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b. Economic and Dignitary Torts

Tort law is not limited to cases of *physical* injury. Some legally recognized injuries involve pure economic harm—that is, harm that costs the plaintiff money without causing him physical injury. Other injuries recognized by law involve “dignitary” harm—that is, harm that neither costs money nor causes physical injury, but may cause emotional harm or demean the plaintiff as a human being.

Libel is an example of a dignitary tort that is not associated with physical harm and may not even cause economic loss. The defendant publishes a statement that the plaintiff is a burglar. That demeans the plaintiff even if it does not cause either physical or economic harm. Fraudulent misrepresentation is an example of a purely economic tort not associated with physical harm. The defendant fraudulently repre-

sents that his house has no termites. A buyer, misled, is induced to purchase. The lie caused no physical harm, but it is actionable as an economic tort.

These economic and dignitary torts are often quite different from physical injury torts. For instance, most of the economic torts involve some form of communication between people and therefore they involve, at least potentially, the First Amendment's protection for free speech. Because of such differences—of which the free speech concern is only one—it is useful to separate many of the economic and dignitary torts for consideration late in the course, devoting the first and largest part of the course to torts that involve physical injury to person or property, or at least to acts that create risks of such injuries.

§ 353. Loss Due to Emotional Disturbance

Recovery for emotional disturbance will be excluded unless the breach also caused bodily harm or the contract or the breach is of such a kind that serious emotional disturbance was a particularly likely result.

Comment:

a. *Emotional disturbance.* Damages for emotional disturbance are not ordinarily allowed. Even if they are foreseeable, they are often particularly difficult to establish and to measure. There are, however, two exceptional situations where such damages are recoverable. In the first, the disturbance accompanies a bodily injury. In such cases the action may nearly always be regarded as one in tort, although most jurisdictions do not require the plaintiff to specify the nature of the wrong on which his action is based and award damages without classifying the wrong. See Restatement, Second, Torts §§ 436, 905. In the second exceptional situation, the contract or the breach is of such a kind that serious emotional disturbance was a particularly likely result. Common examples are contracts of carriers and innkeepers with passengers and guests, contracts for the carriage or proper disposition of dead bodies, and contracts for the delivery of messages concerning death. Breach of such a contract is particularly likely to cause serious emotional disturbance. Breach of other types of contracts, resulting for example in sudden impoverishment or bankruptcy, may by chance cause even more severe emotional disturbance, but, if the contract is not one where this was a particularly likely risk, there is no recovery for such disturbance.

Illustrations:

1. A contracts to construct a house for B. A knows when the contract is made that B is in delicate health and that proper completion of the work is of great importance to him. Because of delays and departures from specifications, B suffers nervousness and emotional distress. In an action by B against A for breach of contract, the element of emotional disturbance will not be included as loss for which damages may be awarded.

2. A, a hotel keeper, wrongfully ejects B, a guest, in breach of contract. In doing so, A uses foul language and accuses B of immorality, but commits no assault. In an action by B against A for breach of contract, the element of B's emotional disturbance will be included as loss for which damages may be awarded.

3. A makes a contract with B to conduct the funeral for B's husband and to provide a suitable casket and vault for his burial. Shortly thereafter, B discovers that, because A knowingly failed to provide a vault with a suitable lock, water has entered it and reinterment is necessary. B suffers shock, anguish and illness as a result. In an action by B against A for breach of contract, the element of emotional disturbance will be included as loss for which damages may be awarded.

4. The facts being as stated in Illustration 19 to § 351, the element of emotional disturbance resulting from the additional operation will be included as loss for which damages may be awarded.

REPORTER'S NOTE

This Section is based on former § 341. See 5 Corbin, Contracts §§ 1076 (1964); 11 Williston, Contracts §§ 1338, 1341 (3d ed. 1968); Comments, 55 Canadian B. Rev. 169, 333 (1977).

Comment a. Illustration 1 is based on Jankowski v. Mazzotta, 7 Mich. App. 483, 152 N.W.2d 49 (1967); cf. Carpel v. Saget Studios, 326 F. Supp. 1331 (E.D. Pa. 1971). Illustration 2 is based on Illustration 1 to former § 341. Illustration 3 is based on Lamm v. Shingleton, 231 N.C. 10, 55 S.E.2d 810 (1949); Hirst v. Elgin Metal Casket Co., 438 F. Supp. 906 (D. Mont. 1977); cf. Stewart v. Rudner, 349 Mich. 459, 84 N.W.2d 816 (1957); Illustrations 3 and 4 to former § 341. Illustration 4 is based on Sullivan v. O'Connor, 363 Mass. 579, 296 N.E.2d 183 (1973); see also Heywood v. Wellers, [1976], 1 All E.R. 300 (C.A.), 55 Canadian B. Rev. 169 (1977).

§ 355. Punitive Damages

Punitive damages are not recoverable for a breach of contract unless the conduct constituting the breach is also a tort for which punitive damages are recoverable.

Comment:

a. Compensation not punishment. The purposes of awarding contract damages is to compensate the injured party. See Introductory Note to this Chapter. For this reason, courts in contract cases do not award damages to punish the party in breach or to serve as an example to others unless the conduct constituting the breach is also a tort for which punitive damages are recoverable. Courts are sometimes urged to award punitive damages when, after a particularly aggravated breach, the injured party has difficulty in proving all of the loss that he has suffered. In such cases the willfulness of the breach may be taken into account in applying the requirement that damages be proved with reasonable certainty (Comment *a* to § 352); but the pur-

pose of awarding damages is still compensation and not punishment, and punitive damages are not appropriate. In exceptional instances, departures have been made from this general policy. A number of states have enacted statutes that vary the rule stated in this Section, notably in situations involving consumer transactions or arising under insurance policies.

Illustrations:

1. A is employed as a school teacher by B. In breach of contract and without notice B discharges A by excluding him from the school building and by stating in the presence of the pupils that he is discharged. Regardless of B's motive in discharging A, A cannot recover punitive damages from B. A can recover compensatory damages under the rule stated in § 347, including any damages for emotional disturbance that are allowable under the rule stated in § 353.

2. A and B, who are neighbors, make a contract under which A promises to supply water to B from A's well for ten years in return for B's promise to make monthly payments and share the cost of repairs. After several years, the relationship between A and B deteriorates and A, in breach of contract and to spite B, shuts off the water periodically. B cannot recover punitive damages from A. B can recover compensation damages under the rule stated in § 347 if he can prove them with reasonable certainty (§ 352), and the court may take into account the willfulness of A's breach in applying that requirement. See Comment a to § 352.

b. *Exception for tort.* In some instances the breach of contract is also a tort, as may be the case for a breach of duty by a public utility. Under modern rules of procedure, the complaint may not show whether the plaintiff intends his case to be regarded as one in contract or one in tort. The rule stated in this Section does not preclude an award of punitive damages in such a case if such an award would be proper under the law of torts. See Restatement, Second, Torts § 908. The term "tort" in the rule stated in this Section is elastic, and the effect of the general expansion of tort liability to protect additional interests is to make punitive damages somewhat more widely available for breach of contract as well. Some courts have gone rather far in this direction.

Illustrations:

3. A, a telephone company, contracts with B to render uninterrupted service. A, tortiously as well as in breach of contract,

fails to maintain service at night and B is unable to telephone a doctor for his sick child. B's right to recover punitive damages is governed by Restatement, Second, Torts § 908.

4. A borrows money from B, pledging jewelry as security for the loan. B, tortiously as well as in breach of contract, sells the jewelry to a good faith purchaser for value. A's right to recover punitive damages is governed by Restatement, Second, Torts § 908.

REPORTER'S NOTE

This Section is based on former § 342. See 5 Corbin, Contracts § 1077 (1964 & Supp. 1980); 11 Williston, Contracts § 1340 (3d ed. 1968); Rice, Exemplary Damages in Private Consumer Actions, 55 Iowa L. Rev. 307 (1969); Simpson, Punitive Damages for Breach of Contract, 20 Ohio St. L.J. 284 (1959); Sullivan, Punitive Damages in the Law of Contract: The Reality and the Illusion of Legal Change, 61 Minn. L. Rev. 207 (1977); Notes, 45 Fordham L. Rev. 164 (1976); 8 Ind. L. Rev. 668 (1975); 46 U. Cin. L. Rev. 170 (1977). As to the impact of Uniform Commercial Code § 1-106(1) on the availability of punitive damages, compare *Waters v. Trenckmann*, 503 P.2d 1187 (Wyo. 1972), with *Z.D. Howard Co. v. Cartwright*, 537 P.2d 345 (Okla. 1975).

Comment a. See generally, *First Nat'l State Bank v. Commonwealth Fed'l Sav. & Loan Ass'n*, 455 F. Supp. 464 (D.N.J. 1978). For an example of a state statute varying the rule stated in this Section in consumer transactions, see Wis. Stat. Ann. §§ 425.107, 425.303. For examples varying the rule in situations arising under insurance policies, see Ark. Stat. Ann. § 66-3228; Ga. Code Ann. § 56-1206; Idaho Code § 41-1839; Ill. Ann. Stat. ch. 73 § 767;

Mo. Ann. Stat. § 375.420; Neb. Rev. Stat. § 44-359; Tex. Ins. Code Ann. art. 3.62. See also the unusual opinion of the United States Supreme Court in *Sniepp v. United States*, 444 U.S. 507 (1980). Illustration 1 is based on Illustration 1 to former § 342; cf. *Hess v. Jarboe*, 201 Kan. 705, 443 P.2d 294 (1968); *Addis v. Gramophone*, [1909] A.C. 488 (H.L.); Illustration 2 is based on *White v. Benkowski*, 37 Wis.2d 285, 155 N.W.2d 74 (1967); see also *J.J. White, Inc. v. Metropolitan Merchandise Mart*, 48 Del. 526, 107 A.2d 892 (Super. Ct. 1954); *Den v. Den*, 222 A.2d 647 (D.C. 1966).

Comment b. Illustration 3 is based on Illustration 2 to former § 342; see *Birmingham Waterworks Co. v. Keiley*, 2 Ala. App. 629, 56 So. 838 (1911). Illustration 4 is based on *Welborn v. Dixon*, 70 S.C. 108, 49 S.E. 232 (1904); cf. *Wright v. Public Sav. Life Ins. Co.*, 262 S.C. 285, 204 S.E.2d 57 (1974); see also *Hibschman Pontiac, Inc. v. Batchelor*, 266 Ind. 310, 362 N.E.2d 845 (1977); *Vernon Fire & Cas. Ins. Co. v. Sharp*, 264 Ind. 599, 349 N.E.2d 173 (1976); *Gruenberg v. Aetna Ins. Co.*, 9 Cal.3d 566, 108 Cal. Rptr. 480, 510 P.2d 1032 (1973).

3. PURE ECONOMIC LOSS

The citadel of privity has now been vanquished. In most cases the fact that *A* was in a contractual relationship with *B* alone cannot defeat a claim that a duty was owed by *A* to *C* to prevent causing *C* foreseeable physical injury. A last bastion survives, however. If the harm is pure economic loss, the courts take more seriously the claim that liability should be restricted. Pure economic loss arises when a person suffers pecuniary loss not consequent upon injury to his person or property. The cases fall into two categories:

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(1) Negligent misrepresentation or misstatement causing economic loss; and

(2) Negligent acts causing economic loss.

The former category is treated in detail in Chapter 21. The paradigmatic cases relate to auditor or accountant liability. An auditor retained by a corporation completes a negligent audit which is then relied upon by a third person to his detriment. Does that third person have a cause of action against the negligent auditors? Does privity describe the limits of liability or does the auditor owe a duty to a class of persons outside privity of contract? Benjamin Cardozo, the champion of the assault on the privity citadel, held back from imposing a duty of care in negligence. *Ultramares Corporation v. Touche*, *infra* page 1094. The courts, nevertheless, have found duties of care to parties outside privity of contract, sometimes narrowly, sometimes broadly, in a way reminiscent of the hesitation that has surrounded the scope of the duty in negligence for emotional distress.

The latter category—negligent acts causing economic loss—held firmly against the proponents of wider tort liability.

State of Louisiana ex rel. Guste v. M/V Testbank

United States Court of Appeals, Fifth Circuit (en banc), 1985.

752 F.2d 1019, cert. denied, 477 U.S. 903, 106 S.Ct. 3271, 91 L.Ed.2d 562 (1986).

HIGGINBOTHAM, CIRCUIT JUDGE: We are asked to abandon physical damage to a proprietary interest as a prerequisite to recovery for economic loss in cases of unintentional maritime tort. We decline the invitation.

