it through a misstatement, liability has commonly been imposed on the basis of negligence. In the case of such liability to the other party, or to others as described below, the negligence may occur either in obtaining¹⁰ or in communicating¹¹ the information.

In the field of physical damage the duty to use care was also first recognized and imposed as incident to special relationships — those involved in certain callings, *e.g.*, carrier, innkeeper, farrier, surgeon. Such duty has now for generations been extended beyond these special relationships to the full range of reasonably foreseeable harm.¹² In the field of purely economic loss, on the other hand, the extension of the duty to use care beyond special relationships has been sluggish and it is uncertain whether it ever will (or should) be carried to the full extent that it has been in physical damage cases. The source of the doubt is the same consideration noted above — the potentially limitless range of economic harm.¹³ And while the

Negligence, or Warranty, 42 HARV. L. REV. 733 (1929); Bohlen, *Should Negligent Misrepresentations be Treated as Negligence or Fraud?*, 18 VA. L. REV. 703 (1932); Carpenter, *Responsibility for Intentional, Negligent and Innocent Misrepresentation*, 24 ILL. L. REV. 749, 9 ORE. L. REV. 413 (1930); Smith, *Liability for Negligent Language*, 14 HARV. L. REV. 184 (1900) (the early leading article).

8. See, *e.g.*, *A Symposium on Professional Negligence*, 12 VAND. L. REV. 535 (1959) (articles treating liability of medical practitioners, pharmacists, architects and engineers, teachers, attorneys, abstracters, and professional accountants).

9. This is clearly assumed in all the cases which discuss the liability to third persons. See, *e.g.*, *Glanzer v. Shepard*, 233 N.Y. 236, 238-39, 135 N.E. 275, 276 (1922). See also RESTATEMENT (SECOND) OF TORTS §552, Comment g (1977).

10. See *International Prods. Co. v. Erie R. Co.*, 244 N.Y. 331, 155 N.E. 662 (1927); *Glanzer v. Shepard*, 233 N.Y. 236, 135 N.E. 275 (1922).

11. See *Slater Trust Co. v. Gardiner*, 183 F. 268, 270-71 (S.D.N.Y. 1910). Cf. *Nash v. Minnesota Title Ins. & Trust Co.*, 163 Mass. 574, 40 N.E. 1039 (1895) (defendant allowed to testify as to his understanding and intention in regard to the meaning of his misrepresentation).

12. See F. HARPER & F. JAMES, LAW OF TORTS §18.1 (1956). The older notion underlay the argument of defendant's counsel in the landmark case of *Vaughan v. Menlove*, 132 Eng. Rep. 490 (C.P. 1837). But in this case the argument was made too late in the course of legal history to prevail.

13. Indeed, in *Ultramares Corp. v. Touche, Niven & Co.*, 255 N.Y. 170, 174 N.E. 441 (1931), the question was not whether negligence should be recognized as a basis of liability in the field of economic harm, but rather the scope of duty or extent of liability. This consideration is commonly mentioned when this problem is discussed. See, *e.g.*, *Rusch Factors, Inc. v. Levin*, 284 F. Supp. 85, 90 (D.R.I. 1968); *Rozny v.*

history of tort law has been marked by increasing abandonment of limitations based on similar considerations — usually without the fulfillment of the dire predictions — it does not follow that such considerations are without merit in all situations or at all times. In the present context they may justify limiting the scope of defendant's duty of care at some point short of its scope in cases of physical damage.

Even where economic loss alone is involved, however, there has been a limited extension of the duty of care beyond those who are privies to a special relationship. Where defendant is in a business or profession which requires care in furnishing information to those who employ him, he has been held to owe such duty also towards those to whom, or on whose specific behalf,¹⁴ he furnishes such information in the course of business or professional dealings even where that person is outside the circle of privity.¹⁵ Other courts have

Marnul, 43 Ill. 2d 54, 62-63, 250 N.E.2d 656, 661 (1969); *Ryan v. Kanne*, 170 N.W.2d 395, 401-02 (Iowa 1969); RESTATEMENT (SECOND) OF TORTS § 552, Comment a (1977); Prosser, *Misrepresentation and Third Persons*, 19 VAND. L. REV. 231, 246-50 (1966); Seavey, *Mr. Justice Cardozo and the Law of Torts*, 39 COLUM. L. REV. 20, 48, 52 HARV. L. REV. 372, 400, 48 YALE L.J. 390, 418 (1939); Comment, *Auditors' Responsibility for Misrepresentation: Inadequate Protection for Users of Financial Statements*, 44 WASH. L. REV. 139, 160 (1968).

14. See, e.g., *Shine v. Nash Abstract & Inv. Co.*, 217 Ala. 498, 117 So. 47 (1928); *International Prods. Co. v. Erie R. Co.*, 244 N.Y. 331, 155 N.E. 662 (1927). See also RESTATEMENT (SECOND) OF TORTS § 552(2) (1977).

15. The leading case is *Glanzer v. Shepard*, 233 N.Y. 236, 135 N.E. 275 (1922). Recent examples are *Rhode Island Hosp. Trust Nat'l Bank v. Swartz, Bresenoff, Yavner & Jacobs*, 455 F.2d 847 (4th Cir. 1972); *Coleco Indus., Inc. v. Berman*, 423 F. Supp. 275 (E.D. Pa. 1976); *Rusch Factors, Inc. v. Levin*, 284 F. Supp. 85 (D.R.I. 1968), noted in 49 B.U. L. REV. 194 (1969), 57 CALIF. L. REV. 281 (1969), 52 MARQ. L. REV. 158 (1968), 53 MINN. L. REV. 1375 (1969); *Ryan v. Kanne*, 170 N.W.2d 395 (Iowa 1969); *Aluma Kraft Mfg. Co. v. Elmer Fox & Co.*, 493 S.W.2d 378 (Mo. App. 1973). Cf. *Milliner v. Elmer Fox & Co.*, ___ Utah ___, 529 P.2d 806 (1974) (accountants not liable to an unlimited and unforeseeable class of equity holders). An unusually advanced application of the concept appears in *Bonhiver v. Graff*, ___ Minn. ___, 248 N.W.2d 291, 302-03 (1976), where an insurance company was audited simultaneously by accountants and by examiners from the state insurance commissioner's office. The accountants showed the examiners uncertified work papers and knew that the examiners relied on those papers, which, it turned out, negligently failed to disclose information from which massive despoliation by a controlling stockholder could have been detected. The accountants were held liable not only to the insurance commissioner, who of course suffered no loss, but also to the policyholders and general agents of the company, who incurred losses because of the commissioner's erroneous conclusion that the company was solvent. Liability was premised on the theory that the commissioner investigated for the policyholders' and agents' benefit, as their "representative" or "agent," and that he therefore in effect embodied them for purposes of the scope of RESTATEMENT (SECOND) OF TORTS § 552 (1977).

