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Negligent Misrepresentation: Fraud or Negligence

*June W. Wiener**

A CERTIFIED PUBLIC ACCOUNTANT, A, is hired by B, a small, poorly run business corporation, to audit its books and present a statement of the financial position of the company. A is urged to complete the job as quickly as possible. As a result, A carelessly omits several important items and the statement falsely reflects a sound financial position. B, relying on the report, decides to expand his business by purchasing a large stock of highly speculative merchandise. B shows the report to C who, relying on the report, agrees to extend credit to B. Shortly thereafter, B becomes bankrupt. Both B and C sue A for negligent misrepresentation of the financial position of the company.

How can this problem be characterized?¹ Although there was no remedy for negligent misrepresentation at common law, and English law apparently still provides none,² the American courts have all, in one way or another, accepted the thesis that "conscience, fair dealing and the usages of business require"³ some type of liability. But the nature and limits of that liability have never been clearly defined by the majority of American jurisdictions.

The factual situation described above contains two distinguishing elements: the defendant is not guilty of an intent to deceive; the damage to the plaintiffs is purely pecuniary.

Early legal debate revolved around the question of the form

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¹ For conduct to constitute negligent misrepresentation, there must be an honest belief in the truth of the statement made. However, the statement is actually false because defendant has failed to (1) make a careful investigation; (2) use normal business or professional competence in forming a judgment on data carefully obtained; or (3) use care in communicating the information. Restatement, Torts § 552 at 122; *U. S. v. Garcia & Diaz, Inc.*, 291 F. 2d 242 (2d Cir. 1961).

² Salmond on Torts 502 (11th ed. 1953). "No action lies for pecuniary damage caused by careless statements"; citing *Candler v. Crane, Christmas & Co.*, 2 K. B. 164 (1951); Paton, *Tort Liability*, 25 *Can. B. J.* 133 (1947); Harper and James, *Torts* 537 (1956).

³ *International Products Co. v. Erie R. Co.*, 244 N. Y. 331, 155 N. E. 662, 663 (1927).

of the action,⁴ either deceit or negligence. More recently, some jurisdictions have eliminated technical procedural distinctions and formal classification, granting recovery as long as the essentials are established.⁵ Having deemed the form of the action immaterial "as long as a remedy is provided," Prosser still maintains that it is "clearly important . . . that the theory of liability is one of negligence rather than intent to mislead."⁶ And Harper and James, in discussing the confusion involved in applying old terms to new concepts, state:

Such loose use of language is not conducive to clarity and it seems better to confine what the law calls "deceit" to genuinely fraudulent misrepresentations, treating liability for nonfraudulent misrepresentations in separate categories.⁷

In other words, though the form may be immaterial under modern forms of pleading, the majority of authors agree it is essential that the courts recognize the nature of the conduct giving rise to a cause of action. It is the failure to distinguish between the theories of fraud and negligence that has led to the current chaotic state of the law of misrepresentation. In spite of the urging of numerous text book writers and law professors, American courts have, by and large, side-stepped the issues. And it has been some time since any writer has taken a poll of current attitudes.

The action of deceit is historically a combination of contractual warranty and intentional tort.⁸ However unlikely or confusing its origin, its development has centered around the essential element of "scienter" or conscious wrong which, even in the earliest cases, included the concept of wanton and willful neg-

⁴ For an interesting discussion see the early debate between Professor Bohlen and Professor Green: Bohlen, *Misrepresentation as Deceit, Negligence or Warranty*, 42 Harv. L. Rev. 733 (1929); Green, *Deceit*, 16 Va. L. Rev. 749, 750-762 (1930); Bohlen, *Should Negligent Misrepresentation Be Treated As Negligence or Fraud*, 18 Va. L. Rev. 703 (1932); Green, *Innocent Misrepresentation*, 19 Va. L. Rev. 242 (1933).

⁵ *E.g.*, *N. Y. Civ. Prac. Act* § 1283; interpreted in *Fayetteville Cemetery Assn. v. McGarry*, 202 Misc. 141, 117 N. Y. S. 2d 63 (Sup. Ct. Onondaga Co. 1953); *Maflo Holding Corp. v. S. J. Blume, Inc.*, 308 N. Y. 570, 127 N. E. 2d 558 (1948). As to *Fraud*: *Kaiser v. Schiess*, 82 N. Y. S. 2d 676 (Sup. Ct. Queens Co. 1948); *McCloskey v. Kidder, Peabody & Co.*, 28 Misc. 2d 761, 212 N. Y. S. 2d 828 (Sup. Ct. N. Y. Co. 1961).

⁶ Prosser, *Law of Torts* 543 (2d ed. 1955).

⁷ Harper and James, *op. cit. supra* n. 1 at 529. See, as to various adjudicated pleadings, Oleck, *Negligence Forms of Pleading* 502-540 (1957 revision).

⁸ Prosser, *op. cit. supra* n. 6 at 522.

ligence.⁹ The law early recognized that, although the realities of the business world demand that those dealing in it practice the "diligence of self protection,"¹⁰ a man cannot protect himself if the conduct of those with whom he is dealing is designed to prevent him from doing so. For by its nature the element of intent to deceive implies power over the plaintiff's ability to protect himself. Although most of the actions brought in deceit involved business transactions, the elements reflect not only the nature of the damage (i.e. pecuniary loss), but the intentional nature of the defendant's conduct. It is primarily this latter consideration which led to the result of limited liability. Thus, there could be no liability where this power over the plaintiff's conduct was lacking. But wherever such control could be found, liability would lie. Since negligent conduct by definition involves the breach of a legal duty to use care "with no precise intention of producing a particular injury,"¹¹ the theory of liability as developed in the action of deceit is ill suited to deal with purely negligent acts. Barring a deliberate attempt to defraud, the plaintiff is in a position to protect himself. Indeed, he has a *duty* to do so. And a duty on the part of defendant to use care is quite different from a duty to act in good faith.

