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Misrepresentation in Indiana: What Hath Fraud Wrought?

Although the Indiana law of fraud¹ provides recovery for damages resulting from the making of knowingly false statements with the intent to mislead the representee, Indiana courts have extended like relief for negligent misrepresentation.² This characterization removes actions for negligent misrepresentation from the law of negligence, and places them under the law of fraud, requiring the Indiana courts to strain the substantive elements of common law fraud. Moreover, this characterization imposes a hardship on defendants in actions for negligent misrepresentations who thus lose their defense of contributory negligence. In an increasingly litigious world, the hardship imposed by the Indiana formulation affects accountants, attorneys and other professionals who make their livings through the tender of information, by subjecting them to continuous potential liability when rendering expert advice or opinions. This result is neither doctrinally nor socially compelled.

Although actions for fraud and negligent misstatement have a common basis in tort law, specifically misrepresentation, they are conceptually different in two fundamental respects. First, fraud is an intentional tort while a misrepresentation made without scienter generally falls within the law of negligence.³ Second, fraud is a breach of a negative duty to avoid intentionally misleading another, while negligent misrepresentation is a breach of an affirmative duty to give accurate information, which arises from a particular relationship.⁴ The common "misrepresentation" denominator apparently has caused the two distinct actions to be dealt with identically, although proper treatment demands analysis as separate actions under two of the basic areas of tort law, intentional wrongs and negligent wrongs. A new focus of analysis permits distinction of these areas without succumbing to the fears of sanctioning deceit currently preventing the Indiana courts from recognizing negligent misrepresentation as a viable cause of action.

Underlying the law of misrepresentation are fundamental policy questions concerning the reliability of statements of material fact.⁵ These questions must be answered in light of the community's accepted business and social mores coupled with the recipient's conformity to "accepted social standards of

¹The terms "fraud" and "deceit" will be used interchangeably in this note.

²For the purposes of this note, a "negligent misrepresentation" is a statement of material fact made without intent to deceive and without reasonable ground for belief in its truth.

³W. PROSSER, *LAW OF TORTS* 704 (4th ed. 1971) [hereinafter cited as PROSSER].

⁴F. HARPER & F. JAMES, *1 TORTS*, 545 (1956) [hereinafter cited as HARPER & JAMES].

⁵Further, there exist somewhat analogous questions surrounding the tenuous continuum of materiality and the "law"—"fact" distinction that are beyond the scope of this note.

propriety and common sense."⁶ The essential inquiry concerns the relationship between the parties and involves a determination of their respective rights and duties.

Privity of contract between plaintiff and defendant or any other special relationship which would give rise to an affirmative duty will not be required as a condition of plaintiff's damage recovery for defendant's fraud.⁷ Under the general law of torts, fraud is an intentional wrong, insofar as defendant's dishonesty lies in his stating, as true, facts which he does not honestly know to be true for the purpose of inducing action on the part of another.⁸ Where liability is predicated on intent, there is no duty on the part of the defrauded party to use care in relying upon defendant's honesty,⁹ and the contributory negligence defense is not available.¹⁰ This is consistent with the general rule that negligence of the plaintiff is not a defense to an intentional tort.¹¹ While plaintiff's reliance must be "justifiable," the cases suggest reliance is justifiable when the relying party subjectively believes he is justified in so relying (as distinguished from the objective contributory negligence standard). This subjective test sustains a right to rely unless the facts indicate that the statement was obviously false¹² or the plaintiff made an investigation unhampered by the influence of the defendant.¹³ The representee is under no duty to investigate unless he is put on notice of the falsity of the statement.¹⁴

On the other hand, an action for negligent misrepresentation, which is based on a representation made with no reasonable grounds for belief in its truth, rests on different principles. The defendant should be able to interpose the affirmative defense of contributory negligence¹⁵ or to show that the relationship between the parties did not require an affirmative duty on the part of defendant to use reasonable care to protect plaintiff.¹⁶

The purpose of this note is to examine and illustrate this misclassification under the Indiana law of fraud with particular emphasis on the confusion

⁶HARPER & JAMES, *supra* note 4, at 539.

⁷HARPER & JAMES, *supra* note 4, at 537.

⁸The intentional wrong of fraud should be confined to situations where defendant either knew of the falsity of the statements or was cognizant that he did not know whether they were true or false. In either case, he does not honestly know the statements to be true.