I. In the early evening of July 22, 1980, the M/V Sea Daniel, an inbound bulk carrier, and the M/V Testbank, an outbound container ship, collided at approximately mile forty-one of the Mississippi River Gulf outlet. At impact, a white haze enveloped the ships until carried away by prevailing winds, and containers aboard Testbank were damaged and lost overboard. The white haze proved to be hydrobromic acid and the contents of the containers which went overboard proved to be approximately twelve tons of pentachlorophenol, PCP, assertedly the largest such spill in United States history. The United States Coast Guard closed the outlet to navigation until August 10, 1980 and all fishing, shrimping, and related activity was temporarily suspended in the outlet and four hundred square miles of surrounding marsh and waterways. * * * [Numerous lawsuits, representing various interests,] were filed and consolidated before the same judge in the Eastern District of Louisiana. * * *

Defendants moved for summary judgment as to all claims for economic loss unaccompanied by physical damage to property. The district court granted the requested summary judgment as to all such claims except those asserted by commercial oystermen, shrimpers, crabbers and fishermen who had been making a commercial use of the embargoed waters. * * *

On appeal a panel of this court affirmed, concluding that claims for economic loss unaccompanied by physical damage to a proprietary interest

were not recoverable in maritime tort. 728 F.2d 748 (5th Cir.1984). The panel, as did the district court, pointed to the doctrine of *Robins Dry Dock & Repair Co. v. Flint*, 275 U.S. 303 (1927), and its development in this circuit. Judge Wisdom specially concurred, agreeing that the denial of these claims was required by precedent, but urging reexamination en banc. We then took the case en banc for that purpose. After extensive additional briefs and oral argument, we are unpersuaded that we ought to drop physical damage to a proprietary interest as a prerequisite to recovery for economic loss. To the contrary, our reexamination of the history and central purpose of this pragmatic restriction on the doctrine of foreseeability heightens our commitment to it. Ultimately we conclude that without this limitation foreseeability loses much of its ability to function as a rule of law. * * *

III. The meaning of *Robins Dry Dock v. Flint*, 275 U.S. 303 (1927) (Holmes, J.) is the flag all litigants here seek to capture. We turn first to that case and to its historical setting.

Robins broke no new ground but instead applied a principle, then settled both in the United States and England, which refused recovery for negligent interference with "contractual rights." Stated more broadly, the prevailing rule denied a plaintiff recovery for economic loss if that loss resulted from physical damage to property in which he had no proprietary interest. See, e.g., *Byrd v. English*, 117 Ga. 191, 43 S.E. 419 (1903); *Cattle v. Stockton Waterworks Co.*, 10 Q.B. 453, 457 (C.A.1875). See also James, *Limitations on Liability for Economic Loss Caused by Negligence: A Pragmatic Appraisal*, 25 Vand.L.Rev. 43, 44-46 (1972) (discussing history of the rule); *Carpenter, Interference with Contract Relations*, 41 Harv.L.Rev. 728 (1928). Professor James explains this limitation on recovery of pure economic loss: "The explanation * * * is a pragmatic one: the physical consequences of negligence usually have been limited, but the indirect economic repercussions of negligence may be far wider, indeed virtually open-ended." James, *supra*, at 45.

Decisions such as *Stockton* illustrate the application of this pragmatic limitation on the doctrine of foreseeability. The defendant negligently caused its pipes to leak, thereby increasing the plaintiff's cost in performing its contract to dig a tunnel. The British court, writing fifty-two years before *Robins*, denied the plaintiff's claim. The court explained that if recovery were not contained, then in cases such as *Rylands v. Fletcher*, L.R. 1 Ex. 265 (1866), the defendant would be liable not only to the owner of the mine and its workers "but also to * * * every workman and person employed in the mine, who in consequence of its stoppage made less wages than he would otherwise have done." *Id.* at 457. [C]

1. In *Robins*, the time charterer of a steamship sued for profits lost when the defendant dry dock negligently damaged the vessel's propeller. The propeller had to be replaced, thus extending by two weeks the time the vessel was laid up in dry dock, and it was for the loss of use of the vessel for that period that the charterer sued. The Supreme Court denied recovery to the charterer, noting: " * * * no authority need be cited to show that, as a

general rule, at least, a tort to the person or property of one man does not make the tort-feasor liable to another merely because the injured person was under a contract with that other unknown to the doer of the wrong. The law does not spread its protection so far * * * "275 U.S. at 309. * * *

2. The principle that there could be no recovery for economic loss absent physical injury to a proprietary interest was not only well established when *Robins Dry Dock* was decided, but was remarkably resilient as well. * * * Indeed this limit on liability stood against a sea of change in the tort law. Retention of this conspicuous bright-line rule in the face of the reforms brought by the increased influence of the school of legal realism is strong testament both to the rule's utility and to the absence of a more "conceptually pure" substitute. The push to delete the restrictions on recovery for economic loss lost its support and by the early 1940's had failed. See W. Prosser, *Law of Torts* § 129, at 938-940 (4th ed. 1971). In sum, it is an old sword that plaintiffs have here picked up.

3. Plaintiffs would confine *Robins* to losses suffered for inability to perform contracts between a plaintiff and others, categorizing the tort as a species of interference with contract. When seen in the historical context described above, however, it is apparent that *Robins Dry Dock* represents more than a limit on recovery for interference with contractual rights. Apart from what it represented and certainly apart from what it became, its literal holding was not so restricted. If a time charterer's relationship to its negligently injured vessel is too remote, other claimants without even the connection of a contract are even more remote. * * *

The language and the cases the *Robins* Court pointed to as "good statement[s]" of the principle make plain that the charterer failed to recover its delay claims from the dry dock because the Court believed them to be too remote. Notably, although the dry dock company did not know of the charter party when it damaged the propeller, delay losses by users of the vessel were certainly foreseeable. Thus, *Robins* was a pragmatic limitation imposed by the Court upon the tort doctrine of foreseeability.

In a sense, every claim of economic injury rests in some measure on an interference with contract or prospective advantage. It was only in this sense that profits were lost in *Byrd v. English* when the electrical power to plaintiffs printing plant was cut off. The printing company's contractual right to receive power was interfered with, and in turn, its ability to print for its customers was impinged. That the printing company had a contract with the power company did not make more remote the relationship between its loss of profits and the tortious acts. To the contrary, the contract reduced this remoteness by defining an orbit of predictable injury smaller than if there were no contract between the power company and the printer. When the loss is economic rather than physical, that the loss caused a breach of contract or denied an expectancy is of no moment. If a plaintiff connected to the damaged chattels by contract cannot recover, others more remotely situated are foreclosed *a fortiori*. Indisputably, the *Robins Dry Dock* principle is not as easily contained as plaintiff would have it. * * *

4. This circuit has consistently refused to allow recovery for economic loss absent physical damage to a proprietary interest. [The court discusses in detail its own decisions and those of other circuits. It gives particular attention to *Petitions of Kinsman Transit Co.*, 388 F.2d 821 (2d Cir.1968) (*Kinsman II*, described in this casebook, *supra* page 330); and *Union Oil Co. v. Oppen*, 501 F.2d 558 (9th Cir.1974)].

IV. Plaintiffs urge that the requirement of physical injury to a proprietary interest is arbitrary, unfair, and illogical, as it denies recovery for foreseeable injury caused by negligent acts. At its bottom the argument is that questions of remoteness ought to be left to the trier of fact. Ultimately the question becomes who ought to decide—judge or jury—and whether there will be a rule beyond the jacket of a given case. * * *

Those who would delete the requirement of physical damage have no rule or principle to substitute. Their approach fails to recognize limits upon the adjudicating ability of courts. We do not mean just the ability to supply a judgment; prerequisite to this adjudicatory function are preexisting rules, whether the creature of courts or legislatures. Courts can decide cases without preexisting normative guidance but the result becomes less judicial and more the product of a managerial, legislative or negotiated function.

Review of the foreseeable consequences of the collision of the [two ships in this case] demonstrates the wave upon wave of successive economic consequences and the managerial role plaintiffs would have us assume. The vessel delayed in St. Louis may be unable to fulfill its obligation to haul from Memphis, to the injury of the shipper, to the injury of the buyers, to the injury of their customers. Plaintiffs concede, as do all who attack the requirement of physical damage, that a line would need to be drawn—somewhere on the other side, each plaintiff would say in turn, of its recovery. Plaintiffs advocate not only that the lines be drawn elsewhere but also that they be drawn on an ad hoc and discrete basis. The result would be that no determinable measure of the limit of foreseeability would precede the decision on liability. We are told that when the claim is too remote, or too tenuous, recovery will be denied. Presumably then, as among all plaintiffs suffering foreseeable economic loss, recovery will turn on a judge or jury's decision. There will be no rationale for the differing results save the "judgment" of the trier of fact. Concededly, it can "decide" all the claims presented, and with comparative if not absolute ease. The point is not that such a process cannot be administered but rather that its judgments would be much less the products of a determinable rule of law. In this important sense, the resulting decisions would be judicial products only in their draw upon judicial resources.

The bright line rule of damage to a proprietary interest, as most, has the virtue of predictability with the vice of creating results in cases at its edge that are said to be "unjust" or "unfair." Plaintiffs point to seemingly perverse results, where claims the rule allows and those it disallows are juxtaposed—such as vessels striking a dock, causing minor but recoverable damage, then lurching athwart a channel causing great but unrecoverable economic loss. The answer is that when lines are drawn sufficiently sharp

in their definitional edges to be reasonable and predictable, such differing results are the inevitable result—indeed, decisions are the desired product. But there is more. The line drawing sought by plaintiffs is no less arbitrary because the line drawing appears only in the outcome—as one claimant is found too remote and another is allowed to recover. The true difference is that plaintiffs' approach would mask the results. The present rule would be more candid, and in addition, by making results more predictable, serves a normative function. It operates as a rule of law and allows a court to adjudicate rather than manage.¹²

V. That the rule is identifiable and will predict outcomes in advance of the ultimate decision about recovery enables it to play additional roles. Here we agree with plaintiffs that economic analysis, even at the rudimentary level of jurists, is helpful both in the identification of such roles and the essaying of how the roles play. Thus it is suggested that placing all the consequence of its error on the maritime industry will enhance its incentive for safety. While correct, as far as such analysis goes, such *in terrorem* benefits have an optimal level. Presumably, when the cost of an unsafe condition exceeds its utility there is an incentive to change. As the costs of an accident become increasing multiples of its utility, however, there is a point at which greater accident costs lose meaning, and the incentive curve flattens. When the accident costs are added in large but unknowable amounts the value of the exercise is diminished.

With a disaster inflicting large and reverberating injuries through the economy, as here, we believe the more important economic inquiry is that of relative cost of administration, and in maritime matters administration quickly involves insurance. Those economic losses not recoverable under the present rule for lack of physical damage to a proprietary interest are the subject of first party or loss insurance. The rule change would work a shift to the more costly liability system of third party insurance. For the same reasons that courts have imposed limits on the concept of foreseeability, liability insurance might not be readily obtainable for the types of losses asserted here. As Professor James has noted, "[s]erious practical problems face insurers in handling insurance against potentially wide, open-ended liability. From an insurer's point of view it is not practical to cover, without limit, a liability that may reach catastrophic proportions, or to fix a reasonable premium on a risk that does not lend itself to actuarial measurement." James, *supra*, at 53. By contrast, first party insurance is feasible for many of the economic losses claimed here. Each businessman who might be affected by a disruption of river traffic or by a halt in fishing activities can protect against that eventuality at a relatively low cost since his own potential losses are finite and readily discernible. Thus, to the

12. Fuller, *The Forms and Limits of Adjudication*, 92 Harv.L.Rev. 353, 396 (1978). This case illustrates how our technocratic tradition masks a deep difference in attitudes toward the roles of a judiciary. The difference between the majority and dissenting opinions is far more than a choice between competing maritime rules. The majority is driven by the principle of self ordering and modesty for the judicial role; the dissent accepts a role of management which can strain the limits of adjudication.

extent that economic analysis informs our decision here, we think that it favors retention of the present rule. * * *

VI. Plaintiffs seek to avoid the *Robins* rule by characterizing their claims as damages caused by a public nuisance. They suggest that when a defendant unreasonably interferes with public rights by obstructing navigation or negligently polluting a waterway he creates a public nuisance for which recovery is available to all who have sustained "particular damages."

* * *

* * * With economic losses such as the ones claimed here the problem is to determine who among an entire community that has been commercially affected by an accident has sustained a pecuniary loss so great as to justify distinguishing his losses from similar losses suffered by others. Given the difficulty of this task, we see no jurisprudential advantage in permitting the use of nuisance theory to skirt the *Robins* rule. * * *

VII. In conclusion, having reexamined the history and central purpose of the doctrine of *Robins Dry Dock* as developed in this circuit, we remain committed to its teaching. Denying recovery for pure economic losses is a pragmatic limitation on the doctrine of foreseeability, a limitation we find to be both workable and useful. Nor do we find persuasive plaintiffs' arguments that their economic losses are recoverable under a public nuisance theory, as damages for violation of federal statutes, or under state law.