On the other hand, the concepts of liability in an ordinary negligence action, developed largely in the field of physical damage to person or property,¹² have been deemed too broad to deal with purely pecuniary interests.¹³ Because of this unwillingness

⁹ It is by way of interpretation of the element of "scienter" that courts have succeeded in allowing negligence actions to be brought in deceit without specifically recognizing the nature of the conduct involved. E.g. (1) "Reckless disregard" is interpreted as gross negligence: *Warman v. Delaney, infra* n. 14. The strict English rule as adopted by N. Y. plus the Restatement [Torts § 525] defines "reckless" as an absence of genuine belief or the presence of conscious ignorance of the truth: *Salmond on Torts, op. cit. supra* n. 1 § 203 at 691. (2) The N. Y. rule that a statement "susceptible of accurate knowledge" and made "as of defendant's own knowledge." [*Kramer v. Joseph P. Day, Inc., 26 N. Y. S. 2d 734, 737, 80 A. L. R. 2d 1239 n. (Sup. Ct. N. Y. Co. 1941); Sgarlata v. Carioto, 201 N. Y. S. 2d 384 (City Ct. of Albany 1960)*] is consistent with the test of conscious misrepresentation. But this modification has become an exception in jurisdictions where the simple fact that the statement is susceptible of precise knowledge is sufficient to infer intent: *Clark v. Haggard, 141 Conn. 668, 109 A. 2d 358 (1954)*.

¹⁰ *Harper and James, op. cit. supra* n. 2 at 542.

¹¹ *Bernstein v. L&H Meat Co., 115 N. Y. S. 2d 175 (Sup. Ct. N. Y. Co. 1951), aff'd. 280 App. Div. 914, 115 N. Y. S. 2d 823 (1952)*.

¹² *Salmond on Torts, op. cit. supra* n. 2 at 501.

¹³ *Seavey, Torts, 34 N. Y. U. L. Rev. 517, 522 (1959); Keeton, Fraud: The Necessity For An Intent To Deceive, 5 U. C. L. A. L. Rev. 583, 599 (1958)*.

to extend liability, plus the acknowledgment that some liability must be imposed, and the already limited liability of the deceit action, a great number of American jurisdictions have dealt with the problem by gradually broadening the concept of intent to include varying degrees of negligence under concepts of "inferred intent,"¹⁴ or other legal fictions. But this approach ignores the essential nature of the wrong.

By trying to incorporate the law of negligence into the already well defined law of deceit, confusion is sure to result. This is especially true in those jurisdictions which, by the use of fictions, do not recognize the nature of the defendant's conduct as being negligent rather than intentional. By paying lip service to the doctrine that intent to deceive is an essential element of the action and at the same time constantly stretching the concept to include all types of unintentional conduct, the courts are far from employing the theory of liability that Prosser says is essential.¹⁵ They are, instead, calling defendants to account for purely negligent conduct without regard to the existence of a duty of care. The concept of contributory negligence is emasculated. This approach has produced inconsistencies, illogical fictions, and unresolvable conflicts of decisions.¹⁶ The result is that an attorney in these jurisdictions is at a loss to predict what theory of liability will be employed. There is an equal unpredictability as to what attitude a reviewing judge may adopt in upholding or reversing a decision.¹⁷ Irrespective of which form of action is adopted, it is essential that any approach to the problem of negligent misrepresentation clearly recognize the real nature of defendant's conduct.

Because the remedy must achieve an equitable balance between two interests, the unrestrained transaction of business as opposed to the economic interests of the plaintiff, it must be

¹⁴ See Keeton, *op. cit. supra* n. 13 at 584 ff. 3 as to *Idaho, Illinois, Iowa, Kentucky, Minnesota, Nebraska, New Jersey, North Carolina, North Dakota*. As to *Ohio, Illinois, Connecticut* see: *Beamer v. Feick*, 113 Ohio App. 264, 177 N. E. 2d 691 (1960); *Brubaker v. Gould*, 34 Ill. App. 2d 421, 180 N. E. 2d 873 (1962); *In re Estate of Baumgarth*, 23 Ill. App. 2d 319, 326, 163 N. E. 2d 201 (1960); *Warman v. Delaney*, 148 Conn. 469, 172 A. 2d 188, 189 (1961) (reckless = gross negligence).

¹⁵ Prosser, *op. cit. supra* n. 6.

¹⁶ Keeton, *op. cit. supra* n. 13 at 583, 591, 594.

¹⁷ For an interesting example of the confusion that can arise when a tort action is not well defined: *Penn-Ohio Steel Corp. v. Allis-Chalmers Mfg. Co.*, 15 Misc. 2d 752, 183 N. Y. S. 2d 40 (1958), *affd.* 7 App. Div. 2d 441, 184 N. Y. S. 2d 58, 187 N. Y. S. 2d 476 (1959).

flexible, taking into account the realities and customs of the business world.