⁹See PROSSER, *supra* note 3, at 716-17 (citing, *inter alia*, *Teter v. Schulz*, 110 Ind. App. 541, 39 N.E.2d 802 (1942)). As Prosser maintained:

It is a sufficient indication that the person deceived is not held to the standard of precaution, or of minimum knowledge, or of intelligent judgment, or the hypothetical reasonable man, that people who are exceptionally gullible, superstitious, ignorant, stupid, dimwitted, or illiterate, have been allowed to recover when the defendant knew it, and deliberately took advantage of it.

¹⁰See, e.g., *Gonderman v. State Exch. Bank, Roann*, ___ Ind. App. ___, 334 N.E.2d 724, 729 (1975).

¹¹See PROSSER, *supra* note 3, at 426.

¹²RESTATEMENT OF TORTS, § 541 (1938).

¹³*Id.* § 547.

¹⁴*Id.* § 541, Comment a.

¹⁵See, e.g., *Garapedian, Inc. v. Anderson*, 92 N.H. 390, 31 A.2d 371 (1943).

¹⁶HARPER & JAMES, *supra* note 4, at 538.

surrounding the distinction between fraud and negligent misrepresentation. It is submitted that a cause of action for fraud should be strictly limited to situations where all of its elements are satisfied or legitimately imputed and that a cause of action for negligent misrepresentation should be recognized, with its appurtenant affirmative defenses, in situations where the relationship of the parties is such as to require the representing party to meet an affirmative duty to be accurate in his representations.

COMMON LAW BACKGROUND

The modern law of fraud was established in 1789,¹⁷ in *Pasley v. Freeman*,¹⁸ where defendant's misrepresentation, made with intent to defraud and relied upon by plaintiff to his damage, was held to constitute a cause of action.¹⁹ Legal scholars of the day assumed that a remedy in fraud would also lie for negligent misrepresentation²⁰ until the House of Lords' 1889 landmark decision, *Derry v. Peek*,²¹ separated the elements of negligent misrepresentation from factors constituting fraud. In *Derry*, the directors of a corporation issued to the public a misleading prospectus upon which plaintiff relied to his detriment. The plaintiff argued that, notwithstanding defendants' belief in the truth of their representations, they would still be liable in damages for fraud if there existed no reasonable grounds for their belief, that is, if they had made negligent misrepresentations. However, the court rejected this argument, holding that an action for fraud required demonstration of a false representation "made (1) knowingly, or (2) without belief in its truth, or (3) recklessly, careless whether it be true or false."²² The *Derry* framework, fundamental to contemporary analysis, thus set a threshold requirement of actual and honest belief in the truth of a representation. Nothing less will provide a full defense to a charge of fraud. Therefore, negligent misrepresentations, honest statements made without reasonable grounds to believe them to be true, satisfy the above criteria and do not constitute fraud.

The New York courts adopted and developed the *Derry* distinction between fraud and negligent misrepresentation,²³ recognizing negligent misrepresentation as a viable independent cause of action²⁴ by separating the

¹⁷See PROSSER, *supra* note 3, at 685.

¹⁸100 Eng. Rep. 450 (K.B. 1789).

¹⁹*Id.* at 457-58.

²⁰PROSSER, *supra* note 3, at 699; Smith, *Liability for Negligent Language*, 14 HARV. L. REV. 184, 191 (1900).

²¹14 App. Cas. 337 (1889).

²²*Id.* at 374, per Lord Herschell. The factual case made out by plaintiff in *Derry v. Peek* was as follows: (1) defendants volunteered a written statement of fact to plaintiff and his class; (2) the statement was not true in fact; (3) defendants, though believing the statement, had no reasonable ground for such belief and would not have entertained it if they had exercised reasonable care to determine its truth.

²³See, e.g., *Briggs, Blitman & Posner v. New York State Thruway Auth.*, 28 Misc. 2d 110, 217 N.Y.S.2d 806 (Ct. Cl. 1961).