Accordingly, the decision of the district court granting summary judgment to defendants on all claims for economic losses unaccompanied by physical damage to property is affirmed.

GEE, CIRCUIT JUDGE, with whom CLARK, CHIEF JUDGE, joins, concurring: * * *

It is my thesis that the dispute-resolution systems of courts are poorly equipped to manage disasters of such magnitude and that we should be wary of adopting rules of decision which, as would that contended for by the dissent, encourage the drawing of their broader aspects before us. * * *

Such a system as ours works tolerably well in the traditional case for which it was developed, where the stakes are limited to who owns the farm or to some other finite benefit. Its deficiencies become immediately and painfully apparent, however, when the consideration of factors inherently extraneous to the dispute becomes necessary or desirable to resolving it. Of these factors, perhaps the most often encountered is that of financial reality.

* * *

Extending theories of liability may not always be the more moral course, especially in such a case as this, where the extension, in the course of awarding damages to unnumbered claimants for injuries that are unavoidably speculative, may well visit destruction on enterprise after enterprise, with the consequent loss of employment and productive capacity which that entails.

[GARWOOD and WILLIAMS, JJ., concurred specially in separate opinions.]

WISDOM, CIRCUIT JUDGE, with whom ALVIN B. RUBIN, POLITZ, TATE, and JOHNSON, CIRCUIT JUDGES, join, dissenting.

Robins is the Tar Baby of tort law in this circuit. And the brierpatch is far away. This Court's application of *Robins* is out of step with contemporary tort doctrine, works substantial injustice on innocent victims, and is unsupported by the considerations that justified the Supreme Court's 1927 decision. * * *

The * * * bar for claims of economic loss unaccompanied by any physical damage conflicts with conventional tort principles of foreseeability and proximate cause. I would analyze the plaintiffs' claims under these principles, using the "particular damage" requirement of public nuisance law as an additional means of limiting claims. Although this approach requires a case-by-case analysis, it comports with the fundamental idea of fairness that innocent plaintiffs should receive compensation and negligent defendants should bear the cost of their tortious acts. Such a result is worth the additional costs of adjudicating these claims, and this rule of liability appears to be more economically efficient. Finally, this result would relieve courts of the necessity of manufacturing exceptions totally inconsistent with the expanded *Robins* rule of requiring physical injury as a prerequisite to recovery. * * *

II. THE INAPPLICABILITY OF *Robins Dry Dock* TO THIS CASE. Whatever the pragmatic justification for the original holding in *Robins*, the majority has extended the case beyond the warrant of clear necessity in requiring a *physical injury* for a recovery of economic loss in cases such as the one before the court. *Robins* prevented plaintiffs who were neither proximately nor foreseeably injured by a tortious act or product from recovering solely by claiming a contract with the injured party. The wisdom of this rule is apparent. This rule, however, has been expanded now to bar recovery by plaintiffs who would be allowed to recover if judged under conventional principles of foreseeability and proximate cause. * * *

Robins held only that if a defendant's negligence injures party A, and the plaintiff suffers loss of expected income or profits because it had a contract with A, then the plaintiff has no cause of action based on the defendant's negligence. * * *

It is a long step from *Robins* to a rule that requires *physical damage* as a prerequisite to recovery in maritime tort. The majority believes that the plaintiff's lack of any contractual connection with an injured party, taken with the *Robins* rule, forecloses liability: "If a plaintiff connected to the damaged chattels by contract cannot recover, others more remotely situated are foreclosed *a fortiori*."

This conclusion follows readily from the reasoning that if uninjured contracting parties are barred from recovery, and if contracting parties have a closer legal relationship than non-contracting parties, then a party who is not physically injured and who does not have a contractual relation to the damage is surely barred.

This argument would be sound in instances where the plaintiff suffered no loss *but for a contract* with the injured party. We would measure a plaintiff's connection to the tortfeasor by the only line connecting them, the

contract, and disallow the claim under *Robins*. In the instant case, however, some of the plaintiffs suffered damages whether or not they had a contractual connection with a party physically injured by the tortfeasor. These plaintiffs do not need to rely on a contract to link them to the tort. The collision proximately caused their losses, and those losses were foreseeable. These plaintiffs are therefore freed from the *Robins* rule concerning the recovery of those who suffer economic loss because of an injury to a party with whom they have contracted.

Because *Robins* provides an overly restrictive bar on recovery, courts have over the years developed a number of exceptions. The traditional exceptions allow recovery for certain husband-wife claims, recovery for negligent interference with contract when the interference results from a tangible injury to the contractor's person or property, and recovery for persons employed on fishing boats to recover for lost income when the employment contract is disrupted by a third party's negligent injury to the ship or equipment. * * * [The opinion discusses other cases.]

One cannot deny that *Robins*'s policy of limiting the set of plaintiffs who can recover for a person's negligence and damage to physical property provides a "bright line" for demarcating the boundary between recovery and nonrecovery. Physical harm suggests a proximate relation between the act and the interference. At bottom, however, the requirement of a tangible injury is artificial because it does not comport with accepted principles of tort law. Mrs. Palsgraf, although physically injured, could not recover. Many other plaintiffs, although physically uninjured, can recover. * * *

With deference to the majority, I suggest, notwithstanding their well reasoned opinion, that the utility derived from having a "bright line" boundary does not outweigh the disutility caused by the limitation on recovery imposed by the physical-damage requirement. *Robins* and its progeny represent a wide departure from the usual tort doctrines of foreseeability and proximate cause. Those doctrines, as refined in the law of public nuisance, provide a rule of recovery that compensates innocent plaintiffs and holds the defendants liable for much of the harm proximately caused by their negligence.

III. AN ALTERNATE RULE OF RECOVERY. Rather than limiting recovery under an automatic application of a physical damage requirement, I would analyze the plaintiffs' claims under the conventional tort principles of negligence, foreseeability, and proximate causation. I would confine *Robins* to the "factual contours" of that case: A plaintiff's claim may be barred only if the claim is derived solely through contract with an injured party. The majority's primary criticism of this approach to a determination of liability is that it is potentially open ended. Yet, there are well-established tort principles to limit liability for a widely-suffered harm. Under the contemporary law of public nuisance, courts compensate "particularly" damaged plaintiffs for harms suffered from a wide-ranging tort, but deny recovery to more generally damaged parties. Those parties who are foreseeably and proximately injured by an oil spill or closure of a navigable river, for example, and who can also prove damages that are beyond the general

economic dislocation that attends such disasters, should recover whether or not they had contractual dealings with others who were also damaged by the tortious act. The limitation imposed by "particular" damages, together with refined notions of proximate cause and foreseeability, provides a workable scheme of liability that is in step with the rest of tort law, compensates innocent plaintiffs, and imposes the costs of harm on those who caused it.

* * *

IV. ADVANTAGES OF THE ALTERNATE RULE OF RECOVERY. The advantages of this alternate rule of recovery are that it compensates damaged plaintiffs, imposes the cost of damages upon those who have caused the harm, is consistent with economic principles of modern tort law, and frees courts from the necessity of creating a piecemeal quilt of exceptions to avoid the harsh effects of the *Robins* rule. * * *

If tort law fails to compensate plaintiffs or to impose the cost of damages on those who caused the harm, it should be under a warrant clear of necessity. When a rule of law, once extended, leads to inequitable results and creates principles of recovery that are at odds with the great weight of tort jurisprudence, then that rule of law merits scrutiny. A strict application of the extension denies recovery to many plaintiffs who should be awarded damages. Conventional tort principles of foreseeability, proximate causation, and "particular" damages would avoid such unfairness.

It is true that application of foreseeability and proximate causation would necessitate case-by-case adjudication. But I have a more optimistic assessment of courts' ability to undertake such adjudication than the majority.³⁸ Certainly such an inquiry would be no different from our daily task of weighing such claims in other tort cases.

The majority opinion also states that the *Robins* rule, being free from the vagaries of factual findings in a case-by-case determination, serves an important normative function because it is more predictable and more "candid." Normative values would also be served, however, by eliminating

38. The majority criticizes foreseeability because it necessitates a case-by-case determination of liability. But this criticism of "foreseeability" as the criterion for judgment applies with equal force to well-established tort law for physical injury. The unquestioned concepts of foreseeability and proximate cause as established in *Palsgraf* and its progeny are open to the same condemnation that the majority makes of a rule of liability that would abandon *Robins*: "The result would be that no determinable measure of the limit of foreseeability would precede the decision on liability. We are told that where a claim is too remote, or too tenuous, recovery will be denied. Presumably then, as among all plaintiffs suffering foreseeable economic loss, recovery will turn on a judge[']s or jury's decision. * * * The point is not that such a process cannot be administered but rather that its judgments would be much less the product of a determinable rule of law." [C]

The majority opinion favors a bright line rule, as opposed to a case-by-case determination of liability, because it enables courts to "adjudicate" rather than to "manage." A bright line rule such as the one the majority proposes, however, requires no adjudication whatsoever. Judges need merely to preside over a self-executing system of limited liability where recovery is predicated upon an easily determined physical injury. The application of such a rule, rather than a case-by-case determination, seems more "management" than adjudication.

a broad categorical rule that is insensitive to equitable and social policy concerns that would support allowing the plaintiffs' claims in many individual cases. In assessing "normative concerns", the courts' compass should be a sense of fairness and equity, both of which are better served by allowing plaintiffs to present their claims under usual tort standards. It is not clear, moreover, that a jury's finding of negligence in a case-by-case determination is "less the product of a determinable rule of law" when the finder of fact is guided in its determination by rules of law. The jury's finding of liability in this case would be no more "lawless" than a finding of proximate cause, foreseeability, and particular damages in a physical damage case. * * *

The economic arguments regarding allocation of loss that purportedly favor the *Robins* rule of nonliability are not as clear to me as they appear to be to the majority. It is true that denial of recovery may effectively spread the loss over the victims. It is not certain, however, that victims are generally better insurers against the risk of loss caused by tortious acts having widespread consequences. Although the victims do possess greater knowledge of their circumstances and their potential damages, we do not know whether insurance against these types of losses is readily available to the businesses that may be affected. We do know that insurance against this kind of loss is already available for shippers. Imposition of liability upon the shippers helps ensure that the potential tortfeasor faces incentives to take the proper care. The majority's point is well taken that the incentives to avoid accidents do not increase once potential losses pass a certain measure of enormity. But in truth we have no idea what this measure is: Absent hard data, I would rather err on the side of receiving little additional benefit from imposing additional quanta of liability than err by adhering to *Robins*' inequitable rule and bar victims' recovery on the mistaken belief that a "marginal incentive curve" was flat, or nearly so. If a loss must be borne, it is no worse if a "merely" negligent defendant bears the loss than an innocent plaintiff absorb the damages.

V. CONCLUSION. The *Robins* approach restricts liability more severely than the policies behind limitations on liability require and imposes the cost of the accident on the victim, who is usually not in a superior position to obtain insurance to cover this loss. I would apply a rule of recovery based on conventional tort principles of proximate cause and foreseeability and limit eligibility only by the requirement that a claimant prove "particular" damages.

ALVIN B. RUBIN, CIRCUIT JUDGE, with whom WISDOM, POLITZ and TATE, CIRCUIT JUDGES, join, dissenting. * * * *Robins* should not be extended beyond its actual holding and should not be applied in cases like this, for the result is a denial of recompense to innocent persons who have suffered a real injury as a result of someone else's fault. We should not flinch from redressing injury because Congress has been indifferent to the problem.

NOTES AND QUESTIONS

1. The principal case follows the clear majority rule, but disagreement in the opinions in the case indicates the current ferment. The case is discussed by Atiyah,

Economic Loss in the United States, 5 Oxford J. of Legal Stud. 485 (1985). For a strong, but isolated, case holding liability, see *People Express Airlines, Inc. v. Consolidated Rail Corp.*, 100 N.J. 246, 495 A.2d 107 (1985) (tank car accident producing toxic fumes requiring evacuation of plaintiff's offices at Newark Airport, resulting in economic loss).

2. The foundational authority in the Common Law world establishing no duty is Justice Holmes's opinion in *Robins Dry Dock & Repair Co. v. Flint*, supra. But see Goldberg, *Recovery of Pure Economic Loss in Tort: Another Look at Robins Dry Dock v. Flint*, 20 J. of Legal Stud. 249 (1991), noting that "[t]ort law is under constant pressure to extend the boundaries of what constitutes a compensable injury" and that *Robins* is inapposite in many contexts in which it has been employed to deny liability. He finds a requirement for "some intellectual apparatus for evaluating the myriad of claims for recovery of mere economic loss."