In *Mutual Life & Citizens' Assur. Co. v. Evatt*, [1971] A.C. 793 (P.C. 1970) (Austl.), a majority of the Privy Council accepted the limitations implied in the text — viz. that defendant be in the business or profession of giving the kind of advice involved. The dissenting judges made a strong case, however, for extending liability

refused to extend liability for negligence beyond those in privity;¹⁶ still others have done so in effect by manipulating the concepts of fraud and scienter.¹⁷ And courts that are willing to extend the duty of care in the way suggested above have sometimes refused to do so where the information is furnished gratuitously,¹⁸ justifying refusal by the analogy of the gift or loan of chattels.¹⁹ But another analogy, which seems²⁰ apt, would lead to liability in at least some of these cases also: "It is ancient learning that one who assumes to act, even though gratuitously, may thereby become subject to the duty of acting carefully, if he acts at all."²¹

to other situations where the advice or information is given in a business or professional, rather than a casual or social, context. *Id.* at 810-13.

16. See, e.g., *Texas Tunneling Co. v. Chattanooga*, 329 F.2d 402 (6th Cir. 1964); *Investment Corp. v. Buchman*, 208 So. 2d 291 (Fla. Dist. Ct. App.), *petition for cert. discharged*, 216 So. 2d 748 (Fla. 1968); *Howell v. Betts*, 211 Tenn. 134, 362 S.W.2d 924 (1962).

As late as 1967 a commentator was able to say "[N]o appellate court decision, English or American, has ever held an accountant liable to a third person for negligent misrepresentation." Comment, *Accountants' Liabilities to Third Parties Under Common Law and Federal Securities Law*, 9 B.C. IND. & COMM. L. REV. 137, 143 (1967). The same statement was made in *Rusch Factors, Inc. v. Levin*, 284 F. Supp. 85, 90 (D.R.I. 1968) (imposing such liability — but not an appellate decision). But an accountant was held liable to a known third party in *Ryan v. Kanne*, 170 N.W.2d 395, 403 (Iowa 1969) ("It is unnecessary at this time to determine whether the rule of no liability should be relaxed to extend to all foreseeable persons who may rely upon the report, but we do hold it should be relaxed as to those who were actually known to the author as prospective users of the report and take into consideration the end and aim of the transaction."). See also *Rhode Island Hosp. Trust Nat'l Bank v. Swartz, Bresenoff, Yavner & Jacobs*, 455 F.2d 847 (4th Cir. 1972); *Coleco Indus., Inc. v. Berman*, 423 F. Supp. 275 (E.D. Pa. 1976); *Bonhiver v. Graff*, ___ Minn. ___, 248 N.W.2d 291 (1976); *Aluma Kraft Mfg. Co. v. Elmer Fox & Co.*, 493 S.W.2d 378 (Mo. App. 1973); *Milliner v. Elmer Fox & Co.*, ___ Utah ___, 529 P.2d 806 (1974).

17. See, e.g., *Anderson v. Tway*, 143 F.2d 95 (6th Cir. 1944); *Watson v. Jones*, 41 Fla. 241, 25 So. 678 (1899).

For discussion of the significance of "gross" negligence in New York, see Comment, *Auditors' Responsibility for Misrepresentation: Inadequate Protection for the Users of Financial Statements*, 44 WASH. L. REV. 139, 161-62 (1968).

18. See, e.g., *Rosenberg v. Cyrowski*, 227 Mich. 508, 198 N.W. 905 (1924); *Renn v. Provident Trust Co.*, 328 Pa. 481, 196 A. 8 (1938). Compare *Bonhiver v. Graff*, ___ Minn. ___, 248 N.W.2d 291 (1976).

19. See *Nash v. Minnesota Title Ins. & Trust Co.*, 163 Mass. 574, 579, 40 N.E. 1039, 1040 (1895); W. PROSSER, *HANDBOOK OF THE LAW OF TORTS* 706 (4th ed. 1971).

20. A sensible distinction is made in RESTATEMENT (SECOND) OF TORTS § 552, Comments c & d (1977), between information given, on the one hand, in the course of the defendant's business or profession, which indicates that he has a pecuniary interest in giving it, even though he receives no consideration for the particular information, and, on the other hand, information given entirely without consideration or pecuniary interest — direct or indirect — in the transaction. *Rosenberg v. Cyrowski*, 227 Mich. 508, 198 N.W. 905 (1924), seems to be at variance with this sensible rule.

21. *Glanzer v. Shepard*, 233 N.Y. 236, 239, 135 N.E. 275, 276 (1922). See also *Sult v. Scandrett*, 119 Mont. 570, 178 P.2d 405 (1947) (where railroad kept scales for

Most courts have balked at extending the duty of care beyond those to whom or on whose specific behalf the statement is made.²² But the possibility of limitless liability which may justify circumscribing the scope of duty does not apply with equal force to all situations. As the Supreme Court of Illinois has recently observed, the mistake of a surveyor in depicting the boundary of a subdivision lot is likely to cause economic loss only to one in a line of more or less remote purchasers so that liability to unknown and presently unidentifiable plaintiffs would involve an exposure quite as finite as that in the typical physical damage case.²³ Liability to a private purchaser was imposed in this case and a few other decisions

accommodation of shippers, it was liable for expenses incurred by prospective shippers who acted in reliance upon negligent misstatement that scales were in good order); *International Prods. Co. v. Erie R. Co.*, 244 N.Y. 331, 155 N.E. 662 (1927) (prospective carrier of goods liable to prospective bailor for loss incurred because of negligent misstatement to him about their location). *See also* C. MORRIS, *TORTS* 265-66 (1953).

22. *See* RESTATEMENT (SECOND) OF TORTS, Note to Institute § 552, para. 4 at 54-56 (Tent. Draft No. 11, 1965).

23. *Rozny v. Marnul*, 43 Ill. 2d 54, 66, 250 N.E.2d 656, 662 (1969) ("The situation is not one fraught with such an overwhelming potential liability as to dictate a contrary result, for the class of persons who might foreseeably use this plat is rather narrowly limited, if not exclusively so, to those who deal with the surveyed property as purchasers or lenders. Injury will ordinarily occur only once and to the one person then owning the lot.").