There are a growing number of jurisdictions which have, by statute or case law, allowed an action in deceit to be brought for negligent conduct without recourse to legal fictions. Indeed, what has been consistently described as a minority view¹⁸ appears to this author to be the dominating tendency in the field of misrepresentation today, when these jurisdictions are considered together with those which have accomplished the same result through the use of inferences.¹⁹ However, it is clear that the distinguishing factual elements of these cases (lack of intent, pecuniary damage) are most easily dealt with, with a minimum of confusion, if a separate action in negligence is evolved along the lines of that developed in New York. The nature of the conduct involved must be the paramount consideration in choosing which theory of liability is applicable. Further modifications or limits to liability depend for their rationale on factors outside

¹⁸ 37 C. J. S. § 25 p. 265; Prosser, *op. cit. supra* n. 6; Oleck, *op. cit. supra* n. 7.

¹⁹ No intent required:

By statute:

Alabama: Code (1940) Tit. 7 §§ 108, 109. *Barrett v. Hanks*, 155 S. 2d 339 (Ala. 1963).

California: Civ. Code § 1710 (2). *Gagne v. Bertram*, 43 Cal. 2d 481, 275 P. 2d 15 (1954).

Oklahoma: 15 Okla. Stat. § 58 (1951). *Farrar v. Chitwood*, 282 P. 2d 729 (Sup. Ct. Okla. 1955).

Texas: Vernon's Ann. Civ. St. Art. 4004. *Blanton v. Sherman Compress Co.*, 210 S. W. 2d 423 (Tex. Civ. App. 1948) (As to real property transactions).

Case Law:

Florida: *Goodman v. Strassburg*, 139 S. 2d 163 (Fla. App. 3rd Dist. 1962).

Kansas: *Ware v. State Farm Mutual Auto. Ins. Co.*, 181 Kan. 291, 311 P. 2d 316, 320 (1957).

Michigan: See note 64 *infra*.

Minnesota: *Moulton v. Norton*, 184 Minn. 343, 238 N. W. 686 (1931) (as to vendor).

Nebraska: *Dargue v. Chaput*, 166 Neb. 69, 80, 88 N. W. 2d 148, 155 (1958).

New Mexico: *Ham v. Hart*, 58 N. M. 550, 273 P. 2d 748, 749 (1954).

Utah: *Ellis v. Hale*, 13 Utah 2d 279, 373 P. 2d 382, 385 (1962). (Makes distinction between fraud and negligence though apparently not in the form of the action. Requires special duty of care. No liability for negligence in the manner of expression.)

Virginia: *B-W Acceptance Corp. v. Benjamin T. Crump Co.*, 199 Va. 312, 99 S. E. 2d 606 (1957).

Statutes imposing liability on the grounds of public policy duty (e.g., notaries, accountants, or food and drug cases) and dangerous instrumentality concepts all show the trend toward strict liability. This warranty concept dispenses with both duty and intent and further exemplifies the court's avoidance of the issues. An attempt to put more and more negligence cases in this category has been resisted to a great extent in New York since the result is greater liability than that for fraud.

the issue involved in this choice, that is, the realities of the economic world. In establishing a duty of care, reference to what the ordinary businessman has a right to expect is a normal consideration.

Since the purpose of this article is to analyze the distinguishing element of negligent misrepresentation as distinct from those where there is an intent to deceive, particular attention will be directed to New York case law which alone has maintained a consistently clear distinction.²⁰ Those few jurisdictions which recognize a cause of action in negligence for the negligent use of words with resulting pecuniary loss have relied heavily on these decisions.²¹

Determinative Elements

Leading the development of a right of recovery for negligent language within tort concepts, New York courts, unhampered by the necessity of fitting the action into an existing doctrine unsuited to the conduct involved, have recognized, indeed emphasized, the need to limit liability far short of the ordinary rule of foreseeability. In addition, having deliberately set the action apart as distinct from fraudulent misrepresentation, they refuse to make liability "coterminous with that of liability for fraud."²² This effort has centered around the concepts of *duty to use care* and *contributory negligence*, as opposed to *intent to induce reliance* and the *right to rely*.

The law imposes a general duty of *honesty*.²³ A dishonest attempt to deceive naturally implies an attempt to prevent plain-

²⁰ *Briggs, Blitman & Posner v. N. Y. State Thruway Auth.*, 28 Misc. 2d 110, 217 N. Y. S. 2d 806 (N. Y. Ct. of Claims 1961). Note: The scope of this article extends only to a direct action for damages and does not include other remedies such as rescission where it is uniformly held that recovery may be had for negligent or innocent mistake. As to damages see: *Sorensen v. Gardner*, 215 Or. 255, 344 P. 2d 471, 476 (1959) (both contract & tort rule of damages used in fraud action). For an annotated discussion of the question of damages in a deceit action: *Gagne v. Bertran*, *supra* n. 19. For an annotated discussion of punitive damages in a fraud action: *Walker v. Sheldon*, 10 N. Y. 2d 401, 179 N. E. 2d 497 (1961). Interest on damage claims: *Purcell v. Long Island Daily Press*, 9 N. Y. 2d 255, 173 N. E. 2d 865 (1961). Rule applied in N. Y.: *Terris v. Cumiskey*, 11 App. Div. 2d 259, 203 N. Y. S. 2d 445 (1960).