²⁴See, e.g., *Glanzer v. Shepard*, 233 N.Y. 236, 135 N.E. 275 (1922).

fraud elements of scienter and justifiable reliance from duty of care and contributory negligence. They also recognized the necessity of limiting liability short of the standard rule of foreseeable plaintiffs in negligent misrepresentation cases,²⁵ to only those the speaker has purpose to reach and influence and those he has reason to expect will be influenced.²⁶

The potential dangers inherent in overlapping fraud and negligent misrepresentation were discussed in the celebrated case of *Ultramares Corporation v. Touche*.²⁷ Defendant accountants prepared a favorable but inaccurate balance sheet for a bankrupt businessman to obtain credit. The New York of Appeals rejected plaintiff creditors' negligence action in the absence of privity between the creditors and the accountants, reasoning that recovery for such negligence would require the creation of an affirmative duty to make accurate representations to unknown and possibly unforeseen parties, which obligation would approximate the negative duty to refrain from fraud.²⁸ Thus, the New York court recognized the necessity of a special relationship existing between the parties in order to mandate an affirmative duty to have reasonable grounds to believe the representations made to be true.

Since *Ultramares*, many jurisdictions, by statute²⁹ or case law,³⁰ have allowed damage remedies for negligent misrepresentations when a special relationship exists.³¹ By contrast, Indiana courts do not recognize a cause of action based upon negligent misrepresentation,³² but deem certain statements, made without reasonable grounds to believe them to be true, to be constructively fraudulent.³³

²⁵Note, *Negligent Misrepresentation*, 13 CLEV.-MAR. L. REV. 250, 255 (1964).

²⁶Prosser, *Misrepresentation and Third Persons*, 19 VAND. L. REV. 231, 255 (1966).

²⁷255 N.Y. 170, 174 N.E. 441 (1931).

²⁸A recovery for fraud was permitted, however, because the statement represented fact as true to the knowledge of the accountants, which the court held to be a reckless misstatement: "The defendants certified as a fact, true to their own knowledge, that the balance sheet was in accordance with the books of account. If their statement was false, they are not to be exonerated because they believed it to be true." *Id.* at 189, 174 N.E. at 448.

²⁹See, e.g., CAL. CIV. CODE § 1710, subd. (2) (West 1973); *Goodman v. Kennedy*, 18 Cal. 3d 335, 556 P.2d 737, 134 Cal. Rptr. 375 (1977).

In California, negligent misrepresentation is given statutory recognition as a form of deceit; hence, broad statements to the effect that scienter is an element of every cause of action for deceit and that an intent to deceive is essential, are untrue, since neither is a requisite for negligent misrepresentation. *Hale v. George A. Hormel & Co.*, 48 Cal. App. 3d 73, 121 Cal. Rptr. 144 (1975).

³⁰E.g., *Williams v. Polgar*, 391 Mich. 6, 215 N.W.2d 149 (1974). It is apparent that many of the courts that have considered analogous situations have thought the potential liability of one who negligently supplies inaccurate information to be such as to militate against imposing liability when the person ultimately damaged was one whose reliance on the information might have been called "foreseeable," but have been willing to impose liability when the reliance of the third party might have been said to be "known." See generally, *National Sav. Bank v. Ward*, 100 U.S. 195 (1880).

³¹See text accompanying notes 64-71 *infra*.

³²*Smart & Perry Ford Sales v. Weaver*, 149 Ind. App. 693, 698, 274 N.E.2d 718, 721 (1971).

³³*Id.* A key difference between fraud and negligent misrepresentation is the latter's lack of

Apparently due to judicial failure to distinguish two distinct legal concepts within tort law, intentional wrongs (actual fraud) and negligent wrongs (negligent misrepresentations),³⁴ the case law in Indiana has focused on misrepresentation as determinative of the nature of the action, although the parties' relationship governs their rights and duties providing the ideal basis for determining the nature of the cause of action. Although there are limits beyond which each type of liability should not be carried,³⁵ the Indiana courts have treated all liability for loss in cases arising from reliance upon misrepresentations as fraud, either actual or constructive. Analysis of the two distinct concepts involved in the laws of misrepresentation will illustrate the confusion surrounding the actions and the inherent unfairness of the Indiana approach. By contrast, the suggested focus on relationship highlights the pertinent obligations and justifiable expectations of the parties, making it obvious that negligent misrepresentations belong under negligence law, and not under the law of fraud.

ACTUAL FRAUD

Under the framework of *Derry v. Peek*, an intentional misrepresentation made to induce another to part with property or to surrender some legal right and having that effect, constitutes the intentional tort³⁶ of actual fraud.³⁷ Indiana recognizes the standard elements of actionable fraud: representation of a material fact, justifiable reliance thereon, falsity of the representation, scienter, deception and injury.³⁸ However, the lack of susceptibility to definition and the substantial internal overlap of these elements have contributed to the confusion demonstrated by the Indiana courts in dealing with fraud.³⁹

The scienter requirement mandates actual knowledge of the falsity of the representation or substantial ignorance of its truth⁴⁰ in order for a fraud to have been committed. It is this element that gives fraud its intentional

scienter and intent to deceive. See text accompanying notes 38-40 *infra*. The Indiana courts have held that scienter is an essential element to relief for a misrepresentation-based cause of action.