The *Rozny* rationale is also used in other negligence contexts, where misrepresentation is not explicitly involved, but where there is a similarity of underlying concerns. The same central issue, whether or not a rule would lead to liability so indeterminate as to appear infinite, *i.e.*, unpredictable for actuarial purposes, affects other doctrinal choices concerning the limitation of liability for negligent conduct, *e.g.*, the question of liability for purely economic loss, or sometimes the delimitation of those to whom there should be liability for physical injury. Where the anticipation of such an unmanageable result can be shown to be unrealistic, the modern tendency is to extend liability, cautiously. *See, e.g.*, Craig, *Negligent Misstatements, Negligent Acts and Economic Loss*, 92 L.Q. REV. 213 (1976); James, *Limitations on Liability for Economic Loss Caused by Negligence: A Pragmatic Appraisal*, 25 VAND. L. REV. 43 (1972); Harvey, *Economic Losses and Negligence*, 50 CAN. BAR REV. 580 (1972); and a series of three English cases which illustrates the interplay among these concepts: *Hedley Byrne & Co. v. Heller & Partners Ltd.*, [1964] A.C. 465 (1963); *Dutton v. Bognor Regis Urban Dist. Council*, [1972] 1 Q.B. 373 (C.A. 1971); and *Anns v. London Borough of Merton*, [1977] A.C. —, 2 All E.R. 492.

Hedley Byrne dealt with the prototypical subject of a misrepresentation — a credit reference. In contrast to the situation in *Pasley v. Freeman*, 100 Eng. Rep. 450 (K.B. 1789), *cf.* § 1 at note 1 *supra*, the misrepresentation here was allegedly only negligent. Liability was denied on the ground that in the particular circumstances defendant was considered to have had only a duty of honesty, but the House of Lords stated that in other circumstances there could in principle be liability for such a misrepresentation negligently made. The discussions of the Law Lords assumed that the claim was for economic damages resulting from negligent words, and their speeches generally considered what, if any, the difference in liability should be between negligent words and negligent acts, and between purely economic damages and those flowing from physical injuries compensable to claimant.

involve similar rulings.²⁴ Moreover, where defendant's purpose is to influence action on the part of a particular group of persons, the fact that a member of the group who does so act is not known by name to

Hedley Byrne was then extensively discussed and relied upon in *Dutton*, which involved a claim against a municipality for injuries to a building resulting in part from a negligent official inspection approval of the foundations, before they were covered up. Lord Denning, M.R., seemed to emphasize the misrepresentation aspect of the negligence, *i.e.*, that the tort lay in the negligently untrue communication (of approval) by defendant's employee to the building contractor rather than in the negligently performed inspection and evaluation. Indeed, Lord Denning treated this case, as he treated *Hedley Byrne*, as involving the duty of care of "a professional man who gives advice to others." And he surmounted the objection that plaintiff, a remote purchaser who neither received nor was aware of this "advice," had not relied on it, by distinguishing between categories of professional men: Those who advise on financial and similar matters, such as bankers, lawyers or accountants, whose duty is owed only to those who rely on the adviser, with his knowledge that they are doing so, and suffer financial loss thereby, and those who give "advice" as to the safety of buildings, machinery or materials, whose duty is to all who may suffer injury "in case . . . [the] advice is bad."

In *Anns*, the House of Lords upheld for the first time the liability of public bodies to remote purchasers in case of negligence relating to the inspection of building foundations. While explicitly describing its action as the upholding of the *Dutton* principle, it did not refer at all to *Hedley Byrne* or to the notion of "advice." The issue was treated as liability for physical damages resulting from negligent conduct (the exercise of the Council's powers of inspection), not as liability for negligent misrepresentation. The principal objection discussed and overcome was simply a question of defendant's immunity in respect to discretionary functions. Yet the reported explanation by Lord Wilberforce of the scope of duty in *Anns* echoes that given in *Rozny*, even though it does not cite it: "A right of action could only be conferred on an owner or occupier who was such when the damage occurred. That disposed of the possible objection that an endless, indeterminate class of potential plaintiffs might be called into existence."

For other examples of how negligence in an inspection report may be viewed as either negligent misrepresentation or as negligence in the performance of the inspection, compare *Clay v. A.J. Crump & Sons*, [1964] 1 Q.B. 533 (C.A. 1963) with *Nelson v. Union Wire Rope Corp.*, 31 Ill. 2d 69, 199 N.E.2d 769 (1964). A similar choice of perspective could be made in some of the most classic negligent misrepresentation cases. The actor could be considered as negligent in the performance of a professional task rather than in his report of it. Two examples are *Glanzer v. Shepard*, 233 N.Y. 236, 155 N.E. 275 (1922) (negligence in weighing rather than in communicating) and *Ultramares Corp. v. Touche, Niven & Co.*, 255 N.Y. 170, 174 N.E. 441 (1931) (tortious auditing, rather than certification). See also note 10 *supra*. Accordingly, it is entirely plausible that the notion of scope of duty for purposes of the law of negligent misrepresentation should evolve in parallel with similar and related developments in negligence law in general.

24. *Walnut Creek Aggregates Co. v. Testing Eng'rs, Inc.*, 248 Cal. App. 2d 690, 56 Cal. Rptr. 700 (1967); *M. Miller Co. v. Central Contra Costa Sanitary Dist.*, 198 Cal. App. 2d 305, 18 Cal. Rptr. 13 (1961). *Accord*, *Granberg v. Turnham*, 166 Cal. App. 2d 390, 333 P.2d 423 (1958) (real estate broker liable to seller for misrepresentation to purchasers that property was located in commercial zone, resulting in rescission of sale); *Ryan v. Kanne*, 170 N.E.2d 395 (Iowa 1969) (accountants liable to party who they knew intended to rely upon accounting statement); *Williams v. Polgar*, 391 Mich. 6, 215 N.W.2d 149 (1974) (title abstractors liable to land purchasers not in privity who relied on abstract); *Mulroy v. Wright*, 185 Minn. 84, 240 N.W. 116 (1931) (city clerk

defendant should not shield him from liability for negligence.²⁵ The *Restatement (Second)* contains a rule which would accommodate these decisions²⁶ and this seems desirable.