²¹ *E.g.*, *Garapedian v. Anderson*, 92 N. H. 390, 31 A. 2d 371 (1943); *Weston v. Brown*, 82 N. H. 157, 131 A. 141 (1925); *Sult v. Scandrett*, 119 Mont. 570, 178 P. 2d 405 (1947); *Valdez v. Gonzales*, 50 N. M. 281, 176 P. 2d 173 (1946) (narrow interpretation of *Ultramares v. Touche, infra*) (*Cf.*, *Ham v. Hart, supra* n. 19).

²² *Ultramares Corp. v. Touche*, 255 N. Y. 170, 174 N. E. 441, 447 (1931).

²³ *Harper and James, op. cit. supra* n. 2 at 542.

tiff from being on guard, making an independent investigation, doubting the validity of the representation, in short, colors the entire relationship of the parties.²⁴ Consequently, where intent is found, liability for false representations will extend to any plaintiff who can have been mesmerized by defendant's malicious actions. One need only prove that defendant intended to influence the transaction in question.²⁵ Whether or not there is a duty to use care, if the defendant knew or had reason to know that a particular plaintiff or class of plaintiffs would rely he will be liable.²⁶ Thus, in *Gluck v. Tankel*,²⁷ the court found an "absolute" duty of honesty. The misrepresentation involved the price paid for goods which the court found were susceptible of precise knowledge. In discussing the relation of the parties (which the court finally determined to be a fiduciary one although its precise nature was left in doubt), they held a duty of "utmost integrity . . . throughout all dealings *leading up to* the formation of" a contractual relationship. Further, that even if the relationship were merely vendor to vendee, although the defendant is not bound to reveal the price paid for goods, if he speaks he must speak the truth because "a misrepresentation as to cost is *naturally calculated* to mislead the purchaser."²⁸ In short, the mere fact that defendant intended to induce plaintiff to enter the transaction was sufficient.

²⁴ "By its very nature a false statement intentionally made is wrongful. If it inflicts material harm upon another, which was or should have been in the contemplation of the actor, and it results in actual damage to the Plaintiff's economic or legal relationships, an action may lie." (Penn-Ohio Steel Corp. v. Allis-Chalmers Mfg. Co., *supra* n. 17.)

²⁵ *Angerosa v. White Co.*, 248 App. Div. 425, 290 N. Y. S. 204, 213, *affd.* 275 N. Y. 524, 11 N. E. 2d 325 (1936). *Cohen v. Glassman*, 110 N. Y. S. 2d 835 N. E. (Sup. Ct. Kings Co. 1952): "One who commits a fraud is liable to whoever (sic) suffers by the fraud, regardless of whether there is any privity (between plaintiff and defendant) . . ." (Defendant knowingly misrepresented minimum retail business to broker who, relying on the representation, lent money to purchaser to complete the sale. Purchaser became insolvent and therefore could not repay the loan. Broker was awarded damages!). *Du Rite Laundry, Inc., v. Washington Electric Co.*, 263 App. Div. 396, 33 N. Y. S. 2d 925, 6 A. L. R. 2d 297 n. (1942). (Contract between seller and buyer, buyer to accept goods only if found without defect by inspection company hired by buyer. Seller relied on report by purchasing from manufacturer and delivering to buyer. Buyer suing seller to rescind because of defective goods. Court allowed seller to interplead inspection company who would be liable to seller for damages.)

²⁶ Restatement, Torts § 531, p. 71.

²⁷ 24 Misc. 2d 841, 199 N. Y. S. 2d 12, *affd.* 12 App. Div. 2d 339, 211 N. Y. S. 2d 602 (1960).

²⁸ 199 N. Y. S. 2d 18.

As was said in *Dale System, Inc. v. General Teleradio, Inc.*:

One important difference between actions for misrepresentation in deceit and those based upon negligence is that the class of persons to whom the Defendant may be liable is considerably more restricted when the basis of liability is negligence rather than intent or recklessness.²⁹

In *Goodman v. Title Guarantee and Trust Co.*³⁰ the court held defendants liable to vendors relying on an incorrect title report issued to a prospective buyer on the theory of fraud but stated they would not be similarly liable in negligence. In *Gardner v. Gerstein*³¹ a complaint for fraudulent inducement of a contract was sufficient.

In addition, contributory negligence on the part of a person who is misled is not a defense against a charge of *intentionally* making misleading statements.³² The *Gluck* case, discussed above,³³ also held the fact that plaintiff made his own estimate on the value of the goods did not preclude his reliance on defendant's statement as to cost. In the action of deceit a right to rely is normally found except where the facts show that the plaintiff was obviously foolish to rely³⁴ or where the plaintiff made an independent investigation *unhampered by* the influence of the defendant.³⁵ He need not investigate unless he is put on notice of the falsity of the statement.³⁶ And even where he has made such an investigation, it will not be a defense if defendant purposely prevents the investigation from being effective.³⁷

In short, where liability is founded on intent, there is no duty on the part of the plaintiff to use care. But where liability is

²⁹ *Dale System v. General Teleradio, Inc.*, 105 F. Supp. 745 (S. D. N. Y. 1952).

³⁰ 11 App. Div. 2d 1003, 206 N. Y. S. 2d 32 (1960).

³¹ 7 App. Div. 2d 631, 179 N. Y. S. 2d 544, aff'd. 6 N. Y. 2d 956, 161 N. E. 2d 225 (1958).

³² *Sease v. Central Greyhound Lines of N. Y.*, 281 App. Div. 192, 118 N. Y. S. 2d 433, 440 (1952), rev'd. 306 N. Y. 284, 117 N. E. 2d 899 (1953). Relying on: *Angerosa v. White Co.*, *supra* n. 25.