3. The rule in *Robins* has been adopted throughout Anglo-American law, although the roots are independent. Often applied in the admiralty context in the United States, in England the rule is traceable to traditional common law in *Cattle v. Stockton Waterworks Co.*, 10 Q.B. 453 (1875). The rule was a backwater in American law until recently: Jane Stapleton, *Comparative Economic Loss: Lessons from Case-Law-Focused "Middle Theory,"* 50 UCLA L.Rev 531-536 (2002). The American Law Institute has focused attention on the recovery of economic loss in torts, through its Restatement (Third) of Torts: Economic Torts and Related Wrongs (Council Draft No. 2, 2007). Inroads have been created by some courts. In some American cases, fishermen suffering disruption to their livelihood by defendant's negligent conduct have been permitted to recover for the consequent economic losses: *Union Oil Co. v. Oppen*, 501 F.2d 558 (9th Cir. 1974) (noting the injury associated with an oil spill was pecuniary loss of "a particular and special nature, limited to the class of commercial fishermen" at 570). The law elsewhere has undergone close examination, and limited exceptions to the *Robins* rule have been crafted, although they are remarkably inconsistent. For example, the rule relating to defects in structures is viewed as falling within the *Robins* rule in England, *Murphy v. Brentwood District Council* [1991] 1 A.C. 398 (H. L.), but not so in Canada, *Winnipeg Condominium Corporation no. 36 v. Bird Construction Co. Ltd.* (1995) 121 D.L.R. (4th) 193. In Australia, the High Court took the position in *Bryan v. Maloney* (1995) 182 C.L.R. 609 that a subsequent buyer of property could sue a builder for the loss of value when the latent defect was manifested, but qualified that holding in *Woolcock Street Investments v. CDG* (2004) 216 C.L.R. 515, refusing to extend liability for structural defects to commercial premises. In the Australian case of *Caltex Oil (Aust.) Pty. Ltd. v. The Dredge "Willemstad,"* 136 C.L.R. 529 (1976) (Austl.), the owner of a dredge severed an oil pipeline between a storage facility on one shore and the refinery on the other, which was not owned by plaintiff refiner. The Australian High Court found an exception to the *Robins* rule in allowing plaintiff refinery to recover the extra costs of transporting oil during repairs to the pipeline. For a broader comparative analysis see M. Bussani and V. Palmer (eds.), *The Frontiers of Tort Liability: Pure Economic Loss in Europe* (Cambridge University Press, 2003).

4. Sometimes the loss will arise from the defectiveness of a good or structure. In *East River Steamship Corp. v. Transamerica Delaval, Inc.*, 476 U.S. 858 (1986), the manufacturers of defective turbine engines owed no duty of care to the charterer of a supertanker, who suffered loss when the turbine had to be replaced because the low pressure turbine had been damaged by faulty installation of a valve. The plaintiff's claim, being for damage to the product itself, was for economic loss

and "most naturally understood as a warranty claim" (p. 872). How is the damage to be characterized in these cases:

(A) the defective engine explodes causing the ship to sink; liability to the injured crew, and to the ship's owner for the loss of his ship?

(B) design defect in a fishing vessel's hydraulic system causes her to catch fire and sink; the accident destroys, in addition to the vessel, equipment added after the initial sale, namely a skiff, a fishing net, and spare parts: *Saratoga Fishing Co. v. J. M. Martinac & Co.*, 520 U.S. 875 (1997)?

(C) the defective engine threatens to explode necessitating drydocking and repairs and resulting in wasted hire charges and a loss of profits? *Colleton Preparatory Academy v. Hoover Universal*, 379 S.C. 181, 666 S.E.2d 247 (2008) (duty extends to economic loss where the breach threatens physical or bodily harm).

(D) the defective engine does not work at all when the manufacturer knew the purpose to which the engine would be put?

5. The courts do not always restrict liability via the duty issue. In *Petitions of Kinsman Transit Co.*, 388 F.2d 821 (2d Cir.1968), *supra* Chapter 6, Kaufman J. employed a proximate cause analysis to deny recovery for economic losses suffered by wheat owners when Buffalo harbor was blocked due to the defendant's negligence.

MISREPRESENTATION

1. INTRODUCTION

"Misrepresentation runs all through the law of torts, as a method of accomplishing various types of tortious conduct which, for reasons of historical development or as a matter of convenience, usually are grouped under categories of their own. Thus a battery may be committed by feeding the plaintiff poisoned chocolates, or by inducing his consent to a physical contact by misrepresenting its character; false imprisonment may result from a pretense of authority to make an arrest, a trespass to land from fraudulent statements inducing another to enter, or a conversion from obtaining possession of goods by false representations; and a malicious lie may give rise to a cause of action for the intentional infliction of mental suffering. A great many of the common and familiar forms of negligent conduct, resulting in invasions of tangible interests of person or property, are in their essence nothing more than misrepresentation, from a misleading signal by a driver of an automobile about to make a turn, or an assurance that a danger does not exist, to false statements concerning a chattel sold, or non-disclosure of a latent defect by one who is under a duty to give warning. In addition, misrepresentation may play an important part in the invasion of intangible interests, in such torts as defamation, malicious prosecution, or interference with contractual relations. In all such cases the particular form which the defendant's conduct has taken has become relatively unimportant, and misrepresentation has been merged to such an extent with other kinds of misconduct that neither the courts nor legal writers have found any occasion to regard it as a separate basis of liability." W. Prosser, Torts § 683 (4th ed.1971).

Misrepresentation as a distinct cause of action has usually been associated with the common law action of deceit. The law of negligent misrepresentation or misstatement has developed rapidly in the past few decades. The causes of action in misrepresentation normally protect economic interests and consequently the parameters of liability have been carefully controlled. A form of strict liability, although occasionally recognized, is mainly banished from the ambit of tort liability.

Misrepresentation is thus a very complex field. The complexity results primarily from the existence of numerous alternative remedies. They include:

1. The tort action of deceit.
2. An action for breach of contract, when the representation is found to be an express or implied term of the contract itself. In the case of the

sale of chattels, this may take the form of an action for breach of warranty, which has definite tort characteristics of its own. The contract liability is of course a strict one, and requires no intent to deceive, negligence, or other fault than the breach of the contract itself.

3. A negligence action for negligent misrepresentation or misstatement. This is now recognized by nearly all courts where tangible injury to person or property results, and by most of the American jurisdictions where the only damage is financial loss.

4. A suit in equity to rescind the transaction or for other relief such as an equitable lien or a constructive trust.

5. An action at law for restitution to recover what the plaintiff has parted with, or the unjust enrichment which the defendant has received from it.

History. The action of deceit is of very ancient origin. There was an old writ of deceit known as early as 1201, which lay only in cases of what we would now call malicious prosecution. At a later period this writ was superseded by an action on the case in the nature of deceit, which became the general common law remedy for any misrepresentation, whether fraudulent or not, which resulted in actual damage. It was used to afford a remedy for many wrongs that we should now regard as breaches of contract, such as false warranties in the sale of goods. Its use was limited almost entirely to direct transactions between the plaintiff and the defendant, and it was treated as inseparable from some contract relation. In other words, tort and contract were not at all clearly distinguished.

"Caveat emptor"—let the buyer beware—was the rule. The buyer could garner protection by exacting a warranty from the seller. Thus in the picturesque old case of *Chandelor v. Lopus*, Cro. Jac. 4, 79 Eng. Rep. 3 (1603), a goldsmith sold a stone to the plaintiff, falsely stating that it was a bezar stone—a "calcareous concretion in the stomach of a goat," believed to have medicinal properties, particularly as a remedy against snake-bite. It was held that there was no liability, even though the seller knew his statement to be false, in the absence of an express undertaking to be bound. The only exception was in the sale of food and drink.

In 1789, in *Pasley v. Freeman*, 3 T.R. 51, 100 Eng. Rep. 450, the action of deceit was held to lie in a case where the plaintiff had had no dealings with the defendant, but had been induced by his misrepresentation to extend credit to a third person. After that date deceit was recognized as purely a tort action, and not necessarily founded upon a contract. At about the same time, in *Stuart v. Wilkins*, 1 Doug. 18, 99 Eng. Rep. 15 (1778), the remedy for breach of warranty was taken over into the action of *assumpsit*, and it was thus established that it had a contract character. Thereafter the two lines of recovery slowly diverge, although some vestige of confusion between the two still remains, even today.

At the beginning of the 19th Century the elements were in place to provide a wide liability for misrepresentations. These developments were put asunder by the momentous case of *Derry v. Peck*, *infra*. Deceit was

established as the basis of tortious liability and deceit required an actual "intention to cheat." Norton v. Ashburton, [1914] A.C. 932, at 953. Dishonesty rather than negligence was the lodestar of liability. The tort requires a fraudulent misrepresentation relied upon by the plaintiff to his detriment. What is a "misrepresentation"?

2. CONCEALMENT AND NONDISCLOSURE

Swinton v. Whitinsville Savings Bank

Supreme Judicial Court of Massachusetts, 1942.
311 Mass. 677, 42 N.E.2d 808.

Action by Neil W. Swinton against Whitinsville Savings Bank to recover damages for alleged fraudulent concealment by defendant in sale of a house to plaintiff. From an order sustaining a demurrer to plaintiff's declaration, the plaintiff appeals.

QUA, JUSTICE. The declaration alleges that on or about September 12, 1938, the defendant sold the plaintiff a house in Newton to be occupied by the plaintiff and his family as a dwelling; that at the time of the sale the house "was infested with termites, an insect that is most dangerous and destructive to buildings"; that the defendant knew the house was so infested; that the plaintiff could not readily observe this condition upon inspection; that "knowing the internal destruction that these insects were creating in said house", the defendant falsely and fraudulently concealed from the plaintiff its true condition; that the plaintiff at the time of his purchase had no knowledge of the termites, exercised due care thereafter, and learned of them about August 30, 1940; and that, because of the destruction that was being done and the dangerous condition that was being created by the termites, the plaintiff was put to great expense for repairs and for the installation of termite control in order to prevent the loss and destruction of said house.

There is no allegation of any false statement or representation, or of the uttering of a half truth which may be tantamount to a falsehood. There is no intimation that the defendant by any means prevented the plaintiff from acquiring information as to the condition of the house. There is nothing to show any fiduciary relation between the parties, or that the plaintiff stood in a position of confidence toward or dependence upon the defendant. So far as appears the parties made a business deal at arm's length. The charge is concealment and nothing more; and it is concealment in the simple sense of mere failure to reveal, with nothing to show any peculiar duty to speak. The characterization of the concealment as false and fraudulent of course adds nothing in the absence of further allegations of fact. * * *

If this defendant is liable on this declaration every seller is liable who fails to disclose any nonapparent defect known to him in the subject of the sale which materially reduces its value and which the buyer fails to discover. Similarly it would seem that every buyer would be liable who fails to disclose any nonapparent virtue known to him in the subject of the

purchase which materially enhances its value and of which the seller is ignorant. [C] The law has not yet, we believe, reached the point of imposing upon the frailties of human nature a standard so idealistic as this. That the particular case here stated by the plaintiff possesses a certain appeal to the moral sense is scarcely to be denied. Probably the reason is to be found in the facts that the infestation of buildings by termites has not been common in Massachusetts and constitutes a concealed risk against which buyers are off their guard. But the law cannot provide special rules for termites and can hardly attempt to determine liability according to the varying probabilities of the existence and discovery of different possible defects in the subjects of trade. The rule of nonliability for bare nondisclosure has been stated and followed by this court. * * * It is adopted in the American Law Institute's Restatement of Torts § 551. See Williston on Contracts, Rev. Ed., §§ 1497, 1498, 1499.

The order sustaining the demurrer is affirmed, and judgment is to be entered for the defendant. * * *

So ordered.

NOTES AND QUESTIONS

1. The classic statement of the effect of nondisclosure is that of Lord Cairns in *Peek v. Gurney*, L.R. 6 H.L. 377, 403 (1873): "Mere nondisclosure of material facts, however morally censurable, however that nondisclosure might be a ground in a proper proceeding at a proper time for setting aside an allotment or a purchase of shares, would in my opinion form no ground for an action in the nature of an action for misrepresentation. There must, in my opinion, be some active misstatement of fact, or, at all events, such a partial and fragmentary statement of fact, as that the withholding of that which is not stated makes that which is stated absolutely false." Perhaps the leading case espousing the view is *Keates v. Earl of Cardogan*, 10 C.B. 591, 138 Eng. Rep. 234 (1851).