On the whole, as indicated above, courts have provided a remedy for negligent misrepresentation principally against those who advise in an essentially non-adversarial capacity.²⁷ As against sellers and other presumed antagonists, on the other hand, the tendency of most courts has instead been either to rely on deceit with the requirement of scienter, however expanded, or to shift (by analogy to restitution or warranty) to strict liability,²⁸ although there have been a few exceptions.²⁹

The legislature may of course create duties of wider scope than the courts have been willing to impose. Some statutes of long standing have been held to do so, as in the case of notaries public,³⁰ recording clerks,³¹ and food inspectors.³² More recently, the Federal Securities Acts have imposed liability on a wide circle of defendants in favor of a wide circle of plaintiffs (any purchaser of a security) for misstatements or omissions in the registration statement required to be filed before securities may be issued. Plaintiff need not prove scienter or even negligence but defendants (other than the issuer)

liable to purchaser of property for false certificate issued to abstractor employed by seller showing no special assessments against realty purchased); *Tartera v. Palumbo*, 224 Tenn. 262, 453 S.W.2d 780 (1970) (liability of surveyor to seller of property for inaccurate plat; purchaser of property in privity with defendant).

25. *Doyle v. Chatham & Phenix Nat'l Bank*, 253 N.Y. 369, 171 N.E. 574 (1930); *Hedley Byrne & Co. v. Heller & Partners Ltd.*, [1964] A.C. 465 (1963); Prosser, *Misrepresentation and Third Persons*, 19 VAND. L. REV. 231, 243-45 (1966). *Cf.* *Hardy v. Carmichael*, 207 Cal. App. 2d 218, 24 Cal. Rptr. 475 (1962) (liability of termite inspector to purchasers of house, though vendor employed inspector, who made his report to a bank with knowledge that property was being sold).

26. RESTATEMENT (SECOND) OF TORTS §552, Comment h & Illustrations 4-11 (1977). *See also id.* Illustration 12 in light of cases cited in note 24 *supra*.

27. 1 F. HARPER & F. JAMES, *THE LAW OF TORTS* 545-46 (1956); Hill, *Damages for Innocent Misrepresentation*, 73 COLUM. L. REV. 679, 685-88 (1973). *See* RESTATEMENT (SECOND) OF TORTS §§552 & 552C (1977).

28. *See* §7 *infra*.

29. *See, e.g.*, *Haynes v. Cumberland Builders, Inc.*, 546 S.W.2d 228, 232 (Tenn. App. 1976); *General Ins. Co. of America v. Lebowsky*, ___ Minn. ___, 252 N.W.2d 252 (1977) (*semble*). For a similar result construing statutory definition of deceit to include negligent misrepresentation, *see* *Clar v. Board of Trade*, 164 Cal. App. 2d 636, 644-45, 331 P.2d 89, 94-95 (1958).

30. *See, e.g.*, *Anderson v. Arohsohn*, 181 Cal. 294, 184 P. 12 (1919); *Barnard v. Schuler*, 100 Minn. 289, 110 N.W. 966 (1907). *Contra*, *New England Bond & Mortgage Co. v. Brock*, 270 Mass. 107, 169 N.E. 803 (1930).

31. *Cole v. Vincent*, 229 App. Div. 520, 242 N.Y.S. 644 (1930). *Cf.* *Mulroy v. Wright*, 185 Minn. 84, 240 N.W. 116 (1931) (liability of clerk without reference to statute).

32. *Nickerson v. Thompson*, 33 Me. 433 (1851); *Pearson v. Purkett*, 32 Mass. (15 Pick.) 264 (1834).

may escape liability by proving due diligence. Ultimate liability turns on negligence but with the burden of proof inverted.³³ An early case³⁴ under this statute held auditors to "surprisingly low accounting standards" of care³⁵ but the recent trend both within the profession and in the courts is to impose a substantially higher standard.³⁶

As negligence becomes an increasingly recognized basis of liability for misrepresentation the question whether contributory negligence is or should be a defense will become increasingly important. The decisions to date are unanimous in recognizing the defense³⁷ and this accords with the view of commentators³⁸ and the American Law Institute.³⁹ To the extent that the defense represents valid policy at all, its justification in the field of business

33. Securities Act of 1933, 15 U.S.C. § 77k (1970). For treatment of liabilities under the Securities Acts, see 3 L. LOSS, *SECURITIES REGULATION* 1623-1876 (2d ed. 1961); 6 *id.* at 3820-4003 (Supp. 1969); sources cited in note 36 *infra*.

34. *Shonts v. Hirliman*, 28 F. Supp. 478 (S.D. Cal. 1939), *noted in* 38 MICH. L. REV. 1103 (1940).

35. 3 L. LOSS, *SECURITIES REGULATION* 1733 (2d ed. 1961).

36. *Escott v. BarChris Constr. Corp.*, 283 F. Supp. 643 (S.D.N.Y. 1968). For commentary on this decision, see, for example, Folk, *Civil Liabilities Under the Federal Securities Acts: The BarChris Case*, 55 VA. L. REV. 1, 199 (1969); Heller, Weiss, Israels & Schwartz, *BarChris: A Dialogue on a Bad Case Making Hard Law*, 57 GEO. L.J. 221 (1968); Jordan, *BarChris and the Registration Process*, 22 SW. L.J. 790 (1968); Latty, *Prospectus Liability — The BarChris Case*, 1970 J. BUS. LAW 65, 68 COLUM. L. REV. 1411 (1968), 1969 DUKE L.J. 1191, 82 HARV. L. REV. 908 (1969), 43 N.Y.U. L. REV. 1030 (1968), 42 S. CAL. L. REV. 293 (1969), 21 STAN. L. REV. 171 (1968), 47 TEX. L. REV. 162 (1968), 117 U. PA. L. REV. 735 (1969).

37. See, e.g., *Texas Tunneling Co. v. Chattanooga*, 204 F. Supp. 821, 835-36 (E.D. Tenn. 1962), *rev'd on other grounds*, 329 F.2d 402 (6th Cir. 1964) (but contributory negligence not found); *Ryan v. Kanne*, 170 N.W.2d 395 (Iowa 1969) (issue held properly for jury in upholding plaintiff's verdict); *Vartan Garapedian, Inc. v. Anderson*, 92 N.H. 390, 31 A.2d 371 (1943) (plaintiff's contributory negligence as matter of law an alternative basis for decision); *Maxwell Ice Co. v. Brackett, Shaw & Lunt Co.*, 80 N.H. 236, 116 A. 34 (1921) (*semble*); *Gould v. Flato*, 170 Misc. 378, 10 N.Y.S.2d 361 (1938) (contributory negligence found as alternative ground for denying recovery).

38. See, e.g., W. PROSSER, *HANDBOOK OF THE LAW OF TORTS* § 716 (4th ed. 1971); Bohlen, *Misrepresentations as Deceit, Negligence, or Warranty*, 42 HARV. L. REV. 733, 739 (1929). *But cf.* Bohlen, *Should Negligent Misrepresentation Be Treated as Negligence or Fraud?*, 18 VA. L. REV. 703 (1932) (contending that a number of the rules which determine contributory negligence are unduly restrictive of the right to recover); Green, *Deceit*, 16 VA. L. REV. 749, 758-59 (1930) (suggesting doubt as to advisability of applying in this field the "negligence network of legal theory" developed in accidental personal injury cases).

