DAMAGE AS REQUISITE TO RESCISSION FOR MISREPRESENTATION

Glenn A. McCleary

University of Missouri Law School

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THE decadence of equity during the nineteenth century has long been an accepted phenomenon. The attempt to make law coincide with morals in the seventeenth and eighteenth centuries was followed in the nineteenth century by the gradual fixing of rules and a consequent stiffening of the legal systems, in which moral principles became lost in a mass of rules derived from such principles. What were once equitable doctrines tended to become mechanical rules. The former strength of equity has been weakened in the various jurisdictions, due in a large measure to the administration of law and equity by the same bench. The judges, familiar with a single body of precedents, tended to treat a subject in a crystallized fashion, overlooking the fact that it may have had different contents in equity and in law when these two branches of the law were administered separately. In general, a legally protected interest tends to possess the same incidents, whether it is invoked in law or in equity, except that equity will afford its own distinctive remedies. Other agencies assisting in this tendency, as pointed out by Dean Pound, are the adoption of the theory of binding precedents, resulting in “case-law equity,” and the procedural changes whereby the distinction between law and equity has been abolished, so that both or either may be administered in the same court. Among the early movements in this direction was the adoption by the common-law courts of the equitable defense of fraud.

*Professor of Law, University of Missouri Law School. B.A., Ohio Wesleyan; J. D., Michigan; S.J.D., Harvard. Author of articles published in various legal publications.—Ed.

and misrepresentation. All of these factors have given renewed vigor to the maxim, *Aequitas sequitur legem.*

One effect of this development is found in the requirement, stated by many courts, that damage must be shown before relief by way of rescission may be had from undertakings which have been induced by a misrepresentation. It is the purpose of this paper to present the legal doctrines and decisions which have dealt with this requirement in an effort to discover the rationale behind it. Should damage always be requisite to rescission for misrepresentation, whether rescission is sought affirmatively or is used in defense to an action brought on the transaction?

I

**Rescission in Equity Compared with Legal Liability for Deceit**

Perhaps it is too late in the day to expect, says Bower, however desirable it may be, that the appellate tribunals of the land may in some case yet to be decided immortalize themselves by boldly discarding the word fraud, and proclaiming its futility. Its meaning includes

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2 See Chafee, "Does Equity Follow the Law of Torts?" 75 Univ. Pa. L. Rev. 1 at 2 (1926). Even when equity was administered as a separate branch of the law, "the Chancellor did not wish to disregard legal rights or add new rights to them unless he saw some strong reason for doing so. Such reluctance was natural and the following reasons for it may be suggested. First, the frequent suspicion and hostility of the common law courts and lawyers toward Chancery made it imprudent to start fresh conflicts unless the proposed departure from legal rules was demanded by a definite body of opinion or was clearly necessary to avoid serious injustice. Secondly, the adoption of legal rules and analogies was doubtless due in part to that economy of effort, sometimes degenerating into pure laziness. . . . Thirdly, wherever two sides of Westminster Hall took different or conflicting views of the same facts, uncertainty and confusion would follow, a result not to be incurred on slight grounds. Consequently, while Chancery would willingly afford new remedies to enforce existing primary rights, which were not adequately safeguarded at law, a wise Chancellor would be slow either to abrogate such existing primary rights by his interference or to add to their number, and when a change was made he would follow the legal system as closely as the accomplishment of his purpose permitted in order to avoid antagonism and confusion so far as possible." But how much more applicable are these observations in a legal system where the same court administers both law and equity.

Bower, *Actionable Misrepresentation,* 2d ed., 404ff. (1927). Publicists and judges have indulged in the fruitless pastime of defining fraud in all centuries. See a collection of the definitions evolved, Moncreiff, *Law of Fraud* 28–31 (1891). Many writers have pointed out the desirability of having no comprehensive definition of fraud, even if this were possible; that if there were a technical definition, and everything had to come within the scope of the words before the law could deal with it as fraud, the very definition would give to the crafty just what they wanted, as it would tell them precisely how to avoid the grasp of the law. See Story, *Equity*
so many different hues and forms that the courts must confine themselves to comparatively few general rules for its discovery and defeat. It is generally understood that the facts and circumstances peculiar to each case, in connection with their legal remedies, are permitted to bear heavily on the judgment of the court or jury in determining whether this ambiguous thing, called fraud, is present or absent. For the purposes of this paper, in an endeavor to avoid the ambiguities of a loose terminology, misrepresentations will be identified according to the remedies employed: as the basis for rescission; and as the basis for liability in the tort of deceit.

The treatment of the two remedies, for the purposes of comparison, must be confined to cases in which a consensual relationship has been entered into as a result of the misrepresentation. If no consensual relationship has resulted, obviously rescission is not an available remedy. Both remedies are designed to restore as fully as possible the balance in the legal relations between the representee and the representor which has been disturbed by a misrepresentation. This balance, in legal theory, is restored in the tort action of deceit by giving the representee a sum of money. The representee retains the consideration or subject matter which he has received from the transaction, the past is accepted and recognized, the change of position is permitted to stand; but he is compensated for the harm which has resulted from the misrepresentation.

Since the tort action aims at repairing the injury done by the misrepresentation, there must be damage to sustain the action. The action for damages for deceit differs from some intended wrongs in that no damage is presumed, and nominal damages are not recognized. The harm is measured in some jurisdictions by the difference between what the plaintiff received and what he gave.

Jurisprudence, 13th ed., § 186ff. (1886); and Bisham, Principles of Equity, 10th ed., § 197 (1922) [§ 174 in 11th ed. (1931)]. Lord Chancellor Hardwicke in Lawley v. Hooper, 3 Atk. 279, 26 Eng. Rep. 962 (1745), said that the court very wisely had never laid down any general rule beyond which it would not go, lest other means of avoiding the equity should be found out. But the same Chancellor in Chesterfield v. Jansen, 2 Ves. Sen. 125 at 155, 28 Eng. Rep. 82 at 100 (1750), proceeded to classify several different kinds of fraud.