³³ *Gluck v. Tankel*, *supra* n. 27.

³⁴ Restatement, Torts, § 541.

³⁵ *Id.* at § 547.

³⁶ *Id.* at § 540. *Clark v. Haggard*, 141 Conn. 668, 109 A. 2d 358 (1954).

³⁷ Restatement, Torts, § 547 at 108.

founded on a relation, the plaintiff must use care because:

An equitable doctrine will not be employed to prevent the assertion of fraudulent and inequitable conduct.³⁸

Where the law of negligence imposes a general duty of care to avoid injury to the tangible interests of others (personal injury or property damage),³⁹ no such general duty is imposed in the case of pecuniary loss. This tendency, "abnormal to the general law of torts,"⁴⁰ reflects "the social and economic policies latent in legal formulae."⁴¹ The law is reluctant to impose liabilities which will hamper efficient and speedy transactions of business. It has recognized, in spite of the tendency to modify the harshness of the rule of *caveat emptor*, that the interests of parties to business transactions are naturally adverse. The primary consideration is what a reasonable businessman has a right to expect according to customary business practices.⁴² He almost always has a right to expect that defendant will be honest and sincere in his representations, but liability hinges in these cases on whether or not he can demand a certain level of care and competence. Defendant's intent to influence the transaction is not enough without some special relationship, contractual or otherwise, giving rise to a duty of care. This reasonable expectation of care may arise from the personal relationship of the parties (*e.g.*, fiduciary, special inducement to rely) or from the nature of the transaction (*e.g.*, public responsibility, expert knowledge, knowledge in the exclusive possession of defendant). Knowledge that the plaintiff will rely is always essential.

Although some jurisdictions have limited the action for negligent misrepresentation for pecuniary loss to those in privity,⁴³ the New York law does not depend upon such a narrow concept.

³⁸ *Crowell-Collier Pub. Co. v. Josefowitz*, 9 Misc. 2d 613, 170 N. Y. S. 2d 373, 376, *affd.* without op. 5 App. Div. 2d 987, 173 N. Y. S. 2d 992, *affd.* 5 N. Y. 2d 998, 184 N. Y. S. 2d 859, 157 N. E. 2d 730 (1957).

³⁹ *Harper and James*, *op. cit. supra* n. 2 § 7.6 p. 545. Restatement, Torts, § 531 p. 71.

⁴⁰ Restatement, Torts, c. 22, p. 58.

⁴¹ *Harper and James*, *op. cit. supra* n. 2 at 539.

⁴² *Id.* at 548.

⁴³ *E.g.* Michigan: *Aldrich v. Scribner*, 154 Mich. 23, 117 N. W. 581, 18 L. R. A. (n. s.) 379 (1908); *Rosenberg v. Cyrowski*, 227 Mich. 508, 198 N. W. 905, 906 (1924); *Kolinski v. Reichstein*, 303 Mich. 710, 7 N. W. 2d 117, 119 (1942); *Dykema v. Muskegon Piston Ring Co.*, 348 Mich. 129, 82 N. W. 2d 467, 471 (1957).

Duty may grow out of a contract even though such duty is not assumed by the contracting parties, since, given the contract and the relation, the duty is imposed by law . . .⁴⁴

Privity.

The concept of a legal duty outside the law of contract which would give rise to liability for words negligently spoken was developed in two often cited and now classic "textbook" cases: *Glanzer v. Shepard* (1922),⁴⁵ and *International Products Co. v. Erie R. Co.* (1927).⁴⁶ These were later modified by *Ultramares v. Touche* (1931).⁴⁷ In the light of the development of the action of negligent misrepresentation, it is necessary to re-examine them briefly to understand the dual conceptual development. The cases, never really reconciled, have given rise to two distinct lines of decision. Those relying on the earlier cases have emphasized the personal relationship of the parties. Those relying on the *Ultramares* decision have emphasized the nature of the transaction.

The facts in the *Glanzer* case involved the performance of a service as well as the negligent use of words incidental thereto. Although, as the court stated, the same result could have been reached by applying the "third party beneficiary rule" of contracts,⁴⁸ it specifically chose to use tort terms in order to establish that the duty to use care is imposed by law and not by contract. "The bounds of duty are enlarged by knowledge of a prospective use,"⁴⁹ and, "one who assumes to act, *even though gratui-*

⁴⁴ *Scholen v. Guaranty Trust Co. of N. Y.*, 288 N. Y. 249, 43 N. E. 2d 28, 141 A. L. R. 1273 (1942). Where one party suffers damage by the acts of another and there is available one remedy in tort and another in contract, the damaged party may elect to pursue either remedy. Generally: *Henderson v. Lincoln Rochester Trust Co.*, 198 Misc. 82, 100 N. Y. S. 2d 840, aff'd. 303 N. Y. 27, 100 N. E. 2d 117, aff'd. 277 App. Div. 1093, 101 N. Y. S. 2d 256 (1950); *Matis v. Griscom*, 64 N. Y. S. 2d 534 (Sup. Ct. N. Y. Co. 1946).

⁴⁵ 233 N. Y. 236, 135 N. E. 275 (1922).

⁴⁶ *Supra* n. 3.

⁴⁷ *Supra* n. 22.