39. RESTATEMENT (SECOND) OF TORTS § 552A (1977). The *Restatement* hedges as to whether comparative negligence, which has now supplanted contributory negligence in a majority of American jurisdictions (at least thirty states as of 1977), should apply to pecuniary harm from negligent misrepresentation in jurisdictions where it applies to physical harm. *Id.* Comment b. In principle comparative negligence would appear more fair in all contexts than the winner-take-all rule of

transactions is at least as strong as in the field of accidental physical injury. It is doubtful, however, whether ordinary contributory negligence has a proper place in legislation concerned with mass consumer protection even where defendant's negligence is made an ingredient of liability. The very need for such protection reflects in part the inadequacy of self-protective care. Section 11 of the Securities Act of 1933, for example, expressly makes it a defense that plaintiff *knew* of the untruth or omission in the registration at the time he acquired his security,⁴⁰ but presumably makes no place for ordinary contributory negligence.

§ 7. LIABILITY FOR INNOCENT MISREPRESENTATIONS

Strict liability has often been imposed by the law of torts¹ and as already noted this has been true in the field of misrepresentation resulting in economic loss.² The procedural vehicles by which such liability has traditionally been imposed are the equity suit for rescission,³ rescission at law,⁴ the action for breach of warranty,⁵ the action for fraud and deceit,⁶ and the doctrine of estoppel.⁷ Innocent misrepresentation may also be a ground of defense⁸ or counterclaim. Each of these procedural vehicles had limitations which were arbitrary in some situations, and each was also the vehicle for

contributory negligence. There may, however, be statutory problems under comparative negligence statutes which appear to be limited by their terms to the abolition of contributory negligence as a bar in actions resulting in death or in injury to person or property, *e.g.*, HAW. REV. STAT. § 663-31 (Supp. 1975); IDAHO CODE § 6-801 (Cum. Supp. 1977); MASS. GEN. LAWS ANN. ch. 231, § 85 (West 1959); MINN. STAT. ANN. § 604.01 (West 1959); N.H. REV. STAT. ANN. § 507:7-a (Supp. 1975); N.J. STAT. ANN. § 2A:15-5.1 (West 1952); N.D. CENT. CODE § 9-10-07 (1975); OR. REV. STAT. § 18.470 (1975); TEX. REV. CIV. STAT. ANN. art. 2212a, § 1 (Vernon 1971); UTAH CODE ANN. § 78-27-37 (1977); VT. STAT. ANN. tit. 12, § 1036 (1973); WASH. REV. CODE ANN. § 4.22.010 (1962); WIS. STAT. ANN. § 895.045 (West 1966); WYO. STAT. § 1-7.2 (1957).

40. Securities Act of 1933, 15 U.S.C. § 77k (1971).

1. See, *e.g.*, F. HARPER & F. JAMES, THE LAW OF TORTS ch. 14 & § 28.15 (1956 & Supp. 1968).

2. Section 4 at note 7 and accompanying text *supra*.

3. See § 15 at notes 35 to 47 and accompanying text *infra*.

4. See § 15 at notes 48 to 54 and accompanying text *infra*.

5. Williston, *Liability for Honest Misrepresentation*, 24 HARV. L. REV. 415, 417-23 (1911).

6. This has been done either by manipulation of the scienter formula in the way described in § 3 at notes 11 to 15 *supra*, or by erecting a presumption that defendant must have known those facts which it was his duty to know. Williston, *Liability for Honest Misrepresentation*, 24 HARV. L. REV. 415, 427-28 (1911).

7. *Id.* at 423-27.

8. See § 15 at notes 62 to 68 *infra*.

liability in cases of conscious deception. The whole made a confusing patchwork.

Sense and order can best be made out of this confusing mass of precedents if attention is focused on the kinds of considerations which may call for the imposition of strict liability rather than on forms of action or legal theories of liability.

Perhaps the clearest case is one where the representor stands to gain by his misrepresentation at the expense of the other party to the transaction induced by the misrepresentation. This is the kind of situation for which rescission, either in equity or at law, is often an appropriate remedy. Where it is, it simply unravels the transaction, so to speak, and puts each party in the position he held before the transaction took place. Where this remedy is sought courts generally are willing to grant it on the basis of innocent, as well as culpable, misstatements;⁹ while the innocent misrepresentor may not deserve a penalty he should not be allowed to benefit by his false statement at his innocent victim's expense.¹⁰ There are situations, however, where rescission is impossible (as where the victim is unable to return what he has received from the transaction) or undesirable (as where a purchaser has made improvements on land he has bought, or simply wants to keep it). In such situations the award of damages without rescission may have substantially the same effect of simply preventing the misrepresentor's unjust enrichment. If, for example, the agreed price of land is expressly or impliedly computed on the basis of acreage and the vendor has innocently overstated the number of acres, damages measured by a suitable abatement of the purchase price will do justice between the parties and let the purchaser keep the land. It is submitted that the victim of innocent misrepresentation in the circumstances described in this paragraph should have a remedy in all cases (subject to other conditions of liability) and that, where rescission is feasible, he should have his choice whether to rescind or to keep what he has received and take damages measured by the unjust enrichment.

The traditional vehicles for a damage remedy have been an action based on warranty and an action for fraud and deceit, and each has limitations which may bar its availability or impair its suitability in some situations where damages are appropriate as a

9. *Fields v. Hauptert*, 213 Or. 179, 323 P.2d 332 (1958) (rescission in equity).

10. "[T]he defendant obtained what the false representations caused the plaintiff to lose. . . . The false statement of fact was an agency whereby the property of the plaintiff was transferred to defendant. The law would be justly subject to reproach if it afforded no redress in such a case." *Aldrich v. Scribner*, 154 Mich. 23, 28, 117 N.W. 581, 583 (1908). See also P. Keeton, *Actionable Misrepresentation: Legal Fault as a Requirement*, 2 OKLA. L. REV. 56 (1949).

substitute for or an alternative to rescission. The concept of warranty has traditionally been limited to sales of tangible chattels and has not been extended to sales of services, securities, or land;¹¹ and limited also to persons in privity of contract where the transaction is one to which a warranty may attach.¹² The proof of a warranty may be excluded by the parol evidence rule.¹³ And the fraud action is precluded by the requirement of scienter¹⁴ unless that is emasculated by some such formula as the one in the *Chatham Furnace Co.* case.¹⁵ Moreover, the measure of damages associated with the fraud action will sometimes exceed the amount by which the misrepresenter has been enriched.¹⁶ What is needed is the recognition that the damage remedy should be available without the baggage of older forms and theories of recovery wherever its effect will be to prevent unjust enrichment,¹⁷ except where such a result

11. Securities: *E.g.*, *Henderson v. Plymouth Oil Co.*, 13 F.2d 932 (W.D. Pa. 1926); *Goodwyn v. Folds*, 30 Ga. App. 204, 117 S.E. 335 (1923); *Burwash v. Ballou*, 230 Ill. 34, 82 N.E. 355 (1907) (only warranty implied is that stock of corporation is genuine). Land: *see* C. MORRIS, TORTS 259-60 (1953).