Sutherland, Damages, 4th ed., § 1171 (1916); and McCormick, Damages, § 121 (1935). See a collection of cases annotated in 57 A. L. R. 1142 (1928), on the measure of damages for fraud which induces the purchase of corporate securities.
of them. If he has lost nothing, he is not harmed. The aim of compensation, in tort theory, is to place the plaintiff in the position he would have been in if the injury had not occurred.\(^5\) In other jurisdictions the harm is measured by the difference between what the value of the article would have been if the article had measured up to the representations and the value of the article actually furnished. This rule protects not only the representee’s loss but gives protection to his interest in making an advantageous bargain. He is compensated for the loss of profits which he would have made had the facts been as he was led to believe.\(^6\) This is the measure of damages which is applied in contract law for the breach of contractual obligations. It projects the injured person to the position he would have occupied if the representations had been true.

Misrepresentations may produce other kinds of damage, since the totality of the harm may not be determined at the time of the transaction. The action of deceit includes these additional results, although the difficulty is obvious in determining whether certain results are to be treated as consequences of the representation. In determining the scope of these consequences, as in other fields of tort law, causation principles are applied to guide and limit the inquiry.\(^7\) It must appear that the tortious conduct has in fact caused the plaintiff’s damage, that it is of the general kind which made his conduct the basis of liability, and that it occurred in such a manner as to come within the rules of legal causation. Ordinarily, the value of the thing which one is fraudulently induced to purchase or receive in an exchange, as the basis for determining the damages recoverable for the fraud, is taken

\(^{5}\) This is the measure of damage laid down by the Supreme Court of the United States and by a minority of the state courts. Sigafus v. Porter, 179 U. S. 116, 21 S. Ct. 34 (1900) (false representations as to the extent and richness of the deposits of ore involved in the sale of a gold mine); Smith v. Bolles, 132 U. S. 125, 10 S. Ct. 39 (1889) (sale of stock); Towle v. Maxwell Motor Sales Corp., (C. C. A. 8th, 1928) 26 F. (2d) 209; Henderson v. Plymouth Oil Co., (D. C. Pa. 1926) 13 F. (2d) 932. For the decisions in New York, see 5 Corn. L. Q. 167 (1920); in Pennsylvania, see 73 Univ. Pa. L. Rev. 207 (1925).

\(^{6}\) 4 SUTHERLAND, DAMAGES, 4th ed., § 1172 (1916); McCormick, DAMAGES, § 122 (1935). On the measure of damage for fraud which induces the purchase of corporate securities, see annotation in 57 A. L. R. 1142 (1928). This measure of damages in deceit actions, although applied in the majority of jurisdictions, is considered by the writer to be unsound as a measure of compensation, the objective of tort remedies.

\(^{7}\) Bower, ACTIONABLE MISREPRESENTATION, 2d ed., §§ 146-150 (1927); Harper, TORTS, § 225 (1933); McCormick, DAMAGES, § 122 (1935); 2 Sedgewick, DAMAGES, 9th ed., § 441 (1912); 4 SUTHERLAND, DAMAGES, 4th ed., §§ 1163-1165, 1173-1178 (1916); and see 43 Harv. L. Rev. 328 (1929).
as of the time of the sale or exchange. But it is obvious that a strict application of this rule, without consideration of subsequent developments in fixing the amount of damage, would in effect deny relief in many cases. In the sale of securities, if they were worth the purchase price at the date of the purchase, the strict application of the rule would prevent recovery for loss due to inherent weakness of an investment, concealed by the representor or seller.

Such was the case of *Hotaling v. Leach & Co.*, where the plaintiff had purchased a bond for $980 for investment. The bond was one of a $5,000,000 issue of first lien bonds of a certain oil company, secured by a trust indenture on its property. Two years later, the company suffered financial troubles which resulted in the appointment of a receiver. The trust indenture was foreclosed, and the property sold at a forced sale to a bondholder's committee for $50,000. The plaintiff received $5.84 for his bond. The representations presented a picture which would lead an investor to believe that the security behind the bonds offered was far greater than was the fact. If conditions in the oil trade had not become demoralized, perhaps the oil company might have been sufficiently successful to pay the principal sum represented by the bond issue. This the court recognized as possible. The weakness was not of the type that might have produced a loss under all circumstances, but which did produce loss when conditions demanding greater financial strength than the company possessed arose in the trade. The court measured the loss proximately caused by the defendant's fraud as the difference between the price paid by the purchaser and the value of what he received when put to the use contemplated by the parties. In this case, that value had to be determined in the light of subsequent events. As long as the fraud continued to operate and induce continued holding of the bond, all loss flowing from that fraud was regarded as proximate. The loss sustained was directly traceable to the original misrepresentation as to the character of the investment which the plaintiff was induced to make. The decision shows the theory of causation carried out logically and, at the same time, it shows the dangers which are involved in following the effect of the misrepresentation over a period of time, especially in those jurisdictions in

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8 247 N. Y. 84, 159 N. E. 870 (1928). It is not uncommon for fraudulent sellers of stock to create an artificial market for the stock during the period in which they are selling it to the public by means of "pool" manipulations. If this market were used as the value of what the purchaser received, the remedy would not serve its function. Therefore, where the same fraudulent activities influence the market value of the stock, other means for valuation must be found.
which the damages are based on the represented value. But the limits of responsibility for consequential losses caused by the standard of proximateness gives opportunity for the exercise of judicial discretion in each case. 9

The other remedy, when there has been a consensual relationship induced by a misrepresentation, is rescission in equity and with it restitution. The function of rescission is to restore the balance in the relations between the parties which has been disturbed by the misrepresentation, by placing the parties substantially in their original positions. The past is undone and the status quo is reestablished. 10 If nothing of value has changed hands, the misrepresentation entitles the representee to treat the agreement as a legal nullity and gives him