⁴⁸ *Glanzer v. Shepard*, *supra* n. 45 at 277, relying on the doctrine of *Lawrence v. Fox*, 20 N. Y. 268 (1859). For cases grounding liability on third party beneficiary theory, especially where a duty is owing to the public by statute, see: *Vandewater & Lapp v. Sacks Builders, Inc.*, 20 Misc. 2d 677, 186 N. Y. S. 2d 103 (Sup. Ct. App. term 1959). (Erroneous drainage map filed with county clerk according to statute. Engineers and surveyors, hired by owner, liable to purchasers.) *Allen Properties, Inc., v. Brydle, Sup.*, 72 N. Y. S. 2d 554, 559, aff'd. 72 N. Y. S. 2d 293 (App. Div. 1947). (Right to rely on filed map.)

⁴⁹ *Glanzer v. Shepard*, *supra* n. 45 at 276.

tously, may thereby become subject to the duty of acting carefully, if he acts at all."⁵⁰

The *International* decision could not have been based on a theory of fraud⁵¹ or contract⁵² but rested entirely on a theory of recovery for words negligently spoken. Often cited for its criticism of the English rule denying liability,⁵³ the opinion set out to define the duty relation recognized in the *Glanzer* case. This definition involved four elements. It required *knowledge or its equivalent* that the information is desired for a serious purpose; that the person to whom it is directed intends to rely and act upon it; that if false or erroneous, he will because of it be injured in person or property. Fourth, it required a relation of the parties, arising out of contract or *otherwise*, giving rise to a right to rely and a duty of care.⁵⁴

Except for the emphasis on the relation of the parties these elements seem to constitute little more than the negligence rule of reasonable expectation of harm.⁵⁵ But "knowledge or its equivalent" is surely more restrictive than "reasonable expectation" and the case has served as a guide in restricting the foreseeability element. It also reinforced the concept that the duty is noncontractual in nature and that the question of contributory negligence is a proper one.⁵⁶

The *Ultramares* case has had the most dominating influence

⁵⁰ *Ibid.* Acts of omission will result in liability for negligence only where there is an affirmative duty to speak, but when one assumes to speak he may be required to speak carefully. In re Perutz' Estate 23 Misc. 2d 229, 199 N. Y. S. 2d 274 (Surrog. Ct. Westchester Co. 1960). (A fiduciary normally owes a duty of complete disclosure.) Saslow v. Novick, 19 Misc. 2d 475, 712, 191 N. Y. S. 2d 645 (Sup. Ct. Kings Co. 1959). (Duty to disclose arises only when there is a confidential or a fiduciary relationship.) Dash v. Jennings, 272 App. Div. 1073, 74 N. Y. S. 2d 881 (1947). (Representation that stock good investment and corporation solvent. Concealment of material facts. Held: No duty to speak, no liability.)

⁵¹ *International Products v. Erie R. Co.*, *supra* n. 3 at 664.

⁵² *Id.* at 663.

⁵³ *Ibid.*

⁵⁴ Here the court relied on *Jaillet v. Cashman*, 235 N. Y. 511, 139 N. E. 714 (1923). *Dale System, Inc., v. General Teleradio, Inc.*, *supra* n. 29 summarizes the holding in *International*: "A cause of action exists if the information is supplied for a stated purpose, with knowledge that it would be acted on to the Plaintiff's injury if false and the relationship between the parties is such that Plaintiff would normally rely on the Defendant for such information. . . . But the scope of the duty falls short of foreseeability of possible harm to anyone in a group of persons."

⁵⁵ See Seavey, *op. cit. supra* n. 13 at 523.

⁵⁶ *International Products v. Erie R. Co.*, *supra* n. 3 at 664: "The Defendant need not benefit."

in the development of this action. The specific intent of the opinion is to limit liability not only short of foreseeability but short of the liability imposed in an action for fraudulent misrepresentation.⁵⁷ Indeed, it is an attempt to limit the action to those in privity:

Liability for (negligent misrepresentation) . . . is bounded by the contract.⁵⁸

As will be seen, it has not quite achieved this latter goal, but it has served as a very strong precedent for limiting liability. The opinion failed to limit liability to those in privity in subsequent cases because of its inconsistency on this point. It distinguishes the *Glanzer* case because the "bond (between the parties) was so close as to approach that of privity," since the defendant knew that the information was *primarily* for the use of the plaintiff.⁵⁹ It distinguishes *International* because there was a "prospective" contractual relation and the information requested was exclusively in the possession of the defendant and therefore in the nature of a warranty.⁶⁰ It is obvious, from a reading of the opinion, that Cardozo was not happy with the effect these decisions had had on subsequent decisions. But he did not overrule them, probably because he also wrote them!

Cardozo seems to be preoccupied with the limitation of liability to a workable number of possible plaintiffs. Indeed, he intimates that, except for this need to limit liability, the elements of deceit would be sufficient to incorporate an action for negligent misrepresentation and that the cases where duty of care and contributory negligence would be ignored would be too few to merit alarm.⁶¹ But he is determined that somehow we must make liability for negligence less broad than that for fraud. For this reason he separates the action and artificially imposes restrictions traceable to the nature of the transaction and to the nature of the damage. This author is much happier with his reasoning in the two prior cases mentioned. Apparently, so are many of the New York courts, as we shall see.

⁵⁷ *Ultramares v. Touche*, *supra* n. 22, 174 N. E. at 447.

⁵⁸ *Id.* at 448. A New Mexico decision, relying on *Ultramares*, held that a duty relation must be found "by reason of a contractual relation or something in the nature of an equivalent to privity." (*Valdez v. Gonzales*, *supra* n. 21.)