The notion of warranty has, however, been extended to an agent's statements that he has authority to do a certain thing, or his conduct implying that he has such authority. *Williston, Liability for Honest Misrepresentation*, 24 HARV. L. REV. 415, 422-23 (1911).

As between buyer and seller of tangible property, many courts have had little difficulty in awarding damages for innocent misrepresentations of fact. *See, e.g.*, *Maurice v. Chaffin*, 219 Ark. 273, 241 S.W.2d 257 (1951); *Pelette v. Mann Auto Co.*, 116 Kan. 16, 225 P. 1067 (1924); *New England Foundation Co. v. Elliott & Watrous, Inc.*, 306 Mass. 177, 27 N.E.2d 756 (1940); *Griswold v. Tucker*, 216 S.W.2d 276 (Tex. Civ. App. 1948). *Contra*, *Dwyer v. Redmond*, 103 Conn. 237, 130 A. 108 (1925).

12. *See* F. HARPER & F. JAMES, THE LAW OF TORTS § 28.16 (1956 & Supp. 1968).

13. *Cummings v. Case*, 52 N.J.L. 77, 18 A. 972 (1889) (*dicta*) (parol evidence held admissible in this case to show the instrument was void); *Cabot v. Christie*, 42 Vt. 121, 1 Am. Rep. 313 (1869); 9 J. WIGMORE, EVIDENCE § 2434 (3d ed. 1940); 2 A. SQUILLANTE & J. FONSECA, WILLISTON ON SALES § 15-10 (4th ed. 1974); *Keeton, Fraud — Statements of Intention*, 15 TEX. L. REV. 185, 204-09 (1937).

14. Sections 3 & 5 *supra*.

15. *Chatham Furnace Co. v. Moffatt*, 147 Mass. 403, 18 N.E. 168 (1888). For a recent example of the emasculation of the scienter requirement, *see Bostic v. Amoco Oil Co.*, 553 F.2d 329 (4th Cir. 1977).

16. This will often be true where defendant is an agent or broker rather than a principal in the transaction. *See, e.g.*, *Krause v. Cook*, 144 Mich. 365, 108 N.W. 81 (1908); *Tischer v. Bardin*, 155 Minn. 361, 194 N.W. 3 (1923).

It may also be true when both parties are principals (as buyer and seller). *See, e.g.*, *Aldrich v. Scribner*, 154 Mich. 23, 30-31, 117 N.W. 581, 584 (1908) (under loss of bargain rule). *Cf. Seeley v. White Motor Co.*, 63 Cal. 2d 9, 403 P.2d 145, 45 Cal. Rptr. 17 (1965) (consequential damage allowed against manufacturer on theory of breach of warranty).

17. *Cf.* 3 A. CORBIN, CONTRACTS § 613 (1960) (an admirable analysis defending the advantages of a "variety of remedies, enforceable by a variety of processes").

The approach of the Michigan court in *Holcomb v. Noble*, 69 Mich. 396, 37 N.W. 497 (1888) and *Aldrich v. Scribner*, 154 Mich. 23, 117 N.W. 581 (1908) comes close

would subvert vital policies embodied in the parol evidence rule. And since innocent false statements could scarcely include false statements of one's own intentions, or promissory fraud, serious collisions with the policy of the parol evidence rule will occur only if that policy is properly extended to non-promissory statements.¹⁸

There is a considerable body of decisions allowing damages in the type of case discussed above without insistence on older limitations which have vexed the remedy.¹⁹ Thus a manufacturer's

to this. But this court, having chosen the action for deceit as the vehicle for liability, saw no way to escape from rigidly applying the conventional measure of damages in that action (plaintiff's loss rather than by the amount of defendant's unjust enrichment). See *Aldrich v. Scribner*, 154 Mich. 23, 30-31, 117 N.W. 581, 584 (1908).

18. Non-promissory false statements of fact which induce a party to enter into a contract are not excluded by the parol evidence rule if they involve conscious fraud, but many authorities hold that innocent misstatements of fact would be actionable only as warranties and therefore come within the parol evidence rule. P. Keeton, *Fraud — Statements of Intention*, 15 TEX. L. REV. 185, 207 (1937). See also J. WIGMORE, EVIDENCE § 2439 (3d ed. 1940); Hill, *Breach of Contract as a Tort*, 74 COLUM. L. REV. 40 (1974); Hill, *Damages for Innocent Misrepresentation*, 73 COLUM. L. REV. 679, 733-37 (1973). Williston, while recognizing this, argues forcefully that the obligation under warranties that are representations of fact is non-contractual; hence that the parol evidence rule should have no application to them. 2 A. SQUILLANTE & J. FONSECA, WILLISTON ON SALES § 15-10 (4th ed. 1974). This view has some judicial support. See, e.g., *Adams v. Gillig*, 199 N.Y. 314, 320, 92 N.E. 670, 672 (1910) (as the statement of present intention "was not promissory and contractual in its nature, there is nothing in the rules of evidence to prevent oral proof of [it]. . ."). *Huddleston v. Lee*, 39 Tenn. App. 465, 284 S.W.2d 705 (1955). See also § 5 at note 15 *supra* (parol evidence rule may not apply to the obligation under warranties that are not representations of fact).

It should also be noted that there are many situations to which the parol evidence rule does not apply, e.g., those where the memorandum does not purport to be complete, those where the question arises between parties not in privity of contract (as in the cases cited in note 19 *infra*).