9 A few cases have carried causation principles too far. See Fottler v. Moseley, 185 Mass. 563, 70 N. E. 1040 (1904), where plaintiff was induced by fraudulent representations to retain stock until it depreciated in value as a result of the embezzlement of an officer of the company. The court held that the risk of depreciation from whatever cause was a part of the legal consequences of the fraud. The decision was followed in David v. Belmont, (Mass. 1935) 197 N. E. 83, with which compare Morrell v. Wiley, 119 Conn. 578, 178 A. 121 (1935), where the depreciation in the value of stock was caused by subsequent events which seem to have no connection with, or relation to, the fraud. See the position taken by the Torts Restatement (Tentative Draft No. 13, 1936), § 625, and 45 YALE L. J. 1138 (1936). In the ordinary situation, however, damages flowing from the misrepresentation are easily traced. In Merguire v. O'Donnell, 103 Cal. 50, 36 P. 1033 (1894), the vendor of livestock who falsely represented that certain stock was free from certain disease was held liable for the loss of other animals in the herd which caught the disease, and for the value of a stable which the vendee had to burn to prevent further contagion. In Economy Hog & Cattle Powder Co. v. Compton, 192 Ind. 222, 135 N. E. 1 (1922), the seller of powder, falsely represented as a hog remedy, was held liable for hogs killed by the powder and for the cost of curing those injured. In Sampson v. Penney, 151 Minn. 411, 187 N. W. 135 (1922), the seller of infected bees was held liable for the damage to the buyer's other colonies. It has not been found difficult to trace the damages which result from selling diseased animals under fraudulent representations. See collection of the authorities in 34 L. R. A. (N. S.) 697 at 701 (1911). In Tuckwell v. Lambert, 5 Cush. (59 Mass.) 23 (1849), the seller of a vessel who falsely represented the age of the vessel was held liable when it was condemned in a foreign port. But as to the loss of profits as an element of damage for fraud of the seller as to the quality of goods purchased for resale, see collection of authorities in 28 A. L. R. 354 (1924). Occasionally, courts have applied the formula of the contract cases that the result must have been within the probable contemplation of the parties when the representation was made. See McCormick, DAMAGES, § 122, p. 460 (1925).

10 This remedy was recognized in the early Roman law and was designated "restituto in integrum." The emphasis was upon the restoration; rescission of the contract was merely an incident. But, as in our law, the relief was by an appeal to equity and, therefore, it was necessary to show equitable grounds. Dig. 4, 1; MacKeldy, ROMAN LAW, Dropsie's Translation, §§ 220-233 (1883); 1 CIVIL LAW, Scott's Translation, 262 (1932).
a defense to an action brought thereon. If something of value has changed hands and the agreement is not purely executory, the representee must restore or offer to restore what he has received before calling upon a court of equity to return him to his former position. The representor's position is not considered to be unduly prejudiced where each party returns to the other what he received in the transaction. The simplicity of the operation of the remedy is easily perceived by the absence of the problem of compensation. Certain problems of valuation may remain in instances where specific restitution on either side is impossible, or where there has been an intervening destruction or deterioration of the subject matter, or where the problem of special damage remains even after restitution has been accomplished; but these are incidental and do not affect the application of the remedy in the ordinary case.


12 A problem of balancing the equities may be involved here. The inability to restore the parties to their original position may be the result of the fault of the representor, or of the fault of the rescinding party, or the fault of neither party. See a discussion of this problem, 29 Col. L. Rev. 791 (1929); 32 Mich. L. Rev. 550 (1934).

13 It has been contended that an action of deceit cannot be brought following rescission because, in theory, there is no damage to be proved since the representee is restored to his original position. But this overlooks special damages which may well be incurred as a result of the misrepresentation. If rescission has been granted for innocent misrepresentation, there will be an obstacle to a recovery on the tort theory for special damages in many jurisdictions. The deceit action for special damages in addition to rescission has been recognized in a number of cases: McRae v. Lonsby, (C. C. A. 6th, 1904) 130 F. 17 (expenses incurred in attempting to raise the hull of a ship); Linderman Machine Co. v. Hillenbrand Co., 75 Ind. App. 111, 127 N. E. 813 (1920) (freight charges and cost of installing a machine); Faris v. Lewis, 41 Ky. 375 (1842) (loss resulting to a buyer of a horse from the spread of an infectious disease to other horses); Copeland v. Reynolds, 86 N. H. 110, 164 A. 215 (1933); Waldman Produce Inc. v. Frigidaire Corp., 157 Misc. 438, 284 N. Y. S. 167 (1935) (value of produce lost as a result of failure of refrigerator sold to maintain required temperature). The last case cites many authorities. The problem is commented on in 29 Col. L. Rev. 791 (1929); 32 Mich. L. Rev. 113 (1933).

14 It is clear that it is not for the representor to question the choice of remedies which are available to the representee. In certain instances it may be a question of honor with him and not a matter of money consideration. If he is given cause by virtue of the misrepresentation to regret his association with an undesirable person, company or project, the law is not concerned with the reasons which cause the representee to exercise his rights in a certain way. In Fletcher v. Porter, 177 Wash. 560, 33 P. (2d) 109 (1934), the plaintiff sued in the alternative, for damages or for rescission. The
There are certain considerations and factors which make the rescission remedy far more adequate in performing this function held in common by the two remedies. The financial responsibility on the part of the representor being assumed, there is the inconvenience which may result from an attempt to satisfy the judgment, with the various problems which may arise in the attempted enforcement. Likewise, in cases where, subsequent to the misrepresentations, the representor has gone into bankruptcy, the tort claim is conspicuously inadequate. While there may be a provable claim under a quasi-contractual theory, yet the realization on the claim undoubtedly will be small. Where the goods have been obtained by fraudulent representations but they can be identified or the proceeds traced, a constructive trust may be imposed; the only question is whether it is a preference to place the representee in statu quo by returning the consideration or subject matter from the general assets, thus making him whole, but thereby reducing the assets for the other creditors who must share pro rata.