2. What is the foundation of the "general rule" that an action of deceit will not lie for tacit nondisclosure, as distinguished from active misrepresentation?

3. Three different rules modifying the harshness of the common law position developed quite early:

A. The courts assumed a much more liberal attitude when the plaintiff sought rescission of the contract, or other equitable relief. Even mutual mistake as to a basic fact affecting the transaction is ordinarily held to be sufficient grounds for such relief; and the position of the defendant is not improved if he has knowledge of the plaintiff's mistake, failed to make disclosure, and took advantage of the situation. See, for example, *Slade v. McIntyre*, 11 Mass. L. Rep. 79, 1999 WL 1335106 (Mass. Super. 1999). See also *Weintraub v. Krobatsch*, 64 N.J. 445, 317 A.2d 68 (1974) (discussing modern trend away from *Peek v. Gurney* in suits in equity).

B. Even in actions at law, the defendant was held liable for nondisclosure if the parties were in some confidential or fiduciary relation to one another, so that reliance upon good faith and full disclosure was justified. *McDonough v. Williams*, 77 Ark. 261, 92 S.W. 783 (1905); *Brasher v. First Nat. Bank of Birmingham*, 232 Ala. 340, 168 So. 42 (1936). "For instance, the relations of trustee and cestui que trust, principal and agent, attorney and client, physician and patient, priest and

parishioner, partners, tenants in common, husband and wife, parent and child, guardian and ward, and many others of like character." *Farmers' State Bank of Newport v. Lamon*, 132 Wash. 369, 231 P. 952 (1925). As to banker and customer, see *Buxcel v. First Fidelity Bank*, 601 N.W.2d 593 (S.D. 1999).

C. In addition, certain types of contracts, such as those of suretyship and guaranty, joint adventure, or insurance, were recognized as in themselves creating or involving something of a confidential relation, and hence as requiring the utmost good faith, and full and fair disclosure of all material facts.

4. An active concealment may constitute an act sufficient to base liability. The leading American case is *Croyle v. Moses*, 90 Pa. 250 (1879), where defendant, selling a horse to plaintiff, hitched him up short for the purpose of concealing the fact that the horse was a cribber and a windsucker.

5. Are words necessary to a misrepresentation? In *Kuelling v. Roderick Lean Mfg. Co.*, 183 N.Y. 78, 75 N.E. 1098 (1905), defendant sold a road roller with its defects concealed with putty and paint. To demonstrate that fraud remained remarkably stable during the course of the 20th century, see *Reichelt v. Urban Inv. & Dev. Co.*, 577 F.Supp. 971 (N.D. Ill. 1984) (seller of home covered up cracks in home with fiberglass and paint).

6. Defendant, selling plaintiff sheets of aluminum, placed good undamaged sheets on top of bundles of sheets that were corroded or otherwise damaged. The bundles were bulky and heavy, and plaintiff did not take them apart. Is this deceit? *Salzman v. Maldaver*, 315 Mich. 403, 24 N.W.2d 161 (1946).

7. Suppose the defendant, in possession of the facts, denies all knowledge in response to plaintiff's inquiry, and thereby discourages him from investigating further? *Smith v. Beatty*, 37 N.C. 456, 40 Am. Dec. 435 (1843).

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§ 529. Representation Misleading Because Incomplete

A representation stating the truth so far as it goes but which the maker knows or believes to be materially misleading because of his failure to state additional or qualifying matter is a fraudulent misrepresentation.

Comment:

a. A statement containing a half-truth may be as misleading as a statement wholly false. Thus, a statement that con-

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tains only favorable matters and omits all reference to unfavorable matters is as much a false representation as if all the facts stated were untrue. Thus a prospectus that accurately states the assets, bonded indebtedness and net earnings of a manufacturing corporation but omits any reference to its floating debt is a false representation of the financial position of the company. So, too, a statement by a vendor that his title has been upheld by a particular court is a false representation if he fails to disclose his knowledge that an appeal from the decision is pending.

b. Whether or not a partial disclosure of the facts is a fraudulent misrepresentation depends upon whether the person making the statement knows or believes that the undisclosed facts might affect the recipient's conduct in the transaction in hand. It is immaterial that the defendant believes that the undisclosed facts would not affect the value of the bargain which he is offering. The recipient is entitled to know the undisclosed facts in so far as they are material and to form his own opinion of their effect. Thus, in the example last given, the fact that the vendor had good grounds for believing that the appeal would fail does not prevent his statement from being a fraudulent misrepresentation.

c. Except where it is sold "as is," one who offers land or a chattel for sale on inspection by so doing impliedly asserts that he knows of nothing that makes the appearance of the article deceptive and that cannot be discovered by such an inspection as a purchaser at the sale should make. In this case the vendor knows that the buyer will assume that, except for faults discoverable by the inspection, the thing is as it appears to be and is guilty of actionable fraud if he does not disclose a latent defect known to him.

Illustrations:

1. A, selling a tract of land to B, warns B that plans for city development already drawn show two unopened streets which, if opened, may condemn a part of the tract. A knows, but does not tell B, that the plans show a third unopened street which, if opened, will condemn part of the tract and cut it in half. B buys the land, believing that there are only the two streets. A's statement is a fraudulent misrepresentation.

2. A, selling an apartment house to B, informs B that the apartments in it are all rented to tenants at \$200 a

month. This is true, but A does not inform B that the rent of \$200 has not been approved by the local Rent Control authorities, and without this approval it is not legal. B buys the apartment house, believing that the rent of \$200 is legal and he can continue to collect it. A's statement is a fraudulent misrepresentation.

TOPIC 2. CONCEALMENT AND NONDISCLOSURE

§ 550. Liability for Fraudulent Concealment

One party to a transaction who by concealment or other action intentionally prevents the other from acquiring material information is subject to the same liability to the other, for pecuniary loss as though he had stated the nonexistence of the matter that the other was thus prevented from discovering.

Comment:

a. The rule stated in this Section is commonly applied in two types of situations, although it is not limited to them. The first occurs when the defendant actively conceals a defect or other disadvantage in something that he is offering for sale to another. Thus a defendant is subject to liability for a fraudulent misrepresentation if he paints over and so conceals a defect in a chattel or a building that he is endeavoring to sell to the plaintiff, and thus induces the plaintiff to buy it in ignorance of its defective character. So also, he is subject to liability if he reads a contract to the plaintiff and omits a portion of it, or if he so stacks aluminum sheets that he is selling as to conceal defective sheets in the middle of the pile.

Illustration:

1. A is seeking to sell to B a horse which is a crib-biter and a wind-sucker. In order to conceal these characteristics from B, A hitches the horse up short with its head raised so that it cannot bite its crib and suck wind. B inspects the horse and does not discover its defects. A is subject to liability to B.
- b. The second situation occurs when the defendant successfully prevents the plaintiff from making an investigation that he would otherwise have made, and which, if made, would have disclosed the facts; or when the defendant frustrates an investigation. Sending one in search of information in a direction where it cannot be obtained is a typical illustration of frustration. Even a false denial of knowledge or information by one party to a transaction, who is in possession of the facts, may subject him to liability as fully as if he had expressly misstated the facts, if its effect upon the plaintiff is to lead him to believe that the facts do not exist or cannot be discovered.

§ 538. Materiality of Misrepresentation

(1) Reliance upon a fraudulent misrepresentation is not justifiable unless the matter misrepresented is material.

(2) The matter is material if

(a) a reasonable man would attach importance to its existence or nonexistence in determining his choice of action in the transaction in question; or

(b) the maker of the representation knows or has reason to know that its recipient regards or is likely to regard the matter as important in determining his choice of action, although a reasonable man would not so regard it.

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Comment:

a. The rules stated in this Section are concerned only with whether the recipient's reliance upon the misrepresentation is justifiable. The rules that determine the fraudulent character of the misrepresentation are stated in §§ 526 to 530. The rules which determine the persons to whom the maker of the misrepresentation may be liable are stated in §§ 531 to 536. The general rule requiring that the recipient in fact rely on the misrepresentation and that his reliance be justifiable is stated in § 537.

b. The rule stated in this Section applies not only to misrepresentations of fact but also to those of opinion, intention and law. When the representation is one of opinion or intention, the question of materiality concerns not only the facts about which the opinion is expressed or the proposed action or inaction to which the intention relates, but also the existence of the opinion or intention itself in the particular individual who asserts it. (See §§ 542, 543, and 544).

c. The rule stated in this Section differs from the rules that determine the right to rescind a contract induced by fraudulent misrepresentation (see Restatement, Second, Contracts § 306) and to obtain restitution for benefits procured by fraudulent misrepresentation. (See Restatement of Restitution, § 9, Comment b). In neither of these cases is it required that the misrepresentation, if fraudulent, be as to a matter that is material, materiality being important in them only when the misrepresentation is negligent and not fraudulent.

Comment on Clause (2), (a):

d. In determining whether a fact is material it is not necessary that it be one that a reasonable man would regard as affecting the pecuniary advantages of the transaction. There are many more-or-less sentimental considerations that the ordinary man regards as important. Thus it is natural that a person should wish to possess portraits of his ancestors even though they have no value as works of art. A fraudulent misrepresentation that a particular picture is a portrait of the purchaser's great-grandfather is a misrepresentation of a material fact.

e. As in all cases in which the conduct of the reasonable man is the standard, the question of whether a reasonable man would have regarded the fact misrepresented to be important in de-

termining his course of action is a matter for the judgment of the jury subject to the control of the court. The court may withdraw the case from the jury if the fact misrepresented is so obviously unimportant that the jury could not reasonably find that a reasonable man would have been influenced by it. Compare § 285, especially Comments *f* and *g* which state the respective functions of court and jury in negligence cases.

f. Even though the matter misrepresented is one to which a reasonable man would not attach any importance in determining his course of action in the transaction in hand, it is nevertheless material if the maker knows that the recipient, because of his own peculiarities, is likely to attach importance to it. There are many persons whose judgment, even in important transactions, is likely to be determined by considerations that the normal man would regard as altogether trivial or even ridiculous. One who practices upon another's known idiosyncracies cannot complain if he is held liable when he is successful in what he is endeavoring to accomplish.

Illustrations:

1. A, seeking to induce B to buy stock in a corporation, knows that B believes in astrology and governs his conduct according to horoscopes. A fraudulently tells B that the horoscopes of the officers of the corporation all indicate remarkable success for the corporation during the coming year. In reliance upon this statement, B buys the stock from A and as a result suffers pecuniary loss. The misrepresentation is material.

2. A, seeking to induce B to give money to a college about to be founded, fraudulently informs B that it is to be named after X, a deceased friend of B of bad character, whom B has regarded with great affection. A knows that the statement is likely to be regarded by B as an important inducement to make a gift. In reliance upon the statement, B makes the gift. The statement is material.

§ 551. Liability for Nondisclosure

(1) One who fails to disclose to another a fact that he knows may justifiably induce the other to act or refrain from acting in a business transaction is subject to the same liability to the other as though he had represented the nonexistence of the matter that he has failed to disclose, if, but only if, he is under a duty to the other to exercise reasonable care to disclose the matter in question.

(2) One party to a business transaction is under a duty to exercise reasonable care to disclose to the other before the transaction is consummated,

(a) matters known to him that the other is entitled to know because of a fiduciary or other similar relation of trust and confidence between them; and

(b) matters known to him that he knows to be necessary to prevent his partial or ambiguous statement of the facts from being misleading; and

(c) subsequently acquired information that he knows will make untrue or misleading a previous representation that when made was true or believed to be so; and

(d) the falsity of a representation not made with the expectation that it would be acted upon, if he subsequently learns that the other is about to act in reliance upon it in a transaction with him; and

(e) facts basic to the transaction, if he knows that the other is about to enter into it under a mistake as to them, and that the other, because of the relationship between them, the customs of the trade or other objective circumstances, would reasonably expect a disclosure of those facts.

Comment on Subsection (1):

a. Unless he is under some one of the duties of disclosure stated in Subsection (2), one party to a business transaction is not liable to the other for harm caused by his failure to disclose to the other facts of which he knows the other is ignorant and which he further knows the other, if he knew of them, would regard as material in determining his course of action in the trans-

action in question. The interest in knowing those facts that are important in determining the advisability of a course of action in a financial or commercial matter is given less protection by the rule stated in this Subsection than is given to the interest in knowing facts that are important in determining the recipient's course of action in regard to matters that involve the security of the person, land or chattels of himself or a third person.

b. The conditions under which liability is imposed for nondisclosure in an action for deceit differ in one particular from those under which a similar nondisclosure may confer a right to rescind the transaction or to recover back money paid or the value of other benefits conferred. In the absence of a duty of disclosure, under the rule stated in Subsection (2) of this Section, one who is negotiating a business transaction is not liable in deceit because of his failure to disclose a fact that he knows his adversary would regard as material. On the other hand, as is stated in Restatement, Second, Contracts § 303(b) the other is entitled to rescind the transaction if the undisclosed fact is basic; and under Restatement of Restitution, § 8, Comment e, and § 28, he would be entitled to recover back any money paid or benefit conferred in consummation of the transaction.