³⁴Carpenter, *Responsibility for Intentional, Negligent, and Innocent Misrepresentation*, 24 ILL. L. REV. 749, 752 (1930).

³⁵Bohlen, *Misrepresentation as Deceit, Negligence or Warranty*, 42 HARV. L. REV. 773 (1927).

³⁶PROSSER, *supra* note 3, at 700.

³⁷*E.g.*, Coffey v. Winger, 156 Ind. App. 233, 296 N.E.2d 154 (1973) (fraud may be actual or constructive); Hutchens v. Hutchens, 120 Ind. App. 192, 91 N.E.2d 182 (1950).

³⁸*E.g.*, General Elec. Co. v. Dorr, 140 Ind. App. 442, 218 N.E.2d 158 (1966).

³⁹*See, e.g.*, Automobile Underwriters, Inc. v. Smith, 131 Ind. App. 454, 166 N.E.2d 341 (1960), evidencing the Indiana courts' confusion.

⁴⁰*Id.* at 467, 166 N.E.2d at 348. For example, if defendant induces plaintiff to invest in a gas-drilling scheme by untruthfully representing to him that defendant had already invested his own funds in the project, and in reliance plaintiff invests and loses a substantial amount of money, it is clear that all the elements of actual fraud are satisfied. Gonderman v. State Exch. Bank, Roann, ___ Ind. App. ___, 334 N.E.2d. 724 (1975).

nature; without its actual or legitimately imputed presence, there can be no fraud.

Also within the fraud requirements of *Derry v. Peek* is the situation where defendant induces plaintiff to act to his detriment by representing material facts as true when defendant is cognizant that he does not know whether the facts are actually true or false.⁴¹ He obviously does not "honestly know" the statements to be true and therefore his representation is deemed to be made recklessly.⁴² The Indiana courts have held that such unconcern for the truth provides basis for an "imputation of scienter."⁴³ This result is consistent with the general tort doctrine, and with *Derry v. Peek*, that reckless, wilful or wanton conduct implies moral turpitude and is "so far from a proper state of mind that it is treated in many respects as if it were so intended."⁴⁴

While caveat emptor no longer controls, it must be recognized that the interests of parties to business transactions are naturally adverse, since each party is vying for the most advantageous position at the other's expense. The relationship between the two parties permits a plaintiff, exercising the minimum caution the law requires, to expect honesty and non-reckless behavior from the defendant, but no more.⁴⁵ Plaintiff may not rely upon the competence⁴⁶ of defendant and a fortiori may not rely upon the information imparted as being warranted or accurate.⁴⁷ Therefore, the intentional tort of fraud should be strictly limited to situations where all the fraud elements are satisfied. Inference of scienter in cases outside the *Derry* framework leads to eccentric and doctrinally unsupported operation of the law of fraud.⁴⁸

⁴¹Capitol Dodge Inc. v. Haley, 154 Ind. App. 1, 288 N.E.2d 766 (1972).

⁴²See text accompanying note 22 *supra*.

⁴³Capitol Dodge Inc. v. Haley, 154 Ind. App. 1, 6, 288 N.E.2d 766, 769 (1972).

⁴⁴PROSSER, *supra* note 3, at 184.

⁴⁵See generally Green, *Deceit*, 16 VA. L. REV. 749 (1930).

⁴⁶In this context, "competence" means having sufficient judgement, knowledge and skill to make an accurate representation.

⁴⁷See Green, *Deceit*, 16 VA. L. REV. 749 (1930).

⁴⁸The Indiana courts have extended the inference of scienter to situations outside of the *Derry* framework where defendant has put emphasis upon certainty of knowledge by making unqualified statements of fact, *Grissom v. Moran* 154 Ind. App. 419, 290 N.E.2d 119 (1972). The reasoning behind such decisions is that business ethics justify the recipient's reliance not only upon the honesty and lack of recklessness of the person making the statement, but also upon the truth of the facts stated, notwithstanding the speaker's objective belief in their truth, *HARPER & JAMES, supra* note 4, at 551. By implying certainty, the speaker has elevated his relationship with the recipient to one requiring his conformance with an affirmative duty to be accurate. Therefore, the speaker must guarantee the truth of such facts under a warranty theory. Cf., *Williston, Liability for Honest Misrepresentation*, 24 HARV. L. REV. 415 (1911) (*Williston* posits a remedy in warranty theory, under contract law, for negligent speech). If liability is to be imposed, it should be recognized as liability without fault under a warranty theory—it is both a fallacy and unnecessary to attempt to supply a fictitious scienter; scienter is neither present nor required.