One argument for ignoring the prophylactic rules of contract law in the case of a tort remedy for innocent misrepresentation has been based on the assumed difference between the out-of-pocket measure of damages for this tort, as in RESTATEMENT (SECOND) OF TORTS § 552C (1977) (which would even exclude recovery of consequential damages), and the benefit-of-the-bargain rule (plus consequential damages) in contract, e.g., U.C.C. § 2-714. This distinction has been forcefully criticized as frequently illusory, on the ground that in the normal sale of a standardized mass-produced product, "the disappointed buyer is not likely to prove convincingly that the value of the property as represented by the concededly honest seller was substantially in excess of the purchase price." Hill, *Breach of Contract as a Tort*, 74 COLUM. L. REV. 40, 46 (1974). The *Restatement* concedes that where "as a practical matter, the amount recoverable under this Section is substantially the same as the amount recoverable for breach of warranty, the argument against recognition of defenses traditional to the warranty action loses much of its force." RESTATEMENT (SECOND) OF TORTS § 552C, Comment b (1977).

19. See RESTATEMENT (SECOND) OF TORTS § 552C (1977). *But cf.* Hill, *Damages for Innocent Misrepresentation*, 73 COLUM. L. REV. 679 (1973) (innocent, non-negligent promissory representations should be governed by contract law; non-promissory

misstatements in advertising through mass communications media²⁰ or on labels on a product²¹ have been held a proper basis for liability to remote purchasers who have relied on such statements to their economic loss, thereby either dispensing with or greatly expanding traditional notions of privity.²² And liability has been found in situations not traditionally covered by warranty law as in the case of sales of securities²³ or land.²⁴

Where the innocent misrepresenter does not benefit from the transaction or where his benefit is only by way of commission or the like so that it does not correspond to the victim's loss, the justification for imposing liability upon him described above is lacking.²⁵ And the same is true in all cases where plaintiff's loss

representations should not be basis of liability in damages) and Hill, *Breach of Contract as a Tort*, 74 COLUM. L. REV. 40 (1974) (addendum).

20. See, e.g., *Randy Knitwear, Inc. v. American Cyanamid Co.*, 11 N.Y.2d 5, 181 N.E.2d 399, 226 N.Y.S.2d 363 (1962); *Inglas v. American Motors Corp.*, 3 Ohio St. 2d 132, 209 N.E.2d 583 (1965); *Ford Motor Co. v. Lonon*, 217 Tenn. 400, 398 S.W.2d 240 (1966); Note, *Economic Loss in Products Liability Jurisprudence*, 66 COLUM. L. REV. 917 (1966); 41 ST. J.L. REV. 401 (1967); 114 U. PA. L. REV. 539 (1966).

21. See, e.g., *Randy Knitwear, Inc. v. American Cyanamid Co.*, 11 N.Y.2d 5, 181 N.E.2d 399, 226 N.Y.S.2d 363 (1962).

22. Cf. *Seeley v. White Motor Co.*, 63 Cal. 2d 9, 403 P.2d 145, 45 Cal. Rptr. 17 (1965) (manufacturer liable to purchaser); *Santor v. A. & M. Karagheusian, Inc.*, 44 N.J. 52, 207 A.2d 305 (1965) (manufacturer liable to purchaser); *Price v. Gatlin*, 241 Or. 315, 405 P.2d 502 (1965) (wholesaler not liable to non-privity purchaser for economic loss); Note, *Privity Eliminated as a Requirement in Loss-of-Bargain Products Liability Cases — The Effects of Santor*, 19 RUTGERS L. REV. 715 (1965) (discussing manufacturer's liability to purchaser); Comment, *Seeley v. White Motor Co.: Retrenchment in California on Strict Products Liability*, 52 VA. L. REV. 509 (1966) (same). See also *Kessler, Products Liability*, 76 YALE L.J. 887, 908-11 (1967) (addressing the broader problem of strict liability, without limitation by privity, for defective products that cause economic loss only).

23. *Iler v. Jennings*, 87 S.C. 87, 68 S.E. 1041 (1910); *Osborne v. Holt*, 92 W. Va. 410, 114 S.E. 801 (1922). Cf. *Peterson v. Schaberg*, 116 Neb. 346, 217 N.W. 586 (1928) (representations about makers of notes).

24. The Michigan cases clearly recognize this without manipulating the scienter formula. See, e.g., *Aldrich v. Scribner*, 154 Mich. 23, 117 N.W. 581 (1908); *Holcomb v. Noble*, 69 Mich. 396, 37 N.W. 497 (1888). See also *Ladner v. Balsley*, 103 Iowa 674, 72 N.W. 787 (1897); *Forsberg v. Baker*, 211 Minn. 59, 300 N.W. 371 (1941).

The same result in effect is more often reached through manipulation of scienter. *Clark v. Haggard*, 141 Conn. 668, 109 A.2d 358 (1954) (sale of land); *Becker v. McKinnie*, 106 Kan. 426, 186 P. 496 (1920) (sale of water rights); *Chatham Furnace Co. v. Moffatt*, 147 Mass. 403, 18 N.E. 168 (1888) (sale of leasehold); *Newberg v. Chicago, B. & Q. R.R.*, 120 Neb. 171, 231 N.W. 766 (1930) (sale of land; rescission or damages decreed alternatively); *Osborne v. Holt*, 92 W. Va. 410, 114 S.E. 801 (1922) (sale of securities; representer had duty to know whereof he spoke); *Palmer v. Goldberg*, 128 Wis. 103, 107 N.W. 478 (1906) (representations about maker of note).

25. "This principle [strict liability for innocent misrepresentations], which is altogether just in its application to cases where the loss of the plaintiff has inured to the profit of the defendant, would be most unjust if applied to cases where the defendant has obtained no such profit." *Aldrich v. Scribner*, 154 Mich. 23, 28, 117 N.W. 581, 583 (1908).

exceeds defendant's gain, to the extent that it does so. Such liability — or liability to such extent — must therefore be justified on some other ground.

A possible basis is the strong psychological effect in inducing reliance on positive and unequivocal statements of fact made by a person in a position — or apparently in a position — to know the facts.²⁶ This effect is accentuated in the common situation by the plaintiff's relative lack of access to the facts.²⁷ It may be that the risk of causing loss by inaccuracy in statements made in this form is so great as to justify a rule that one makes them at his peril. But this seems harsh if it is applied to one who has made what is by hypothesis an honest and a non-negligent statement unless he gets some benefit from making it. This consideration may, however, justify saddling the one who made the misstatement with his equally innocent victim's loss from it, wherever the former benefits from making the statement even where the loss exceeds the benefit.²⁸

26. Harper & McNeeley, *A Synthesis of the Law of Misrepresentation*, 22 MINN. L. REV. 939, 955 (1938).

“The rule is followed at the present time in practically all American jurisdictions, in respect to transactions involving both real and personal property, that one to whom a positive, distinct, and definite representation has been made is entitled to rely on such representation and need not make further inquiry concerning the particular facts involved.”