The court said that no reason could be seen why he could not, in a code state such as that in which the action arose, and, in order to avoid multiplicity of actions, sue in the same action in the alternative for the damage as the value of the property received from him, in case he could not be placed in statu quo. But the judgment in the alternative seems to permit the representor to select the remedy. Compare, Bacon v. Fox, 267 Mich. 589, 255 N. W. 340 (1934), in which the court reached the opposite result.

The problems of exemptions, fraudulent conveyances to conceal assets, the technical questions involved in the levy, sheriff’s return, details of the sale, and many similar problems are often serious obstacles to the effective enforcement of the judgment, or, at least, are potential issues for further litigation and inconvenience.

The rule which permits the owner of property converted to waive the tort and recover the property as on an implied contract is based on the ground that the representor’s estate has been unjustly enriched by the conversion. 39 Harv. L. Rev. 386 (1926); 10 A. L. R. 756 (1921), containing a collection of authorities on the problem. An interesting question arises where an action in tort has been started before the petition in bankruptcy has been filed. May the representee waive the tort and file his claim in assumpsit, or does the election of remedies preclude him? Compare Stalick v. Slack, (C. C. A. 8th, 1920) 269 F. 123, with In re International Match Corp., (C. C. A. 2d, 1934) 69 F. (2d) 73; Remington, Bankruptcy, 3d ed., § 770 (1923). As to whether a creditor who is compelled to file a claim under these circumstances may sue in tort for the additional damages which the quasi contractual claim would not take into account, see 31 Mich. L. Rev. 389 (1933).

It may be questioned whether or not the creation of a constructive trust or a preference, which is at the expense of the creditors, is a desirable thing. The considerations are between the general creditors who took a chance and the rescinding claimant who was misled by the bankrupt, thereby adding to the assets. Remington, Bankruptcy, 3d ed., § 1450 (1923); 32 Yale L. J. 267 (1923). But it is generally held that where a person makes material fraudulent representations as to his financial condition, and induces another to sell him goods, the seller is entitled to rescind and reclaim the goods from the purchaser’s trustee in bankruptcy.
But usually the representee can secure the return of the goods or proceeds, unless the equities of the creditors are stronger.  

The uneven operation of the two remedies, rescission and deceit, appears clearly in periods of rapidly fluctuating values. For example, in a sale of stock in a corporation, suppose there are misrepresentations which would enable the buyer to use either of these remedies. Suppose, also, before the misrepresentations are discovered, the market has declined. In this situation rescission is the only remedy which can approximate the restoration of the parties to their former positions, as the representee would be entitled to a return of his purchase money in the absence of factors affecting third persons. By way of damages, he would be limited to the difference between the real value and the represented value, or the difference between the actual value and the contract price, depending on the measure of damages in the particular jurisdiction. This, quite conceivably, could be much less than the damages which are actually suffered due to the decline in the market. In *Seneca Wire & Manufacturing Co. v. Leach & Co.*, the plaintiff

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18 But there may be other considerations which make it too late as against creditors to rescind for misrepresentation and to prefer a claim for moneys paid, even though the fraud is not discovered until a subsequent time, i.e., where the creditors have extended credit in reliance upon the additional resources which the representee reasonably may have caused them to believe the representor possessed. Stock subscriptions furnish this type of case. REMINGTON, BANKRUPTCY, 3d ed., § 990 (1923), and cases cited; 24 HARV. L. REV. 147 (1910). The same is true if third persons bona fide and for value acquire property or possessory rights in the goods obtained by the misrepresentation. These rights are valid as against the representee. As between the right of the defrauded vendor and an attaching creditor, see 12 MICH. L. REV. 595 (1914). As to the effect of receivership proceedings, see 42 HARV. L. REV. 129 (1928); 37 HARV. L. REV. 767 (1924); 45 YALE L. J. 942 (1936).

19 If the market decline may be treated as a legal consequence of the misrepresentations, the tort remedy may be as adequate. As to this possibility, see the discussion, supra, pp. 4-5.

20 247 N. Y. 1, 159 N. E. 70 (1928). The case is particularly interesting in that the court upheld the plaintiff's action at law to recover the purchase price. That he might have recovered in equity the consideration paid by him as a result of innocent misrepresentation is well recognized. Bloomquist v. Farson, 222 N. Y. 375, 118 N. E. 855 (1918). The court pointed out that as no equitable relief was required, it was inappropriate, if not impossible, for the plaintiff to maintain an action for rescission in equity. All that the plaintiff wanted was his money and the action at law was held, therefore, to be proper. The proof required was no different from that which would be required in equity. Since it would not be necessary, in order that a contract may be rescinded for fraud or misrepresentation, that the party making the representation should have known that it was false, the court held that the same rule applied to actions at law based upon rescission as well as to actions for rescission in equity. Under reformed procedure, it is quite desirable that the old distinction between suits in equity and actions at law should be disregarded where the ultimate aim of the
was told by the defendant’s representative that certain securities were a good investment and that application would be made, and later that such application had been made, to list them on the New York Stock Exchange. Relying on these representations the plaintiff purchased the securities. The corporation in which the plaintiff had invested subsequently failed. It was then learned that the securities had never been listed and the defendant had never intended to list them, although the good faith of the defendant’s representative was not questioned. The damage resulting from the falsity of the representations would be a small part of the actual loss to the representee, for the injury traceable to the misrepresentation is little more than nominal. On the other hand, rescission may operate unfairly where there is a general market drop, in that the purchaser would get his money which, due to fundamental changes in the economic structure, would be of greater value than had he obtained the very thing as represented. This operates to compel the representor to bear a loss not caused by his misrepresentation, but one caused by unforeseen and catastrophic changes in economic conditions. It would seem that, if possible, a court should take into account these factors in determining a just solution as to which party should bear this loss.