While warranty is usually treated as contractual in nature, liability for a breach thereof was first recognized in the action of deceit before the beginnings of modern contract law in the action of assumpsit, *See Carpenter, Responsibility for Misrepresentation*, 24 ILL. L. REV. 749, 761 (1930).

NEGLIGENT MISREPRESENTATION

Outside the fraud framework of *Derry* are situations in which the parties' relationship alone raises an affirmative duty on the part of one or both parties to employ reasonable care to avoid misleading the other.⁴⁹ Their relationship dictates that a party may reasonably assume that the communicating party "is reasonably qualified to make such statements and that he has employed reasonable diligence to ascertain their accuracy"⁵⁰ and therefore will not make negligent misrepresentations, statements for which he has no reasonable basis in fact. The law should require the communicating party to fulfill the relying party's expectations or be liable for adverse consequences.

The foregoing defines the communicating party's affirmative duty to be accurate in his representations, and negligent deviations from this duty should be dealt with under the law of negligence. It is here, however, where the Indiana courts, have ruled that "if the defendant professed to be an expert and . . . induced the plaintiff to rely upon his superior judgment or skill," a relationship raising an affirmative duty to be accurate, then a case of *constructive fraud* results from subsequent misrepresentations made within the scope of the relationship.⁵¹

Constructive fraud has been described by the Indiana courts as fraud which arises by operation of law from "acts or (a) course of conduct which, if sanctioned by law, would either in the particular case or in common experience, secure an unconscionable advantage" to the actor,⁵² and thereby acts as a device to prevent unjust enrichment.⁵³ The doctrine as applied by the Indiana courts is quite broad and amorphous as evidenced by its definition as a "breach of a legal or equitable duty which the law declares fraudulent because of its tendency to deceive others, to violate public or

The Indiana courts, in the interest of doctrinal consistency should therefore refrain from vainly searching for a means to escalate this action to the realm of fraud by the inference of scienter. Instead the action must be categorized under the law of strict liability.

In practical application the defense of contributory negligence will be foreclosed to the defendant in such a strict liability situation anyway, thus misclassification of the action as fraud does not work a substantial hardship upon defendants but the justifiability of the recipient's reliance must be "determined largely by what the preponderant mass of men in fact do in . . . situations," HARPER & JAMES, *supra* note 4, at 553, where they have been induced to rely upon statements as true by unqualified statements of fact. Recipients of information have a right to rely if the "exercise of reasonable prudence does not dictate otherwise." *Soft Water Utils. Inc. v. LeFevre*, ___ Ind. App. ___, 308 N.E.2d 395, 398 (1974).

⁴⁹*E.g.*, the relationship of: principal-agent, physician-patient, attorney-client or any relationship wherein one of the parties induces the other to rely upon the former's "superior judgment or skill." *Smart & Perry Ford Sales, Inc. v. Weaver*, 149 Ind. App. 693, 698, 274 N.E.2d 718, 722 (1971).

⁵⁰HARPER & JAMES, *supra* note 4, at 545.

⁵¹*Smart & Perry Ford Sales Inc. v. Weaver*, 149 Ind. App. 693, 698, 274 N.E.2d 718, 722 (1971).

⁵²*Brown v. Brown*, 235 Ind. 563, 568, 135 N.E.2d 614, 616 (1956).

⁵³J. Eaton, HANDBOOK OF EQUITY JURISPRUDENCE 292 (Throckmorton's 2d ed. 1923).

private confidence, or to injure public interests."⁵⁴ It may exist without the presence of either moral guilt⁵⁵ or intent to defraud⁵⁶ on the part of the fraud-feasor.