⁵⁹ *Id.* at 446.

⁶⁰ *Ibid.*

⁶¹ *Id.* at 447, 448.

Extension of Ultramares

Because the law reflects the customary usages of business, and because of the effect of the *Ultramares* decision, not only the nature of the conduct but the nature of the transaction has had a profound effect in determining the existence of liability. The *Ultramares* decision was actually concerned with a public accountant who was held liable on a theory of fraud to a third party relying on his report. An accountant was deemed to be speaking "as of his own knowledge," simply by the nature of his calling.⁶² Therefore, on the theory discussed above, if there is no reasonable basis for the statement, an honest belief in its truth is no defense. Although Cardozo was unwilling to extend liability for negligent words "in an indeterminate amount for an indeterminate time to an indeterminate class,"⁶³ he was able to extend the concept of "scienter" to reckless misstatement by a class of persons who have exclusive knowledge of the facts in question. In short:

Although public accountants may not be found liable, upon the theory of ordinary negligence, to parties with whom they are not in privity, it has been held that they may (be liable) upon a theory of fraud . . . where (they) . . . have reason to know (their statement) . . . will be relied upon.

However, in several cases the fraud has been held inferrable from conduct in effect constituting gross negligence.⁶⁴

In this regard, note the opinion in a recent case:

Heedless and wanton disregard by a CPA of the consequences of an incorrect financial statement will take the place of a deliberate intention to defraud, and may warrant holding of the accountant liable to third persons who have justifiably acted upon the certificate to their injury.⁶⁵

Thus, the following fact situations gave rise to an inference of fraud with resulting liability to third parties. Accountants were held liable where a large percentage of accounts receivable were fictitious and would not have been included on the balance sheet except through the gross negligence of the accountants in failing to check for their existence.⁶⁶ Where, although the state-

⁶² *Id.* at 449.

⁶³ *Id.* at 444.

⁶⁴ 54 A. L. R. 2d 345 (1957).

⁶⁵ *Duro Sportswear v. Cogen*, 131 N. Y. S. 2d 20, *affd.* 285 App. Div. 867, 137 N. Y. S. 2d 829 (1955).

⁶⁶ *Ultramares v. Touche*, *supra* n. 22.

ment was purported to be made "in their opinion," accountants were liable for a failure to account for slow collections apparently uncollectible and there were circumstances showing a conscious suppression of information.⁶⁷ An accountant understated deficits through a failure to include bills received but not posted, although he had personal knowledge of the methods of the company and should have known or knew of them.⁶⁸ Where an accountant was hired by a borrower to furnish a report to be used by him for procuring loans and securing credit from plaintiff, he was liable for fraud where he had knowledge that the books upon which he based his report had been falsified.⁶⁹

On the other hand, it is well established in New York, on the basis of these same cases, that where there is no indication of fraudulent intent and no *contractual* relation, an accountant will not be liable to third parties for mere negligent misrepresentation. Thus, where failure to mention contingent liabilities is deemed merely not consistent with good accounting practice the defendant is not liable.⁷⁰ In short, although cases can be found where accountants are held liable in fraud, the courts have refused to find a duty relation extending beyond the contracting parties where the conduct is negligent. Cardozo was concerned lest attorneys who could not prove fraud find an easy recovery in negligence. But the effect of his decision has been to so arbitrarily restrict the negligence action as to force an expansion of the action of fraud.

Similar precedents have been established in other fields.⁷¹

⁶⁷ *State St. Trust Co. v. Ernst*, 278 N. Y. 104, 15 N. E. 2d 416, 120 A. L. R. 1250 (1938). This same case, however, is cited as authority that accountants are *not* liable for ordinary negligence in the absence of a contractual relationship or its equivalent, even though the accountants are aware that the balance sheet will be used to obtain credit.

⁶⁸ *Duro Sportswear v. Cogen*, *supra* n. 65. (In this case plaintiff's right to rely was questionable since he was in charge of posting bills and he was not in privity with defendant.)

⁶⁹ *Mutual Ventures, Inc., v. Barondess*, 17 Misc. 2d 483, 186 N. Y. S. 2d 308, 54 A. L. R. 2d 324 (Sup. Ct. Kings Co. 1959). The fact that the petition alleged that the accountant "certified" rather than "represented" did not destroy the cause of action because: "any action or conduct, which is sufficient to create on the mind a distinct impression of fact conducive to action, is a 'representation.'"

⁷⁰ *O'Connor v. Ludlam*, 92 F. 2d 50 (2d Cir. 1937), cert. den. 302 U. S. 758, 58 S. Ct. 364, 82 L. Ed. 586 (1938).

⁷¹ As to misrepresentation as to the financial condition or credit of another brought by one induced to extend credit, generally, see 32 A. L. R. 2d 184 (1953).