A further difference between the two remedies is seen where a transaction has been induced by innocent misrepresentations. Generally speaking, an honest statement of fact, believed to be true by the party making it, though made with a view to be acted upon, and a reliance upon it, will not, if it is in fact false, create liability for damages. It is usually said that the action for deceit is limited to cases where the defendant had a fraudulent state of mind. The House of Lords, in Derry v. Peek, settled the English law to the effect that the action for deceit cannot be maintained by one who has been misled into a disadvantageous commercial venture unless the defendant is guilty of conscious misrepresentation. A large number of American jurisdictions have followed this doctrine and require this conscious dishonesty.
Perhaps the reason for this is that the interest which is involved did not receive protection until quite late in our legal history. But it is a real burden on the representee to establish this very essential element, and the turning point of many cases, in which a recovery has been denied, has hinged here. Thus, the holding in *Derry v. Peek* prevents relief in those cases where the representee has not been able to convince a jury that there was more than an innocent misrepresentation. If, however, the party who has been misled by the misrepresentation seeks, not damages, but the protection of the courts against the other party, in order to prevent him from deriving an advantage from his misrepresentations, it matters not whether the misrepresentations were with knowledge of any sort or were done in perfect good faith and innocence, with full and just belief in their truth. On the very same evidence produced in *Derry v. Peek*, the representee would have been entitled to restitution. To refuse it would virtually amount to the court’s lending its aid to what now, on the allegation that the representations were false, is a known wrong; for the party complained of is now, at all events, apprised of the untruth of the representations, and it is inequitable for him to press his advantage longer.

The other group treats a statement of fact made as of the representor's knowledge as substantially tantamount to a warranty that a fact exists. These views are criticised from the standpoint that they have abandoned conscious misrepresentation as the basis of liability, and have in fact recognized a new basis of liability, upon principles substantially different from those previously applied in the tort action, by Bohlen, "Misrepresentation as Deceit, Negligence, or Warranty," 42 HARV. L. REV. 733 (1929). A full presentation of the American doctrines is given in HARPER, TORTS, §§ 221-222 (1933).

The interest protected by the deceit action is the representee's interest in economic transactions and enterprises, as well as the social interest in the security of transactions. Or it may be said that it is his interest in making a free choice and in exercising his own judgment in making decisions with respect to his transactions and enterprises. To cheat a man by deceptive practices is regarded by the law as a wrong. But only since the middle of the last century has the tort action for fraud been understood in its present meaning. It has been said that the case of Taylor v. Ashton, 11 M. & W. 401, 152 Eng. Rep. 860 (1843), marks the full maturity of the doctrine. But courts were accustomed in tort cases to finding a formal statement, at least, of malice in analogous cases of defamation and malicious prosecution.

This assumes that the proceeds could have been traced and that no superior equities of third persons had intervened, as to which, see supra p. 8. Because of the failure to obtain the necessary consent of certain agencies, the company was unable to carry out its plans and, as a consequence, was wound up.

Reece River Silver Mining Co. v. Smith, L. R. 4 H. L. 64 (1869); Redgrave v. Hurd, 20 Ch. D. 1 (1881); Arkwright v. Newbold, 17 Ch. D. 301 at 320 (1880); Leary v. Geller, 224 N. Y. 56, 120 N. E. 31 (1918); Bloomquist v. Farson, 222 N. Y. 375, 118 N. E. 855 (1918); 2 POMEROY, EQUITY JURISPRUDENCE, 4th
It is somewhat questionable whether rescission is necessary to do complete justice to the representee in all cases. It seems clear that, if the representation is fraudulent, it ought always to entitle the representee to rescind and refuse to carry out the bargain; yet there may be situations, where the representation is made innocently, that ought to be distinguished. Some courts have seen this distinction and have held, where the misrepresentation was innocently made, that if the discrepancy is relatively unimportant and readily measurable in money, rescission may be denied. Strong support for such a position is seen in those cases where a vendor who has innocently misrepresented the subject matter of the contract may still have specific performance by accepting an abatement of the purchase price. If it is a small deficiency in the acreage of a farm, the representee is obtaining substantially the very thing he wanted, and the court can readily measure the deficiency.

ed., § 885 (1918); Williston, “Liability for Honest Misrepresentation,” 24 Harv. L. Rev. 415 (1911); 3 Williston, Contracts, §§ 1500 ff. (1920), citing several cases which have not distinguished between the two remedies on the question of innocent misrepresentation. See, also, the collection of cases dealing with this question in stock subscriptions, in 73 A. L. R. 1120 at 1143 (1931). Another distinction is seen in the desire of equity to prevent the consequences of misrepresentations, where it is made possible for the representee to secure relief when the door to damages at law would be closed. In applying the rules as to the period of limitations to actions, equity has constantly held the door open, even though the period had run against the action at law. For the history and development of this question, together with a collection and analysis of the various statutes of limitations, see Dawson, “Undiscovered Fraud and Statutes of Limitations,” 31 Mich. L. Rev. 591 (1933). In general, it may be said that the rule of the courts of equity is that the cause of action or suit arises when and as soon as the party has a right to apply to a court of equity for relief. Story, Equity Jurisprudence, 13th ed., § 1521 ff. (1886).

26 Labar v. Lindstrom, 158 Minn. 453, 197 N. W. 756 (1924). The plaintiff contracted to purchase a house and lot for $17,000. The material and workmanship in the building were represented to be first-class. About two years later a defect was discovered which could be remedied at an expense of $275. The court pointed out that with this expenditure of money the house could be placed in the condition that the plaintiff expected it to be when he purchased it, and it would give him exactly what he expected to obtain. But where the misrepresentations are such that a reduction in price or an allowance for damages would not give the purchaser substantially what he bargained for, the court recognized an undoubted right to rescind, even if the representations were made in the belief that they were true. Straabe v. Jackson, 134 Minn. 179, 158 N. W. 915 (1916). To the same effect, see Murphy v. Sheftel, 121 Cal. App. 533, 9 P. (2d) 568 (1932); Baker v. Combs, 232 Ky. 73, 22 S. W. (2d) 442 (1930); Ziegler v. Stinson, 111 Ore. 243, 224 P. 641 (1924); and see the discussion in Voorhees v. Baier, 194 Iowa 1320, 191 N. W. 125 (1922), and compare Dubovy v. Woolf, 127 Me. 269, 143 A. 58 (1928), where a contract for the sale of a tenement building was rescinded even though the defects could have been repaired for $50, and the purchase price was $7750.
in the acreage with a corresponding reduction in the purchase price.\textsuperscript{27} In comparable situations, such a doctrine would seem reasonable as applied to rescission. But where the thing does not have a definite value or where the representee has received something substantially different in character from that which he expected, a reduction in price or an allowance for damages is not only based on conjecture largely, but the abatement or damage in the latter situation still leaves the representee with something substantially different than he bargained for.