Application of this broad test for constructive fraud permits negligent misrepresentations to be encompassed within a category of fraud under the eccentric operation of the doctrine, by the imputation of a fraudulent purpose,⁵⁷ even though the statements may have been only negligently inaccurate. By the same token, however, injuries from negligent misrepresentations may go unremedied under this approach. If the representing party derives no unjust enrichment from the other party's reliance, there is no constructive fraud and therefore no relief.⁵⁸ Thus the Indiana approach is, in a sense, both over-inclusive and under-inclusive in its treatment of negligent misrepresentation.

As a consequence of treating negligent misrepresentation as constructive fraud, the defendant loses his affirmative defense of contributory negligence in relying upon the accuracy of the misrepresentations.⁵⁹ Foreclosing the contributory negligence defense by imputing fraudulent purpose in such cases has been justified by the Indiana courts with the policy statement that "the design of the law is to protect the weak and credulous from the wiles and stratagems of the artful and cunning, as well as those whose vigilance and security enable them to protect themselves."⁶⁰ However, as applied, this policy fails to provide appropriate results because of the under-inclusive operation of the doctrine and the unfairness inherent in foreclosing the contributory negligence defense. In attempting to resolve the dilemma of deterring dishonesty without encouraging negligence and inattention to one's own interests, the Indiana courts have found fraud deterrence the less objectionable end⁶¹ and have established that one who is misled by a negligent misrepresentation is not barred by his failure to utilize his own equal opportunity to discover its inaccuracy.⁶²

Further, by classifying negligent misrepresentations under the doctrine of constructive fraud, the Indiana courts have disregarded the specific caution

⁵⁴McKinley v. Overbay, 132 Ind. App. 272, 281, 177 N.E.2d 389, 393 (1961).

⁵⁵*Id.*

⁵⁶See Coffey v. Winger, 156 Ind. App. 233, 239, 296 N.E.2d 154, 159 (1973).

⁵⁷*Id.* at 240, 296 N.E.2d at 159.

⁵⁸Voelkel v. Tohulka 236 Ind. 588, 599, 141 N.E.2d 344, 349 (1957), *cert. denied* 355 U.S. 891 (1957).

⁵⁹See, e.g., Grenier v. Harley, 250 F.2d 539, 544 (9th Cir. 1957).

⁶⁰Ingalls v. Miller, 121 Ind. 188, 191, 22 N.E. 995, 995 (1889).

⁶¹In Grissom v. Moran, where the intent to defraud had been inferred from the representation's lack of qualification, the court said that: "While the person relying is bound to use ordinary care and diligence to guard against the fraud . . . the requirement of reasonable prudence in business transactions is not carried to the extent that the law will ignore an intentional fraud practiced upon the unwary." 154 Ind. App. 419, 429, 290 N.E.2d 119, 124 (1972).

⁶²Voelkel v. Tohulka 236 Ind. 588, 599, 141 N.E.2d 344, 349 (1957), *cert. denied* 355 U.S. 891 (1957).

enunciated in *Ultramares Corp. v. Touche* against making liability for negligent misrepresentations coterminous with liability for fraud.⁶³ While there is the general negative duty of care the law imposes upon everyone to refrain from unduly exposing others to harm, this duty is not breached by an honest but negligent misstatement of fact.

The proper inquiry in a case of misrepresentation should be one directed to the nature of the services provided by the person making the representations and the relationship he has with the relying party. If the person provides services requiring special competence or if he occupies the capacity of one supplying special information, he should be held to that standard of competence commensurate with his position.⁶⁴ It is this special competence that has attracted those who deal with such a person, and the law should impress upon him the affirmative duty, arising out of the relationship between himself and the party receiving the information, to exercise care and diligence in the representations he makes.⁶⁵ If he willfully or recklessly breaches this duty, he has committed fraud. But if he has merely made statements without reasonable grounds for believing them to be true, he has not committed fraud, actual or constructive. Any cause of action against him should be dictated by the law of negligence.⁶⁶

The standard to be met under the proposed negligent misrepresentation formula is that of the degree of care a reasonably prudent man in the plaintiff's position has a right to expect from the defendant according to customary business practices predicated upon their relationship.⁶⁷ While the plaintiff has a right to expect that the defendant will be honest in his representation,⁶⁸ the defendant's duty to be accurate depends on the nature of his business and his relationship, contractual or otherwise,⁶⁹ with the plaintiff. Thus, the reasonable expectation of care may arise from the personal relationship of the parties⁷⁰ or from the peculiar nature of the transactions.⁷¹

Further, while it may be sound to reject as a defense to an actual fraud action that the defrauded party ought not to have trusted the defendant or was negligent in so doing, the policy goes too far when it constrains the

⁶³255 N.Y. 170, 185, 174 N.E. 441, 447 (1931).