Comment on Subsection (2):

c. A person under the duty stated in this Subsection is required to disclose only those matters that he has reason to know will be regarded by the other as important in determining his course of action in the transaction in hand. He is therefore under no duty to disclose matter that the ordinary man would regard as unimportant unless he knows of some peculiarity of the other that is likely to lead him to attach importance to matters that are usually regarded as of no moment.

d. Under the rule stated in this Subsection the person under a duty of disclosure is not subject to liability merely because he has failed to bring the required information home to the person entitled to it. His duty is to exercise reasonable care to do so. If reasonable care is exercised, the fact that the information does not reach the person entitled to it does not subject him to liability. Thus a trustee whose distant cestui que trust is contemplating a sale of part of his interest in the trust res to a third person and who writes to his cestui que trust communicating certain information which it is material for the latter to know in the transaction in question, is not subject to liability in an action of deceit, if the

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letter goes astray and therefore does not reach the cestui until the sale is made. On the other hand, if the trustee knows that the consummation of the transaction is immediately imminent, it may not be reasonable for him to communicate by mail rather than by telegraph. However, in the great majority of cases the person owing the duty has so available an opportunity to make the required disclosure that it is rare that the failure to give it can be other than intentional or negligent.

Comment on Clause (a):

e. On the duty of a trustee to disclose all material matters to his beneficiary with whom he is dealing on the trustee's own account, see Restatement, Second, Trusts § 170(2). On the duty of a trustee to disclose to his beneficiary matters important for the beneficiary to know in dealing with third persons, see Restatement, Second, Trusts § 173, Comment d. On the duty of an agent to disclose to his principal matters important for the principal to know in dealing with the agent or a third person and the similar duty of the principal to the agent, see Restatement, Second, Agency §§ 381 and 435. It is not within the scope of this Restatement to state the rules that determine the duty of disclosure which under the law of business associations the directors of a company owe to its shareholders.

f. Other relations of trust and confidence include those of the executor of an estate and its beneficiary, a bank and an investing depositor, and those of physician and patient, attorney and client, priest and parishioner, partners, tenants in common and guardian and ward. Members of the same family normally stand in a fiduciary relation to one another, although it is of course obvious that the fact that two men are brothers does not establish relation of trust and confidence when they have become estranged and have not spoken to one another for many years. In addition, certain types of contracts, such as those of suretyship or guaranty, insurance and joint adventure, are recognized as creating in themselves a confidential relation and hence as requiring the utmost good faith and full and fair disclosure of all material facts.

Comment on Clause (b):

g. A statement that is partial or incomplete may be a misrepresentation because it is misleading, when it purports to tell the whole truth and does not. (See § 529). So also may a statement made so ambiguously that it may have two interpretations, one of which is false. (See §§ 527, 528). When such a statement

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has been made, there is a duty to disclose the additional information necessary to prevent it from misleading the recipient. In this case there may be recovery either on the basis of the original misleading statement or of the nondisclosure of the additional facts.

Comment on Clause (c):

h. One who, having made a representation which when made was true or believed to be so, remains silent after he has learned that it is untrue and that the person to whom it is made is relying upon it in a transaction with him, is morally and legally in the same position as if he knew that his statement was false when made.

Illustrations:

1. A, a stock breeder, tells B, a prospective buyer, that a thoroughbred mare is in foal to a well-known stallion. The mare miscarries. Immediately afterwards B offers \$500 for the mare relying, as A knows, upon his statement. A does not inform B of the mare's miscarriage. A is subject to liability to B for the loss that he suffers because the mare is not in foal as originally represented.

2. A, the president of a mercantile corporation, makes a true statement of its financial position to a credit rating company, intending the substance to be published by it to its subscribers. The corporation's financial position becomes seriously impaired, but A does not inform the credit rating company of this fact. The corporation receives goods on credit from B, a subscriber of the rating company, who when the goods are bought is relying, as A knows, on the credit rating based on his statements to the rating company. A is subject to liability in deceit to B.

Comment on Clause (d):

i. One who knowingly makes a misrepresentation without any expectation that the recipient will act upon it may subsequently discover that the other is relying upon it in a transaction then pending between them. If, in this case, he does not exercise reasonable care to inform the other that his misrepresentation is untrue, he is under the same liability as though he had then made it for the purpose of influencing the other's conduct in the transaction in hand.

The rule stated in Clause (d) is not necessarily limited to "a transaction with him." When, for example, the defendant makes

a statement to the plaintiff concerning the credit of a third person not expecting it to be acted upon and then discovers that the plaintiff is about to lend money to the third person in reliance upon the statement, it would appear that the duty of disclosure would arise.

Comment on Clause (e):

j. *"Facts basic to the transaction."* The word "basic" is used in this Clause in the same sense in which it is used in Comment c under § 16 of the Restatement of Restitution. A basic fact is a fact that is assumed by the parties as a basis for the transaction itself. It is a fact that goes to the basis, or essence, of the transaction, and is an important part of the substance of what is bargained for or dealt with. Other facts may serve as important and persuasive inducements to enter into the transaction, but not go to its essence. These facts may be material, but they are not basic. If the parties expressly or impliedly place the risk as to the existence of a fact on one party or if the law places it there by custom or otherwise the other party has no duty of disclosure. (Compare Restatement, Second, Contracts § 296).

Illustrations:

3. A sells to B a dwelling house, without disclosing to B the fact that the house is riddled with termites. This is a fact basic to the transaction.

4. A sells to B a dwelling house, knowing that B is acting in the mistaken belief that a highway is planned that will pass near the land and enhance its value. A does not disclose to B the fact that no highway is actually planned. This is not a fact basic to the transaction.

5. Having purchased a certain tract of land for \$25,000. A hears that B may have a claim to it. He goes to B and offers to purchase B's interest. B does not believe he has a valid legal claim but agrees to give A a quit-claim deed for \$250. B's lack of a valid legal claim is not a fact that he is under a duty to disclose.

Comment:

k. *Nondisclosure of basic facts.* The rule stated in Subsection (1) reflects the traditional ethics of bargaining between adversaries, in the absence of any special reason for the application of a different rule. When the facts are patent, or when the plain-

tiff has equal opportunity for obtaining information that he may be expected to utilize if he cares to do so, or when the defendant has no reason to think that the plaintiff is acting under a misapprehension, there is no obligation to give aid to a bargaining antagonist by disclosing what the defendant has himself discovered. To a considerable extent, sanctioned by the customs and mores of the community, superior information and better business acumen are legitimate advantages, which lead to no liability. The defendant may reasonably expect the plaintiff to make his own investigation, draw his own conclusions and protect himself; and if the plaintiff is indolent, inexperienced or ignorant, or his judgment is bad, or he does not have access to adequate information, the defendant is under no obligation to make good his deficiencies. This is true, in general, when it is the buyer of land or chattels who has the better information and fails to disclose it. Somewhat less frequently, it may be true of the seller.

Illustrations:

6. A is a violin expert. He pays a casual visit to B's shop, where second-hand musical instruments are sold. He finds a violin which, by reason of his expert knowledge and experience, he immediately recognizes as a genuine Stradivarius, in good condition and worth at least \$50,000. The violin is priced for sale at \$100. Without disclosing his information or his identity, A buys the violin from B for \$100. A is not liable to B.

7. The same facts as in Illustration 6, except that the violin is sold at auction and A bids it in for \$100. The same conclusion.

8. B has a shop in which he sells second-hand musical instruments. In it he offers for sale for \$100 a violin, which he knows to be an imitation Stradivarius and worth at most \$50. A enters the shop, looks at the violin and is overheard by B to say to his companion that he is sure that the instrument is a genuine Stradivarius. B says nothing, and A buys the violin for \$100. B is not liable to A.

1. The continuing development of modern business ethics has, however, limited to some extent this privilege to take advantage of ignorance. There are situations in which the defendant not only knows that his bargaining adversary is acting under a mistake basic to the transaction, but also knows that the adversary, by reason of the relation between them, the customs of the trade

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or other objective circumstances, is reasonably relying upon a disclosure of the unrevealed fact if it exists. In this type of case good faith and fair dealing may require a disclosure.

It is extremely difficult to be specific as to the factors that give rise to this known, and reasonable, expectation of disclosure. In general, the cases in which the rule stated in Clause (e) has been applied have been those in which the advantage taken of the plaintiff's ignorance is so shocking to the ethical sense of the community, and is so extreme and unfair, as to amount to a form of swindling, in which the plaintiff is led by appearances into a bargain that is a trap, of whose essence and substance he is unaware. In such a case, even in a tort action for deceit, the plaintiff is entitled to be compensated for the loss that he has sustained. Thus a seller who knows that his cattle are infected with tick fever or contagious abortion is not free to unload them on the buyer and take his money, when he knows that the buyer is unaware of the fact, could not easily discover it, would not dream of entering into the bargain if he knew and is relying upon the seller's good faith and common honesty to disclose any such fact if it is true.

There are indications, also, that with changing ethical attitudes in many fields of modern business, the concept of facts basic to the transaction may be expanding and the duty to use reasonable care to disclose the facts may be increasing somewhat. This Subsection is not intended to impede that development.

§ 525. Liability for Fraudulent Misrepresentation

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.

Comment:

a. The rules that determine the fraudulent character of a misrepresentation are stated in §§ 526-530. The rules that deal with the requirement that the representation must be made for the purpose of inducing that conduct of the other from which his

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harm results are stated in §§ 531-536. The rules that determine whether the recipient of the misrepresentation is justified in relying upon it are stated in §§ 537-545. The measure of damages is stated in § 549.

As to the liability for negligent misrepresentation inducing reliance that causes pecuniary loss, see § 552. As to innocent misrepresentation, see § 552C.

b. *Misrepresentation defined.* "Misrepresentation" is used in this Restatement to denote not only words spoken or written but also any other conduct that amounts to an assertion not in accordance with the truth. Thus, words or conduct asserting the existence of a fact constitute a misrepresentation if the fact does not exist.

Illustration:

1. A, a dealer in used automobiles, offers a second-hand car for sale in his showroom. Before doing so he turns the odometer back from 60,000 to 18,000 miles. B, relying on the odometer reading, purchases the car from A. This is a misrepresentation.

c. A representation of the state of mind of the maker or of a third person is a misrepresentation if the state of mind in question is otherwise than as represented. Thus, a statement that a particular person, whether the maker of the statement or a third person, is of a particular opinion or has a particular intention is a misrepresentation if the person in question does not hold the opinion or have the intention asserted.

d. *Representations of fact, opinion and law.* Strictly speaking, "fact" includes not only the existence of a tangible thing or the happening of a particular event or the relationship between particular persons or things, but also the state of mind, such as the entertaining of an intention or the holding of an opinion, of any person, whether the maker of a representation or a third person. Indeed, every assertion of the existence of a thing is a representation of the speaker's state of mind, namely, his belief in its existence. There is sometimes, however, a marked difference between what constitutes justifiable reliance upon statements of the maker's opinion and what constitutes justifiable reliance upon other representations. Therefore, it is convenient to distinguish between misrepresentations of opinion and misrepresentations of all other facts, including intention.

A statement of law may have the effect of a statement of fact or a statement of opinion. It has the effect of a statement of fact if it asserts that a particular statute has been enacted or repealed or that a particular decision has been rendered upon particular facts. It has the effect of a statement of opinion if it expresses only the actor's judgment as to the legal consequence that would be attached to the particular state of facts if the question were litigated. It is therefore convenient to deal separately with misrepresentations of law.

e. Representation implied from statement of fact. A misrepresentation of fact may concern either an existing or past fact. A statement about the future may imply a representation concerning an existing or past fact. (See Comment *f*). To be actionable, a misrepresentation of fact must be one of a fact that is of importance in determining the recipient's course of action at the time the representation is made. Thus a statement that a horse has recently and consistently trotted a mile in less than two minutes may justifiably be taken as an implied assertion of the capacity of the horse to repeat the performance at the time the statement is made. So, too, a past fact may be one that makes it obligatory or advisable for the recipient to take a particular course of action, as when A falsely tells B that he has caused the arrest of a criminal for whose arrest B has offered a reward, or when in an insurance policy the insured has falsely stated that his father did not die of tuberculosis. A fraudulent misrepresentation of such a fact may be the basis of liability.

f. Representation implied from statement promissory in form. Similarly a statement that is in form a prediction or promise as to the future course of events may justifiably be interpreted as a statement that the maker knows of nothing which will make the fulfillment of his prediction or promise impossible or improbable. Thus a statement that a second-hand car will run fifteen miles on a gallon of gasoline is an implied assertion that the condition of the car makes it capable of so doing, and is an actionable misrepresentation if the speaker knows that it has never run more than seven miles per gallon of gasoline.