There are certain disadvantages to the tort remedy which are inherent in the very nature of the remedy. There is clearly a difference between the situation where the representee has received an easily salable thing with a definite value, such as securities which are quoted...
on the exchange, and where he has received land or some other thing which either is not immediately salable or whose value is not readily ascertainable. In the latter case, to restrict a person to an action of deceit would frequently work a great hardship. How can damage be made out in such cases? In the absence of evidence as to the market value, the damage will be largely a matter of speculation. For commodities which are not standardized on the market, value is a mere inference as to the action of an imaginary purchaser, and the finders of the fact may reasonably differ within wide limits depending on the nature of the property. If the property is not salable, the value to the owner is taken as the standard of value. But the process for ascertaining the damage only sinks deeper into conjecture. Even though the securities are quoted on the exchange, if they have both an actual or intrinsic value and a market value, difficulties arise over which value will prevail as the basis of computation. The market price may have been influenced by the same representations on which the representee relied. On these facts it has been held that the actual or intrinsic value will be taken as the basis of computation, but again the damage will be somewhat speculative, although not to such a degree as in the other type of case where is a total absence of market price. Furthermore, the same difficulty is present in determining the represented value, where the measure of damage is the difference between what the rep-

28 For a discussion of the problem of value as a legal and as an economic conception, of market value, and of the problem where there is no market value, see McCormick, Damages, §§ 43-45 (1935). In the head note of § 46, it is said that:

"The market value of personal property may be proved by opinion evidence of those who are familiar with the selling prices of such property at the particular time and place, or by price lists and market reports proved to be such as are generally relied on in the trade. Where there is no market value or market value is inadequate, value to the owner may be shown by evidence of the original cost or the present cost to replace the property, together with proof of its qualities, condition, and depreciation, if any.

"The value of land may be proved by opinion evidence of those familiar with its value, by evidence of its location, area, and productiveness, and, in most states, by evidence of the prices paid on sales of similar land in the neighborhood within a reasonable time before or after the time of valuation."

29 Peck v. Derry, 37 Ch. D. 541 (1887); Whiting v. Price, 172 Mass. 240, 51 N. E. 1084 (1898); Morrow v. Franklin, 289 Mo. 549, 233 S. W. 224 (1921); 32 Mich. L. Rev. 968 (1934); and see the collection of cases on the problem in 57 A. L. R. 1142 at 1153 (1928). The factors involved in the determination of the adequacy of the remedy in damages are similar to the factors to be considered in determining the same question in specific performance cases as to contracts other than for the transfer of an interest in land. See Contracts Restatement, § 361 (1932).
resentee received and what he would have received had the representations been true. This will always be more or less speculative.

While damage is a vital problem in the tort cases, the problem before the court in rescission cases, assuming a misrepresentation of a material fact which has misled the representee, is whether or not the reasonable expectations of the representee induced by the representor have been substantially fulfilled. If damage is employed in rescission, it has an entirely different function to serve than in the tort action. In the latter, money is taken from the pocket of the representor and given to the representee as compensation for his loss. In legal theory, this makes him whole. In rescission, damage may be employed as a device to enable the court to determine whether there is any reason for restoring the representee to his original position. Since damage is employed for this purpose and not for the purpose of compensating the representee, it is not necessary to be so specific in the proof of its extent, nor is it necessary that the injury be of such a nature that it can be adequately measured in money. If the court can see from the facts that the qualities of the subject matter, as represented, do not exist, so that the things is not substantially as valuable as it would have been with these qualities, damage is made out sufficiently to enable a court to determine that the compliance by the representor has fallen short. But the court may have other and different guides for measuring this compliance to determine whether or not it is substantially what the representee was led to expect.

From the language of the cases, the courts seem to be in serious disagreement whether damage should be employed at all as a determinate of the larger problem of substantial compliance. It is necessary,

80 Compare the following statements in cases arising out of identical facts in which shares of stock in a company were represented to be treasury stock, whereas it was the individually owned stock of the seller. In Fawkes v. Knapp, 138 Minn. 384 at 386, 165 N. W. 236 (1917), the court said: "But this was not an action to recover damages for deceit. It was simply to recover what plaintiff had parted with, after he had rescinded the contract by his own act. If the representations were made and were material, if without them plaintiff would not have bought the stock, it is not necessary to his right to rescind and to recover back what he parted with that he be damaged in any particular amount, or suffer any real injury." But see the opposing theory in the case of Stillwell v. Rankin, 55 Mont. 130 at 135, 174 P. 186 (1918):

"Courts of equity, like courts of law, however, do not concern themselves with wrongs which do not produce injury...."

"If the allegations of this complaint are true, plaintiff was induced by fraudulent representations to assume obligations which otherwise he would not have
therefore, to look into the various types of situations which have been presented for rescission to see what is behind this apparent conflict. Have the courts been dealing with comparable situations? If they have tended to lay down opposing doctrines in situations which are not comparable, both doctrines may be usefully employed in their respective spheres, and the apparent conflict may not be so serious as it appears at first sight. It seems more valuable to find how theory is applied in the decisions than what theories are professed, and thus to define the doctrine in terms of its consequences.

But before going into the analytical study of the cases in regard to the general problem as to whether or not damage is necessary to rescission for misrepresentation, it is necessary to look at the language and reasoning employed by the courts and by the doctrinal writers where they have treated this question. In spite of what the courts have actually done when confronted with this matter, what they have said about it is also of importance. Therefore, an examination of the origin of the doctrine that damage is essential and a study of its development and growth may throw some light on the various views which the courts and jurists have taken.