⁶⁴See *id.* at 183-84, 174 N.E. at 446:

There is a class of cases where a person within whose special province it lay to know a particular fact, has given an erroneous answer to an inquiry made with regard to it by a person desirous of ascertaining the fact for the purpose of determining his course accordingly, and has been held bound to make good the assurance he has given.

⁶⁵For example, the duty would surely arise if the information was provided in the course of the defendant's business "for the guidance of others in their business transactions." See RESTATEMENT (SECOND) OF TORTS §552 (Tent. Draft No. 11, 1965).

⁶⁶*Id.*

⁶⁷HARPER & JAMES, *supra* note 4, at 548.

⁶⁸The law imposes a general duty of honesty. HARPER & JAMES, *supra* note 4, at 542.

⁶⁹See text accompanying notes 64-66 *supra*.

⁷⁰E.g., fiduciary, extraordinary inducement to rely.

⁷¹E.g., expert knowledge in the exclusive possession of the defendant.

defense to an action based upon a negligent misrepresentation. When a person embarks upon a business transaction, he, in reality as well as in the law,⁷² is expected to exercise reasonable prudence and not to rely upon those with whom he deals to protect and care for his interests. The fraud deterrence policy should not be permitted to thwart the availability to such defendants of the contributory negligence defense. Indeed, no such result is mandated.

The American Law Institute, in its Restatements of Torts⁷³ has provided for a remedy for such a negligent misrepresentation, fundamentally rooted in the law of negligence rather than that of fraud. Moreover, the Restatement (Second) also provides for a defense of contributory negligence to a charge of negligent misrepresentation.⁷⁴ The Indiana courts should adopt this portion of the Restatement to permit reasoned decision-making and fairness in the law of misrepresentation. Those who are entitled to rely upon the accuracy of representations, written or oral, must have remedies for material inaccuracies in those certificates, reports or other media of information. However, the sacrifice of the theoretical underpinnings of the law of misrepresentation and the affirmative defenses that should be available to one honestly mistaking fact exacts too high a price for such protection.

⁷²See, e.g., *Dupuy v. Dupuy*, 551 F.2d 1005 (5th Cir. 1977).

⁷³(1) One who, in the course of his business, profession or employment, or a transaction in which he has a pecuniary interest, supplies false information for the guidance of others in their business transactions, is subject to liability for pecuniary loss caused to them by their justifiable reliance upon such information, if he fails to exercise reasonable care or competence in obtaining or communicating the information.

(2) Except as stated in subsection (3), the liability stated in subsection (1) is limited to loss suffered

(a) by the person or one of the persons for whose benefit and guidance he knows the information to be intended; and

(b) which it is intended to influence his conduct.

(3) The liability of one who is under a public duty to give the information extends to loss suffered by any of the class of persons for whose benefit the duty is created, in any of the transactions in which it is intended to protect them.

RESTATEMENT (SECOND) OF TORTS § 552 (Tent. Draft No. 10, 1964), somewhat modifying the approach taken in the earlier Restatement:

One who in the course of his business or profession supplies information for the guidance of others in their business transactions is subject to liability for harm caused to them by their reliance upon the information if

(a) he fails to exercise that care and competence in obtaining and communicating the information which its recipient is justified in expecting, and

(b) the harm is suffered

(i) by the person or one of the class of persons for whose guidance the information was supplied, and

(ii) because of his justifiable reliance upon it in a transaction in which it was intended to influence his conduct or in a transaction substantially identical therewith.

RESTATEMENT OF TORTS, §552 (1938).

⁷⁴"The recipient of a negligent misrepresentation is barred from recovery for pecuniary loss suffered in reliance upon it if he is negligent in so relying." RESTATEMENT (SECOND) OF TORTS, § 552A (Tent. Draft No. 11, 1965).