Illustrations:

2. A, in order to induce B to buy a heating device, states that it will give a stated amount of heat while consuming only a stated amount of fuel. B is justified in accepting A's statement as an assurance that the heating device is capable of giving the services that A promises.

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3. A, knowing that the X Corporation is hopelessly insolvent, in order to induce B to purchase from him shares of its capital stock assures B that the shares will within five years pay dividends that will amount to the purchase price of the stock. B is justified in accepting these statements as an assurance that A knows of nothing that makes the corporation incapable of making earnings sufficient to pay the dividends.

g. Representation implied from statement as to past events. On the same basis, a statement that a particular condition has recently existed or that an event has recently occurred or that a particular person has recently by words or acts expressed a particular opinion or intention, may, if reasonable under the circumstances, be understood and accepted as asserting that the situation has not changed since the time when the condition is said to have existed, the event to have occurred or the opinion or intention to have been expressed.

Illustrations:

4. A, in order to induce B to buy a horse, falsely states that a veterinary surgeon a week before had examined the horse and had pronounced it sound. Unless B knows of something that might have changed the horse's condition in the interim, B is justified in interpreting A's statement as implying that the horse is sound at the time of the sale.

5. A tells B that C had the day before offered him \$2000 for a particular piece of land. In the absence of anything known to him that might indicate the contrary, B is entitled to assume that C's opinion as to the value of the land is unchanged.

h. Misrepresentation causing physical harm. This Section (and this Chapter) covers pecuniary loss resulting from a fraudulent misrepresentation, and not physical harm resulting from the misrepresentation. As to the latter, see § 557A, which also covers the economic loss deriving from the physical harm. This type of economic loss is not intended to be included in the term, pecuniary loss, as used in this Chapter. See also § 310 (liability in negligence for a conscious misrepresentation involving risk of physical harm) and § 311 (negligent misrepresentation involving risk of physical harm).

§ 533. Representation Made to a Third Person

The maker of a fraudulent misrepresentation is subject to liability for pecuniary loss to another who acts in justifiable reliance upon it if the misrepresentation, although not made directly to the other, is made to a third

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person and the maker intends or has reason to expect that its terms will be repeated or its substance communicated to the other, and that it will influence his conduct in the transaction or type of transaction involved.

Caveat:

The Institute expresses no opinion on whether the liability of the maker of a fraudulent representation may extend beyond the rule stated in this Section to other persons or other types of transactions, if reliance upon the representation in acting or refraining from action may reasonably be foreseen.

Comment:

a. On what constitutes justifiable reliance, see §§ 537 to 545A.

b. The rule stated in this Section is a special application of that stated in § 531. It is stated in a separate Section in order to make it clear that the rule applies when the misrepresentation is made to a third person. The Comments and Illustrations under § 531 are therefore applicable to this Section, so far as they are pertinent.

c. *Inducing action between third persons.* The rule stated in this Section is applicable not only when the effect of the misrepresentation is to induce the other to enter into a transaction with the maker, but also when he is induced to enter into a transaction with a third person.

d. *Reason to expect repetition.* In accordance with Comment d under § 531, it is not enough to make the rule stated in this Section applicable that the maker of the misrepresentation does recognize, or should recognize, the possibility that the third person to whom he makes it may repeat it for the purpose of influencing the conduct of another. He must make the misrepresentation with that intent, or must have information that gives him special reason to expect that it will be communicated to others, and will influence their conduct.

If the misrepresentation is made for the purpose of having it communicated, the maker is subject to liability. Thus one who, to aid a friend in selling his land, gives him for transmission to a prospective purchaser a fraudulent misrepresentation as to the quantity or quality of the land, is subject to liability to the purchaser under the rule stated in this Section. On the same basis, an architect who gives a fraudulent certificate as to the amount of work done to a builder for use in obtaining an advance from

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a bank is subject to liability to the bank. This is also true of one who supplies a fraudulent abstract of title to be transmitted to a prospective purchaser or mortgagor.

The liability, however, extends beyond those whom the maker of the misrepresentation intends to reach or to influence. It includes those whom he has reason to expect it to reach and influence, although he does not make the misrepresentation with that intention or purpose. If he is aware of the intention of the third person to make use of the misrepresentation by communicating it to others, he has a special reason to expect that it will be so communicated and will be relied on. There may be other circumstances that give him reason to expect the repetition, as when, for example, he is informed that the other is interested in the matter misrepresented and proposes to make inquiry of the third person for guidance in his conduct.

e. Maker's interest in the transaction. As stated in Comment *d*, the fact that the maker of the misrepresentation has no interest in the transaction does not take the case out of the rule stated in this Section. However, the fact that the maker has an advantage to gain, even though it is in some other transaction, by furnishing the misrepresentation for repetition to the third person is of great significance in determining whether he has reason to expect that the original recipient should so repeat it. Thus, the customary practice of bankers who purchase bonds of a corporation, to summarize reports made by the corporation to them in the prospectus that they issue to the investing public, will support a finding that the officers of the corporation have reason to expect the substance of their reports to be communicated to the investing public in order to influence the public's purchase of the bonds from the bankers. These considerations apply with added force when the corporation has an indirect interest in the sale of the bonds to the investing public because of the bankers' agreement to take a further issue of bonds when the first issue is distributed to the public.

f. Misrepresentation to credit-rating company. One of the situations to which the rule stated in this Section is frequently applied is where misrepresentations are made to a credit-rating company for the purpose of obtaining a credit rating based on them. In this case the maker is subject to liability to any person who may be expected to and does extend credit to him in reliance upon the erroneous rating so procured. The fact that

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the rating company does not communicate the figures misstated by the maker of the misrepresentations is immaterial. It is enough that their substance is summarized with reasonable accuracy or that the rating given expresses the effect of the misstatements made. The fact that the misrepresentations are made to a company that purports to give only credit ratings is usually sufficient to justify a finding that their purpose is to obtain credit through the unwarranted ratings and unless the circumstances are sufficient to show some further reason to expect action the maker is subject to liability only to those who extend credit to him in reliance upon the ratings. On the other hand, if the company is one whose ratings purport to show the general financial position of those who make reports to it, the maker of the misrepresentation is subject to liability to anyone who in reliance upon the rating deals with him in any one of the ways in which the maker's financial position is material.

g. Repetition to unidentified person. Although the maker of the representation is liable only if it is repeated to a person to whom he intends or has reason to expect to have it repeated, it is not necessary that he have any particular person in mind. It is enough that he intends or has reason to expect to have it repeated to a particular class of persons and that the person relying upon it is one of that class. Thus, if a firm of accountants employed to audit the books of a corporation gives a certificate fraudulently overstating its assets, knowing that the corporation intends to make use of it to obtain a loan, it is immaterial that the identity of the prospective lender is not known to the accountants. Indeed, even though the audit is asked for the purpose of obtaining a particular loan from a particular bank, the circumstances may justify a finding that the maker was aware that the identity of the particular bank was immaterial, and hence that he had reason to expect that the certificate would be used by the corporation to obtain a loan of a similar amount from any bank. In this case it makes little or no difference to the accountants whether the bank which advances the money is one bank or another. The important thing is that they are aware of the intent to obtain a loan from some bank. On the other hand, if the certificate is used by the corporation, not to obtain a loan in the contemplated amount, but obtain unlimited credit, the transaction is of a different type, and there is no liability. (See Comment *f* under § 531).

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Comment on Caveat:

h. A developing trend toward extending the scope of liability in this area of the law may eventually extend beyond the rule stated in this Section. The Section is not intended to foreclose or discourage further developments. The Caveat therefore leaves open the issue. For elaboration, see § 531, Comment *h*.

TITLE C. JUSTIFIABLE RELIANCE

§ 537. General Rule

The recipient of a fraudulent misrepresentation can recover against its maker for pecuniary loss resulting from it if, but only if,

(a) he relies on the misrepresentation in acting or refraining from action, and

(b) his reliance is justifiable.

Comment:

a. The recipient of a fraudulent misrepresentation can recover from the maker for his pecuniary loss only if he in fact relies upon the misrepresentation in acting or in refraining from action, and his reliance is a substantial factor in bringing about the loss. (See § 546 and Comments). If the recipient does not in fact rely on the misrepresentation, the fact that he takes some action that would be consistent with his reliance on it and as a result suffers pecuniary loss, does not impose any liability upon the maker.

b. The recipient must not only in fact rely upon the misrepresentation, but his reliance must be justifiable. The rules that determine whether he is justified in reliance upon various types of misrepresentations are stated in §§ 538 to 545 and in § 547.

Griffith v. Byers Constr. Co. of Kansas, Inc.

Supreme Court of Kansas, 1973.

212 Kan. 65, 510 P.2d 198.

FROMME, JUSTICE. The purchasers of new homes in Woodlawn East Addition, City of Wichita, Kansas, brought separate actions for damages because of the saline condition of the soil of their homesites. These actions were filed on alternative theories, (1) breach of an implied warranty of fitness and (2) fraud in the concealment of a material matter. The actions were brought against the developer. This appeal is from an order granting summary judgments in favor of the developer, Byers Construction Co. of Kansas, Inc. (Byers).

The petitions allege that Byers developed and advertised the addition as a choice residential area. Prior to the time of development the addition was part of an abandoned oil field which contained salt water disposal areas which Byers knew or should have known would not sustain vegetation because of the saline content of the soil. It was alleged that Byers graded and developed the whole addition for homesites in such a manner that it became impossible for a purchaser to discover the presence of these salt areas. It further appears from allegations in the petitions and testimony in depositions that each of the plaintiffs selected a homesite which was located within a salt water disposal area. After houses were constructed attempts

to landscape the homesites failed. Grass, shrubs and trees were planted and died because of the saline content of the soil. * * * No inquiry was made and no assurance was given by Byers on soil fertility.

The facts of this case appear to be unique for, although many cases can be found on a vendor-builder's liability for the sale of a defective home no cases are cited and we find none which discuss a developer's liability for defects arising from sterility of soil. The saline content of the soil of these homesites does not affect the structural qualities of the homes. The allegations of the petitions and deposition testimony indicate that landscaping is either impossible or highly expensive.

A real estate developer by subdividing and offering lots for sale as choice residential homesites does not by implication warrant the fertility of the soil of said lots. Liability on an implied warranty of soil fertility cannot reasonably be imposed upon the real estate developer in this case. * * *

Our next inquiry is directed to the claims based on fraud. The trial court held as a matter of law no claims for fraud could be maintained because of lack of privity between the developer and these appellants. The residential lots were sold to the builders who in turn constructed the houses and then deeded the improved lots to the appellants. * * *

The allegations of fraud appear to be viable issues for trial if nondisclosure of a known material defect in the lots constitutes actionable fraud as to the appellants.

This court has held that the purchaser may recover on the theory of fraud from a vendor-builder for nondisclosure of defects. In *Jenkins v. McCormick*, 184 Kan. 842, 339 P.2d 8, it is stated:

"Where a vendor has knowledge of a defect in property which is not within the fair and reasonable reach of the vendee and which he could not discover by the exercise of reasonable diligence, the silence and failure of the vendor to disclose the defect in the property constitutes actionable fraudulent concealment." * * *

This *Jenkins* rule approximates that stated in Restatement (Second) of Torts, § 551:

"(1) One who fails to disclose to another a thing that he knows may justifiably induce the other to act or refrain from acting in a business transaction is subject to the same liability to the other as though he had represented the nonexistence of the matter that he has failed to disclose, if, but only if, he is under a duty to the other to exercise reasonable care to disclose the matter in question.

"(2) One party to a business transaction is under a duty to disclose to the other before the transaction is consummated. * * *

"(e) Facts basic to the transaction, if he knows that the other is about to enter into it under a mistake as to them, and that the other, because of the relationship between them, the customs in the trade or other objective circumstances, would reasonably expect a disclosure of those facts."

* * * We see no reason why the rule in *Jenkins* should not be extended in the present case to a developer of residential lots.