II

THE HISTORICAL DEVELOPMENT OF THE REQUIREMENT OF DAMAGE FOR RESCISSION BASED ON MISREPRESENTATION

Due to the fact that the tort of deceit in its present form did not come into the law until the close of the eighteenth century, and due to its comparatively slow growth during the first half of the nineteenth century, the problem whether damage must be shown by the representative, before he is entitled to rescission for misrepresentation, appa-

We deem the allegations sufficient to disclose damage within the meaning of that term which we adopt. In both cases rescission was allowed. Compare Stern v. Kirby Lumber Co., (C. C. N. Y. 1904) 134 F. 509, with Martin v. Hill, 41 Minn. 337, 43 N. W. 337 (1889), in which the misrepresentations were as to the values of the company, the stock of which was the subject of the transactions in both cases; Antognini v. Grandi Co., 89 Cal. App. 628, 265 P. 378 (1928), with Ludowese v. Amidon, 124 Minn. 288, 144 N. W. 965 (1914), in which the misrepresentations were as to the value of shares of stock which were the subject matter of the purchase. Rescission was granted in all these cases in spite of diverse doctrine on the question of damage as an element in the case.

In subdivision III, which will appear in a subsequent installment, these situations are analyzed under the various kinds of harms which may result from a misrepresentation.
ently did not occur to the courts much before the second half of the century. Although the various elements for the tort of deceit were not worked out in detail, as we know them now, the very fact that there was this new remedy created no little stir in the law, to judges and jurists alike. Until the case of Pasley v. Freeman, except against a party to the contract induced thereby, there was no tort action for damages resulting from misrepresentation. Until this decision, equity had exercised the remedy of rescission whenever the representee had established the fact of misrepresentation, its materiality and the misleading effect. No case has been found prior to this time in which any consideration was even suggested of a further requirement of damage suffered by the representee. But following Pasley v. Freeman, the word fraud began to take on an extremely technical meaning. The new tort remedy of deceit was restricted to a type of harm which was thought to exist only where certain technical elements were found. Thus, it was very easy for judges, trained largely in the substantive law, to confuse the two remedies for misrepresentation, the one for rescission and the other for damages. The ambiguous word fraud was, unconsciously perhaps, given its tort content even when the judges were dealing with a case in which rescission was asked. The administration of law and equity by the same judge, whose training and experience caused him to think in terms of legal analogies, contributed greatly in breaking down the distinctions between the two entirely different approaches to the problem of relief for misrepresentation.

Prior to 1890, very few cases involve this question. Beginning around 1900, the question has been presented in a constantly increasing number of cases. Each decade shows an increase over the previous one. This may be explained, perhaps, on one or two grounds: the lawyers found a body of precedents which was developing in the cases and in the treatises; and courts, exercising equity powers, were more and more losing sight of the difference which inhered in the relief at law and the relief in equity. To be sure, there were many rescission cases in the books, but the question in issue is not mentioned.

A perusal of the early decisions involving fraud will show the influence of Pasley v. Freeman, 3 T. R. 51, 100 Eng. Rep. 450 (1789). For example, see Donelson v. Young, Meigs (19 Tenn.) 155 (1838), and note thereto.

3 T. R. 51, 100 Eng. Rep. 450 (1789). Bohlen says that up to this time no case has been found "where an action of deceit was maintained except against a party to the contract induced thereby." Bohlen, Cases on Torts, 3d ed., 680 (1930).

Many of the old decisions involving rescission for misrepresentation are referred to in Fonblanque, Equity 111 (1893). The essential elements for relief from misrepresentations were well developed in the equity cases long before Pasley v. Freeman.

See Pollock, Contracts, 1st ed., 461 (1876), for an observation of this tendency.
Where the action started at law on the contract and the equitable defense of rescission for misrepresentation was pleaded under the liberal procedural changes, it is not difficult to understand how a court might think in terms of deceit.

There are three distinct lines of development to be observed in the decisions with respect to the requirement of damage for rescission. Two of these lines may be traced to the same root, but as to their influence in the decisions they may be treated separately. The first is found in those decisions which have accepted the tort analogy and state that rescission will be denied unless damage is shown. The earliest case, perhaps, to present this view is *Austell v. Rice,* where an action was brought on a promissory note which had been executed by certain legatees under a will, in consideration of the release by the widow and son of their claims under the will. The defense was that the makers would not have entered into the settlement, had they known that Austell was interested in one-half of what the widow would receive under the settlement, because they wanted the widow to receive the entire sum specified in the note. The court, in answering this contention, admitted that the false statements of Austell were morally wrong, and very clearly so, and that they constituted fraud, but it was fraud without injury. It concluded that, "Fraud without injury, or injury without fraud, will not sustain an action, or a defense. . . . Whether the agent, Austell, misrepresented his interest in the transaction or not; whether the plea be true or false, the defendants will have neither more nor less to pay on their contract." For if it was true, reasoned the court, it did not increase their liability; they were not injured by it, and had no right to complain.

Fraud, according to this court, must refer to and affect the consideration which moved the representatives to act—it must reach and lessen the benefits which they derive from the contract. An examination of the authorities cited for the proposition that damage was necessary shows that the court definitely was thinking of the elements necessary for the tort of deceit as its measurement of relief for the misrepresentation. But the defendants were not seeking damages for the deceit by way of counterclaim; they were asking for defensive rescission because of the misrepresentation concerning the purpose for

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88 5 Ga. 472 at 479 (1848).
which the consideration moving from the representee was to be used.