Rummer v. Throop, 38 Wash. 2d 624, 633, 231 P.2d 313, 319 (1951) (quoting Cunningham v. Studio Theatre, Inc., 38 Wash. 2d 417, 424, 229 P.2d 890, 894 (1951)) (quoting 23 AM. JUR. *Fraud and Deceit* § 161 (1938)).

27. In earlier decisions upon the subject, a great deal of stress was laid on inequality of access to the facts, and this may once have been a requirement for liability. See, e.g., Smith v. Richards, 38 U.S. (13 Pet.) 26 (1839).

[W]herever a sale is made of property not present, but at a remote distance, which the seller knows the purchaser has never seen, but which he buys upon the representation of the seller, relying on its truth, then the representation, in effect, amounts to a warranty; at least, that the seller is bound to make good the representation.

Id. at 72.

The tendency of more recent cases is to extend the buyer's right to rely on statements of fact by the seller even where he “may have been foolishly credulous in doing this,” so long as the buyer does not actually see or know the falsity of the statement. Rummer v. Throop, 38 Wash. 2d 624, 634, 231 P.2d 313, 319 (1951). “[I]t is immaterial that the means of knowledge are open to the complaining party, or easily available to him, and that he may ascertain the truth by proper inquiry or investigation.” *Id.* at 633, 231 P.2d at 319 (quoting Cunningham v. Studio Theatre, Inc., 38 Wash. 2d 417, 425, 229 P.2d 890, 894 (1951) (quoting 23 AM. JUR. *Fraud and Deceit* § 161 (1938))). See RESTATEMENT (SECOND) OF TORTS § 540 (1977).

This overlaps the problem of the plaintiff's justifiable reliance on defendant's statement. See § 8 *infra*.

28. Thus an agent who makes positive representations on behalf of his principal has been held strictly liable. Angell v. Loomis, 97 Mich. 5, 55 N.W. 1008 (1893); Tischer v. Bardin, 155 Minn. 361, 194 N.W. 3 (1923). So has the president of a bank for whose credit he induced another bank to purchase commercial paper. Peterson v. Schaberg,

Few actual decisions go beyond this point whether they adopt outright a rule of strict liability or reach the same result through manipulating scienter by imposing an absolute duty to know.²⁹ And liability for false statements in a registration statement required by the Federal Securities Acts may be defeated (except by the issuer) by a showing of due diligence.³⁰

Another possible basis for strict liability in some cases is the notion of enterprise liability — that an enterprise which inevitably

116 Neb. 346, 217 N.W. 586 (1928) (the Nebraska rule “practically charges the defendant with notice of the truth in all cases where he makes positive representations of known facts.”). *Id.* at 349, 217 N.W. at 587 (quoting *Holtry v. Foley*, 43 Neb. 133, 137, 61 N.W. 120, 122 (1894)). *See also* *Osborne v. Holt*, 92 W. Va. 410, 114 S.E. 801 (1922). *But cf.* §5 at note 5 *supra* (scienter requirement sometimes applied where defendant is a broker or agent).

For the rule governing the agent’s liability in Michigan, *compare* *Krause v. Cook*, 144 Mich. 365, 108 N.W. 81 (1906) *with* *Aldrich v. Scribner*, 154 Mich. 23, 27–32, 117 N.W. 581, 583–84 (1908) (discussing *Krause*). *See* *Irwin v. Carlton*, 369 Mich. 92, 95–96, 119 N.W.2d 617, 619 (1963) (discussing the distinction between *Krause* and *Aldrich*). These decisions indicate that an agent will not be liable for an innocent repetition of his principal’s misstatement of fact where plaintiff’s loss greatly exceeds defendant’s commission, although the *Aldrich* case suggests that recovery would be allowed if there were some way to measure damages in a fraud action by defendant’s gain rather than plaintiff’s loss. *See* note 17 *supra*. *Cf.* *People’s Furn. & Appl. Co. v. Healy*, 365 Mich. 522, 526, 113 N.W.2d 802, 804 (1962) (real estate broker, sued for return of deposit held by him as result of sale induced by his innocent misrepresentation, liable in amount of the deposit since to this extent plaintiff’s loss “has inured to the benefit of the defendant.”).

Similarly, a doctrine of “innocent misrepresentation or constructive fraud” has been applied in New Mexico to impose strict liability on the seller himself for buyer’s damages from a misrepresentation in a multiple listing service that a house had a wood-burning fireplace. *Archuleta v. Kopp*, 90 N.M. 273, 562 P.2d 834, 837 (1977). In fact the fireplace was not functional, and was moreover a fire hazard. Plaintiff, who was blind, could not detect these defects on inspection, and at least one judge thought the defects “would not have been visible to plaintiff even if he could see” *Id.* at —, 562 P.2d at 841. The appellate court accepted, with obvious skepticism, findings by the trial court that the misrepresentation was neither intentional nor negligent; noting that plaintiff suffered smoke damage to the house when he tried to ignite a fire in the fireplace, and also that the fireplace would have to be rebuilt to correct its defects, it remanded to the trial court for a determination of damages, without specifying how they should be computed, but clearly without reference to the amount of seller’s profit on the sale.

Frequently buyer’s loss, measured by the “out-of-pocket” rule, *see* § 15 at note 5 *infra*, may also be the measure of seller’s benefit by way of unjust enrichment, in which case there should be no hesitation to award damages for such loss, in the absence of subversion of other vital policies. *See, e.g.,* *Yates v. Tindall & Son Pontiac*, 531 F.2d 293 (5th Cir. 1976) (defendant, who innocently sold a used car with false odometer reading, held liable to buyer for difference between price buyer paid and the actual fair market value of the vehicle if correctly described).

29. *But cf.* *National Bank of Pawnee v. Hamilton*, 202 Ill. App. 516 (1916) (representer held liable for false representations of fact though he did not volunteer information and apparently did not benefit by plaintiff’s actions).

30. *See* § 6 at notes 33 to 36 and accompanying text *supra*.

causes losses of a certain kind may justly be called upon to compensate its victims and administer these losses as part of its cost of doing business or carrying on the enterprise.³¹ This ground of liability has loomed large in products liability cases recently where it overlaps the first consideration noted above.³² It may also conceivably compete with negligence as the proper basis of liability for misstatements by those in the business of getting and communicating information, though there seems to be no perceptible trend in this direction.

31. See generally *Hall v. E.I. DuPont De Nemours & Co.*, 345 F. Supp. 353, 368-69 (E.D.N.Y. 1972).

32. See notes 20 to 22 and accompanying text *supra*.

Part II of this article, comprising Section 8 to 15, will appear in Volume 37 No. 3 of the *Maryland Law Review*.