The appellee Byers next contends, without agency, there can be no privity and without privity there can be no duty to disclose. Here, of course, appellants never dealt with the appellee, Byers. The duty to disclose the saline nature of the soil must extend to appellants if their fraud claims are to be upheld. However, the doctrine of privity provides no defense to appellee Byers if appellants were within a class of persons appellee intended to reach. * * *

Under the alleged facts of our present case, accepting the same in the light most favorable to the appellants, we must assume the appellee, Byers, had knowledge of the saline content of the soil of the lots it placed on the market. After the grading and development of the area this material defect in the lots was not within the fair and reasonable reach of the vendees, as they could not discover this latent defect by the exercise of reasonable care. The silence of the appellee, Byers, and its failure to disclose this defect in the soil condition to the purchasers could constitute actionable fraudulent concealment under the rule in *Jenkins v. McCormick*, supra. One who makes a fraudulent misrepresentation or concealment is subject to liability for pecuniary loss to the persons or class of persons whom he intends or has reason to expect to act or to refrain from action in reliance upon the misrepresentation or concealment.

Of course, the fraudulent concealment to be actionable has to be material to the transaction. A matter is material if it is one to which a reasonable man would attach importance in determining his choice of action in the transaction in question. (Restatement (Second) of Torts, § 538.) There is little doubt in this case a prospective purchaser of a residential building site would consider the soil condition a material factor in choosing a lot on which to build his home. It materially affected the value and acceptability of the homesite.

As to privity we do not believe it is important to categorize its existence under a particular legal theory. Suffice it to say the appellants were in that class of persons desiring building lots in a choice residential area whom appellee intended and had reason to expect would purchase and build their homes. The fact that title was first taken in the names of the builders did not change the identity of those who would be ultimately affected by any fraudulent misrepresentations or nondisclosure of material defects in the lots. The building contractors were acting on behalf of their respective purchasers as a conduit or temporary way station for the legal title which, it was understood, would pass on completion of the homes to the appellants. There is no lack of privity in this case which would prevent causes of action based on fraud, and, in this, the district court erred in entering summary judgments for the appellee, Byers. * * *

The order of the district court entering summary judgment in favor of the appellee is affirmed as to those claims based on implied warranty but reversed as to the alternative claims based on fraud, and these cases are

remanded with instructions to proceed in accordance with the views expressed herein.

NOTES AND QUESTIONS

1. The principal case was applied in *Ensminger v. Terminix Intern. Co.*, 102 F.3d 1571 (10th Cir. 1996), where the buyers of a home, found to be infested with termites, brought an action in fraudulent misrepresentation against the termite company that, at the request of the seller, had inspected the house prior to its sale. The court stressed the unequal access to information in the hands of a specialist on whom reliance is rested.

2. The duty to disclose material information is much debated and replete with contradictory law. The information may be possessed exclusively by the buyer or by the seller. Sellers knowing of a termite infestation are often obligated to disclose; buyers knowing of particularly valuable gold deposits on the properties are generally found not to owe duty to disclose that information to the seller. When is it that parties assume the risk that information will not be disclosed?

3. A person in the contemplation of the provider of the information who will act upon the information as given, although not directly given to that person, may have an action against the information provider in both fraudulent and negligent misrepresentation. Thus, the issuer of a letter of credit intended to be acted upon for a third party in a transaction may be liable for a fraudulent and negligent misrepresentation. See *Banca Del Sempione v. Provident Bank of Maryland*, 75 F.3d 951 (4th Cir. 1996) (applying Maryland law). The scope of liability is more narrowly circumscribed for fraudulent misrepresentation because of the intentional core of the tort. Thus, in the classic case of *Peek v. Gurney*, [1893] 6 H.L. 377, corporate directors prepared a prospectus to induce the public to buy stock in the company. It was held that no liability would attach to persons who bought the stock from a stockholder. Under the Restatement (Second) of Torts § 531, a person who makes a misrepresentation is liable to the person or class of persons the maker intends, or "has reason to expect" will act in reliance upon the misrepresentation. Foreseeability alone is not sufficient; the tortfeasor must have information that would at least lead a reasonable person to conclude that there is an "especial" likelihood that it would influence persons in plaintiff's position. See *Ernst & Young, L.L.P. v. Pacific Mut. Life Ins. Co.*, 51 S.W.3d 573 (Tex. 2001). With the more expansive definition of intent in the modern law, the courts, as in *Banca Del Sempione*, have extended the range of persons able to recover in fraudulent misrepresentation. Note Cardozo's recognition of the limits of liability in *Ultramares*, *infra* page 1094.

TITLE B. EXPECTATION OF INFLUENCING CONDUCT

§ 531. General Rule

One who makes a fraudulent misrepresentation is subject to liability to the persons or class of persons whom he intends or has reason to expect to act or to refrain from action in reliance upon the misrepresentation, for pecuniary loss suffered by them through their justifiable reliance in the type of transaction in which he intends or has reason to expect their conduct to be influenced.

Caveat:

The Institute expresses no opinion on whether the liability of the maker of a fraudulent representation may extend beyond the rule stated in this Section to other persons or other types of transactions, if reliance upon the representation in acting or in refraining from action may reasonably be foreseen.

Comment:

a. This Section deals with the persons to whom the maker of a fraudulent misrepresentation may be liable. The general rule of liability for fraudulent misrepresentation is stated in § 525. As to what constitutes a fraudulent misrepresentation, see § 526. As to the extent of liability for negligent misrepresentation, see § 552.

b. *Unintended and unexpected persons.* The rule stated in this Section governs the liability of the maker of a fraudulent misrepresentation to those plaintiffs whom he intends or has reason to expect to act, or to refrain from action, in reliance upon it. If the maker neither intends nor has reason to expect that the misrepresentation will reach a particular person or class of persons or that they will act or refrain from acting in reliance upon it, the fact that it does reach them and they do so act does not bring him within the rule stated in this Section. In

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this respect, the rule stated in this Section as to liability for pecuniary loss is somewhat more narrow than that stated in § 310, as to the liability for conscious misrepresentation resulting in physical harm. (See Comment *d* below).

Illustrations:

1. A, an agent of X Company, is seeking to sell stock owned by the company to B. For this purpose he makes fraudulent statements concerning the character of the stock to B, in the presence of C. A does not desire to sell the stock to C, and has no reason to know that C has any interest in it. In reliance upon A's statements, C purchases the stock directly from X Company, and suffers pecuniary loss. A is not liable to C under the rule stated in this Section.

2. A makes fraudulent statements concerning the financial standing of B to C and asks him to repeat them to D for the purpose of inducing D to extend credit to B. A does not intend and has no reason to expect that C will repeat the statements to any one other than D. C repeats them to E, who relies upon the statements and extends credit to B, and as a result suffers pecuniary loss. A is not liable to E under the rule stated in this Section.

3. A, seeking to sell corporate stock to B, C and D, sends them a private prospectus marked "Confidential," in which he makes fraudulent statements concerning the financial condition of the corporation. A does not intend and has no reason to expect that the prospectus will be shown to any one else. B exhibits it to E, who in reliance upon the fraudulent statements comes to A and buys some of the stock from him, without mentioning the fact that he has seen the prospectus. A is not liable to E under the rule stated in this Section.

c. *Intended results.* A result is intended if the actor either acts with the desire to cause it or acts believing that there is a substantial certainty that the result will follow from his conduct. (See § 8A). Thus one who believes that another is substantially certain to act in a particular manner as a result of a misrepresentation intends that result, although he does not act for the purpose of causing it and does not desire to do so.

d. *"Reason to expect."* 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. (Compare, in § 12(1), the meaning of "reason to know.")

In order for the maker of a fraudulent misrepresentation to have reason to expect that it will reach third persons and influence their conduct it is not enough that he recognizes, or as a reasonable man should recognize, the risk that it may be communicated to them and they may act upon it. When physical harm results from the misrepresentation, the maker may be liable under the rules stated in §§ 310 and 552A. When only pecuniary loss results, the magnitude of the extent to which misrepresentations may be circulated and the losses that may result from reliance upon them has induced the courts to limit the liability to the narrower rule stated in this Section.

Virtually any misrepresentation is capable of being transmitted or repeated to third persons, and if sufficiently convincing may create an obvious risk that they may act in reliance upon it. (See Illustrations 1 to 3, above). This risk is not enough for the liability covered in this Section. The maker of the misrepresentation must have information that would lead a reasonable man to conclude that there is an especial likelihood that it will reach those persons and will influence their conduct. There must be something in the situation known to the maker that would lead a reasonable man to govern his conduct on the assumption that this will occur. If he has the information, the maker is subject to liability under the rule stated here. For example, one who gives fraudulent information concerning his finances to a commercial credit agency cannot be heard to say that he does not expect that it will be communicated to its subscribers.

e. Class of persons. The maker may have reason to expect that his misrepresentation will reach any of a class of persons, although he does not know the identity of the person whom it will reach or indeed of any individual in the class. Thus the business man who furnishes fraudulent information concerning his credit to the commercial credit agency has reason to expect that it will reach and influence any subscriber of the agency who may be interested in extending credit to him, although he does not know who the subscribers are. The class may include a rather large group, such as potential sellers, buyers, creditors, lenders or investors, or others who may be expected to enter into dealings in reliance upon the misrepresentation.

Illustrations:

4. A, a certified public accountant, fraudulently certifies an erroneous balance sheet for B Company. A is informed that B Company intends to exhibit the balance sheet to one or more of a group of banks or other lenders or investors for the purpose of obtaining a loan. A does not know the identity of any of the persons whom B Company may decide to approach. B Company exhibits the balance sheet to C Company, which, in reliance upon it, makes a loan to B Company, and as a result suffers pecuniary loss. A is subject to liability to C Company.

5. A, an architect, fraudulently furnishes erroneous specifications for a building to B, who is under contract to construct it. A is informed that B intends to obtain bids from subcontractors for work on the building as called for by the specifications, but A does not know the identity of any of the persons who may bid. B publishes an invitation for bids. In response to it C, in reliance upon the specifications, bids for the plumbing work on the building, is awarded the contract and as a result suffers pecuniary loss. A is subject to liability to C.

f. *Specific individuals.* A fortiori, the maker of the fraudulent misrepresentation is subject to liability to a specific, known and identified person if he knows that the representation is likely to reach that person, and knows of any special reason to expect that he will act or refrain from action in reliance upon it.

Illustration:

6. The same facts as in Illustration 1, except that A knows when he makes the statements that C is interested in buying some of the land, and has been making inquiries about the matter stated. A is subject to liability to C.

g. *Type of transaction.* The liability under this Section of the maker of a fraudulent misrepresentation is also limited to pecuniary losses suffered in the type of transaction in which he intends or has reason to expect the conduct of others to be influenced. On "intends" and "has reason to expect," see Comments c and d above.

This does not mean that the transaction into which the plaintiff enters must be identical with that contemplated by the defendant. It may differ in matters of detail or in extent, unless these differences are so great as to amount to a change in the

essential character of the transaction. Whether it does so may be to a considerable extent a matter of degree. Thus one who expects a mortgage in the amount of \$10,000, secured by particular land, is not relieved from liability when the mortgage is in fact made for \$20,000 and secured by the same land; but when the result is a bond issue in the amount of \$1,000,000, secured by all of the assets of a corporation, the transaction is of a different type. No definite rules can be stated, and the question in each case is whether the transaction that in fact results is sufficiently similar to that which the defendant has reason to expect to hold him responsible for the loss incurred in it.

Illustration:

7. A, seeking to sell a lot owned by him, publishes in newspapers fraudulent statements concerning the character of all lots in the real estate development in which it is located. B reads these statements, and in reliance upon them purchases another lot in the same development from C. A is not liable to B under the rule stated in this Section.

Comment on Caveat:

h. The area of the law covered by this Section has been undergoing change in the direction of liberalizing the rules as to the expected reliance. This Section is not intended to foreclose or discourage further developments. The Caveat therefore leaves open the question of whether there may be cases in addition to those covered by the rule stated in this Section, in which there is no special reason to expect that a given person or a class of persons will take action or refrain from it in reliance upon the fraudulent representation, but it is foreseeable that they may do so, and the circumstances are such that the maker of the presentation may be held subject to liability. On these cases the Institute takes no position.

Illustrations:

8. A, seeking to sell sheep to B, fraudulently tells C, who is B's agent negotiating the purchase, that the sheep are physically sound, although they are in fact diseased. A does not intend that C shall buy the sheep and has no reason to know that he has any interest in them. C buys the sheep for B, and then, in reliance upon A's statement, himself buys the sheep from B and as a result suffers pecuniary

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loss. The Institute expresses no opinion as to whether A is subject to liability to C.

9. A, seeking to float an issue of bonds on his land, issues circulars that fraudulently state that the mortgage securing the bonds is a first mortgage and that there is no prior lien. There is in fact a prior vendor's lien on the land. B reads one of the circulars and in reliance upon it comes to A and buys from him a part of the land, without mentioning the circular. As a result B suffers pecuniary loss. The Institute expresses no opinion as to whether A is subject to liability to B.