In the early *Jaillet* case⁷² the defendant operated a ticker service for brokers. His relation to the public was held to be the same as a publisher of a newspaper, that is, no liability outside a contractual or fiduciary relationship for an unintentional mistake. The courts have clearly refused to confuse the action for negligent misrepresentation with that of libel or injurious falsehood. Unless there is a provable intent to injure the particular plaintiff there is no relationship raising a duty of care between publishers and any member of the general public. Undoubtedly, this policy flows from reluctance found in *Ultramares* to extend liability to an inordinately large class of plaintiffs. Thus, suits brought on the theory of negligent misrepresentation against radio broadcasters⁷³ and newspapers⁷⁴ were dismissed for lack of a duty relation or knowledge that plaintiff would rely. In a recent case the court held that "the remedy open to plaintiff through libel is far broader than an action based on negligence" which has strict limits of liability for the use of negligent language.⁷⁵

Effect of International—Glanzer

But the relation of the parties remains the primary consideration in the bulk of the decisions which are not dominated by the nature of the transaction, and, especially the latter (*Glanzer*), where no contractual relationship exists. The very early case of *Doyle v. Chatham & Phoenix Nat. Bank*,⁷⁶ decided before the *Ultramares* case, did much to reinforce the principles set out in *International*. A trustee negligently represented to a prospective purchaser that certain bonds were adequately secured. It was essential that the defendant knew the information was requested for a serious purpose and plaintiff would rely. But further, relying on *International*, the court found a "prospective" relationship⁷⁷ of trustee and *cestui que trust* between the parties. In ad-

⁷² *Jaillet v. Cashman*, *supra* n. 54.

⁷³ *Advance Music Corp. v. American Tobacco Co.*, 268 App. Div. 707, 53 N. Y. S. 2d 337, rev'd. 296 N. Y. 79, 70 N. E. 2d 401 (1945); *Dale System, Inc. v. General Teleradio, Inc.*, *supra* n. 29.

⁷⁴ *Sacco v. Herald Statesman, Inc.*, 32 Misc. 2d 739, 223 N. Y. S. 2d 329 (Sup. Ct. Westchester Co. 1961); *Ciffolillo v. Westchester County Publishers, Inc.*, 32 Misc. 2d 911, 224 N. Y. S. 2d 606 (Sup. Ct. Westchester Co. 1961).

⁷⁵ *Ciffolillo*, *supra* n. 74.

⁷⁶ 253 N. Y. 369, 171 N. E. 574 (1930).

⁷⁷ A Montana decision, citing *International*, relies on a similar "prospective contractual relationship." *Sult v. Scandrett*, *supra* n. 21.

dition, the question of contributory negligence was discussed in connection with the good faith of plaintiff in relying on the certification if he was aware of the shady nature of the trustor's business.

Two recent cases illustrate the principle that knowledge in defendant's exclusive possession can give rise to a duty of care not founded on a contractual relationship. In *De Atucha v. Manufacturers Trust Co.*⁷⁸ plaintiff sold an automobile, the price to be paid by deposit in defendant bank to plaintiff's account. Plaintiff's agent inquired of the bank if the deposit had been made. Relying on the bank's negligent representation that it had been, plaintiff transferred title and released security. After finding (from the nature of the banking business) that defendant knew that plaintiff would rely for a serious purpose, the court found that the relation of banker and depositor was sufficient to require the defendant "in morals and good conscience"⁷⁹ to use care in giving information which was solely in its possession. The plaintiff has a right to expect care in these circumstances and, by giving the information to plaintiff's agent, the bank admitted the latter's right to it. Contributory negligence was treated, as usual, as a question of fact.

Facts very similar to those of the *Glanzer* case were the basis of liability in *Plata American Trading, Inc. v. Lancashire*.⁸⁰ Defendant was an experienced weigher hired by the seller to measure and certify the amount of goods delivered to a carrier for the benefit of the plaintiff shipper. Defendant knew the purpose of the certificate and that it would be relied upon in determining the price paid. Defendant was negligent in not ascertaining the fact that all the goods which left the seller's tank did not reach the carrier but were partially diverted into another tank in the seller's warehouse. He was found to have a duty as an expert weigher to use care in giving information on which plaintiff had a right to rely.

Finally, a 1949 decision⁸¹ draws a very nice distinction be-

⁷⁸ 155 N. Y. S. 2d 537 (Sup. Ct. N. Y. Co. 1956), *affd.* 3 App. Div. 2d 902, 163 N. Y. S. 2d 402 (1957).

⁷⁹ The court was here quoting the language used in *International*, *supra* n. 3 at 664.

⁸⁰ 29 Misc. 2d 246, 214 N. Y. S. 2d 43 (1957).

⁸¹ *Champion Construction & Engineering Co. v. Bush Terminal Building Co.*, 275 App. Div. 1055, 92 N. Y. S. 2d 242 (1949).

tween the liability for fraud and that for negligence. Defendant owner represented to a subcontractor (plaintiff) that he had procured a bond, in accordance with his contract with the general contractor, for payment by the general contractor of its obligations to the owner and subcontractors. Plaintiff relied by furnishing labor and materials. The plaintiff was allowed to recover on the theory of fraud, since it was found that the defendant knew his statement was false. But, the court held, he could not recover if the defendant was merely negligent in failing to obtain the bond from the general contractor because he had no statutory or contractual duty owing to the plaintiff to insist on a bond or to inspect the bond furnished by the general contractor.⁸²

Conclusion

Although the New York law is somewhat ambiguous, due to Judge Cardozo's change of heart in the *Ultramares* decision, it is still the leading jurisdiction in defining the differences between negligent and intentional misrepresentation. Other jurisdictions would do well to take a second look at the confusion in their own decisions and try to arrive at a clear understanding of the difference between a negative prohibition against intentional infliction of harm and an affirmative duty to protect the interests of another.

⁸² Intent not to perform a promise may be fraudulent: *Channel Master Corp. v. Aluminum Ltd. Sales, Inc.*, 4 N. Y. 2d 403, 176 N. Y. S. 2d 259, 151 N. E. 2d 833 (1958).