Further, the provision of a negligent misrepresentation remedy in Indiana would be consistent with precedent. In *Brown v. Sims*,⁷⁵ the Indiana Appellate Court found liability of an abstractor to a third person when the abstractor had prepared, at the request of the owner of the land, an inaccurate abstract and furnished it to a third person. Though the facts would have supported a finding of reckless misstatement of material fact, the court held that the abstractor owed the ultimate recipient of the abstract, on the basis of their implied relationship, the affirmative duty to prepare the abstract with reasonable care and skill and held the abstractor liable for a breach thereof.⁷⁶

In 1965, *Brown v. Sims* was narrowly construed, apparently restricting its application to situations where there is privity of contract between the parties (a far narrower relationship test than in the proposed standard) and where express provisos or assurances are made as to the accuracy of the statement in question.⁷⁷ However, *Brown* has recently been held as precedent for the still valid assertion that an "abstractor is liable to his employer for damages proximately caused by his failure to fulfill his duty to use ordinary care and diligence in preparing the abstract."⁷⁸ Therein lie the doctrinal foundations for the proposed relationship-based misrepresentation analysis. The employer-abstractor relationship is quite similar to the relationship between the client and one who provides services requiring special competence or yielding special information.

Moreover, there is no reason to believe that the express provision of a remedy for negligent misrepresentation will require the destruction of the entire doctrine of constructive fraud in Indiana. First, the constructive fraud formula applied in Indiana to instances of negligent misrepresentation is one of three facets of the doctrine.⁷⁹ Foreclosing its application to negligent

⁷⁵22 Ind. App. 317, 53 N.E. 779 (1899).

⁷⁶[The abstractor] delivered the abstract to the appellant for his use, and certified it to be a correct and true abstract of title; and he represented to the appellant, before he made the loan, that the title was free and unincumbered, and that there were no liens of the real estate; and the appellant informed the abstractor that he would rely entirely on the abstract and representation; and the abstractor informed the appellant, before he made the loan, that he could so rely; and the appellant did so rely in making the loan, having no other knowledge or information. We think it cannot properly be said that the appellee did not owe a duty to the appellant arising under the contract, the attending circumstances indicating that it was the understanding of all the parties that the service was to be rendered for the use and benefit of the appellant, the particular person who was to loan his money in reliance upon what the abstractor should do and represent in the premises. If such a duty did arise, the appellee was bound to the person to whom he owed the duty to perform it with reasonable care and skill.

Id. at 325-26, 53 N.E. at 781.

⁷⁷*Peyronnin Constr. Co. v. Weiss*, 137 Ind. App. 417, 427-28, 208 N.E.2d 489, 494-95 (1965).

⁷⁸*Mayhew v. Deister*, 144 Ind. App. 111, 118, 244 N.E.2d 448, 452 (1969).

⁷⁹

(1) Frauds arising from facts and circumstances of imposition.

misrepresentation would not effect the continued viability of the remaining facets. Second, by analogy, in California, where an action for negligent misrepresentation was provided for by statute,⁸⁰ the laws of negligence and fraud have coexisted successfully with constructive fraud continuing to remedy instances of unjust enrichment deemed to have detrimental effect upon public interests.⁸¹

CONCLUSION

The law of misrepresentation is a forked road, its two branches corresponding with two of the general areas of tort law: intentional wrongs and negligent wrongs. However, the Indiana courts have treated all cases of misrepresentation as forms of fraud. This approach not only confuses the substantive laws applicable to misrepresentation and is inconsistent with the underlying doctrines shaping the two distinct types of liability, but deprives those charged with uttering negligent misrepresentations of their contributory negligence defense.

The proper course of action for the Indiana courts is to recognize the fundamental differences between the two types of misrepresentation and to approach cases involving misrepresentation with an eye to the relationship between the parties, and the source of their respective rights and duties. This approach would provide a remedy for misrepresentations negligently made and would bar a plaintiff who had been contributorily negligent in failing to discover the inaccuracies of the litigated representations.

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- (2) Frauds apparent from the intrinsic nature and subject of the bargain itself.
 - (3) Frauds presumed from the circumstances and condition of the contracting parties.
 - (4) Fraud upon third persons not parties to the fraudulent contract.

The first of these classes constitutes actual fraud; the other three, constructive fraud. J. Eaton, *HANDBOOK OF EQUITY JURISPRUDENCE* 260 (Throckmorton's 2d ed. 1923), citing Lord Hardwicke in *Earl of Chesterfield v. Janssen*, 28 Eng. Reprint 82, 100 (1750).

⁸⁰CAL. CIVIL CODE § 1710, Subd. (2) (West 1973).

⁸¹*See, e.g., Hale v. George A. Hormel & Co.*, 48 Cal. App.3d 73, 121 Cal. Rptr. 144 (1975), *Gold v. Los Angeles Democratic League*, 49 Cal. App.3d 365, 122 Cal. Rptr. 732 (1975).