It is true that in a few of the earliest cases, including the immediate case, the question arose in actions on promissory notes for damages for breach of contract. Here the defense of fraud was set up, not for damages, but by way of defensive rescission. It is possible that these early cases may be explained partly by the fact that the defense of fraud was applied by law judges in law actions in its strictly legal content as found in the actions for deceit. 39

The same reasoning was employed in Jones v. Foster, 40 where the plaintiff was seeking to set aside a deed to land on the ground that it had been obtained by misrepresentation. In denying relief, the court said, "it is a well settled principle in regard to false representations, that fraud without damage is neither sufficient to support an action at law, nor a ground for relief in equity. Fraud and injury must concur to furnish a ground for judicial action." It held that in an action for fraudulent representations the plaintiff must not only show that the representations were made, and that they were false and fraudulent, "but he must also show affirmatively that he has been injured thereby." 41 Here is a court of equity using language identical

39 For further illustrative cases, see Harris v. Ransom, 24 Miss. 504 (1852); Cunningham v. Edgefield & Kentucky R. Co., 1 Head (38 Tenn.) 23 (1858). It is striking to see the development in Alabama, where, in the first cases involving actions on promissory notes, rescission was held to require damage. Rice v. Gilbreath, 119 Ala. 424, 24 So. 421 (1898), and Bomar v. Rosser, 131 Ala. 215, 31 So. 430 (1901). When a bill in equity was brought for rescission, the court seemed to hold that damage was not necessary. Fuller v. Chenault, 157 Ala. 46, 47 So. 197 (1908). Even though this may assist in explaining a few of the early decisions, it does bear further application, for in most of the first cases to require damage in the various jurisdictions, the representee was seeking rescission affirmatively. And curiously in one case, the requirement of damage was said by way of dictum to apply only to suits for affirmative relief, and not where fraud was set up as a defense. Stewart v. Lester, 49 Hun 58, 1 N. Y. S. 699 (1888).

40 175 Ill. 459 at 469, 51 N. E. 862 (1898).

41 For other Illinois decisions in which tort cases are cited in support of the same conclusion, see Struve v. Tatge, 285 Ill. 103, 120 N. E. 549 (1918); Felt v. Bell, 205 Ill. 213, 68 N. E. 794 (1903).

For a fairly recent example, see Pace v. Edgmont Investment Co., 138 Ore. 32, 4 P. (2d) 633 (1931). It is interesting to note that the court in this case seemingly ignored a sizeable list of previous Oregon decisions in which it had been held that for rescission damage was not an element necessary to be shown. Brooke v. Perfection Tire Co., 110 Ore. 567, 223 P. 939 (1924); Larsen v. Lootens, 102 Ore. 579, 194 P. 699, 203 P. 621 (1922); McGowan v. Williamette Valley Irrigation Land Co., 79 Ore. 454, 155 P. 705 (1916); Steen v. Weisten, 51 Ore. 473, 94 P. 834 (1908). A different position had been taken on this question in Ziegler v. Stinson, 111 Ore. 243, 224 P. 641 (1924), yet even this case was passed over for the tort authorities. It merely shows that in this jurisdiction, as in many others, the whole problem is in a very
with that to be found in any action of deceit. Furthermore, the court cited a list of tort cases to support its proposition.

The second line of development, which may be observed in the decisions with respect to the damage requirement for rescission, is found in those cases which have been based upon statements in texts and doctrinal treatises. Undoubtedly, the greatest influence was Story's *Equity Jurisprudence,* in which, throughout the fourteen editions, it is asserted that some such requirement is necessary for rescission. In the first edition, 1836, in treating of fraud in equity, Story says:

"And, in the next place, the party must have been misled to his prejudice or injury; for Courts of Equity do not, any more than Courts of Law, sit for the purpose of enforcing moral obligations, or correcting unconscientious acts, which are followed by no loss or damage. It has been very justly remarked, that, to support an action at law for a misrepresentation, there must be a fraud committed by the defendant, and a damage resulting from such fraud to the plaintiff. And it has been observed with equal truth, by a very learned Judge in Equity, that fraud and damage coupled together will entitle the injured party to relief in any Court of Justice."

It may be observed that Story did not define what he meant by "loss or damage," but good evidence of what he had in mind may be obtained from the authorities which he considered as bearing on this proposition. For the first proposition which he proposed, he cited a tort case for deceit, and the authorities for his last proposition do not throw further light. The effect of Story is seen particularly in the

confused state. For illustrative cases from other jurisdictions, see the following decisions: Morrison v. Lods, 39 Cal. 381 (1870), citing Pasley v. Freeman, 3 T. R. 51, 100 Eng. Rep. 450 (1789); Srader v. Srader, 151 Ind. 339, 51 N. E. 479 (1898); Branham v. Record, 42 Ind. 181 (1873) (based on an earlier tort case in which Pasley v. Freeman, supra, was the authority followed); Sieveking v. Litzler, 31 Ind. 13 (1869); Wolcott v. Wise, 75 Ind. App. 301, 130 N. E. 544 (1921); Lakeside Forge Co. v. Freedom Oil Works Co., 265 Pa. 528, 109 A. 216 (1920).

*1st ed. § 203 (1836). The same statement appears in all subsequent editions.*

It is curious, in view of the fairly evenly divided stand on the question in the cases, that this single authority, based on the tort of deceit, would have stood unchallenged throughout the various editions. In the eleventh and twelfth editions an additional case is added to that of Vernon v. Keys, 12 East 632, 104 Eng. Rep. 246 (1810), to sustain the proposition, namely, Hagee v. Grossman, 31 Ind. 223 (1869). But this was also an action for deceit and of course does not support the proposition as to cases involving rescission in equity.


*45 Bacon v. Bronson, 7 Johns. Ch. 194 at 201 (N. Y. 1823). There the court merely asserted that equity would take jurisdiction of this case since both fraud and*
older cases where he may be cited as the only authority for the decision. His influence is also seen in a number of treatises on equity, including those by Kerr, Bispham, Bigelow, and Pomeroy, all of which lay down the requirement that damage is necessary for rescission of contracts which have been induced by misrepresentation. And even if these jurists did not lean wholly on the text of Story, they are least cite decisions to sustain their statements which were decided on the authority of Story. Therefore, in the decisions and

It cannot be considered as dictum for the proposition that if damage were absent there could be no relief. The other case which is cited is Fellowes v. Lord Gwydyr, 1 Sim. 63, 57 Eng. Rep. 502 (1826), which was decided on the ground that there was no fraud in the case because there was no material misrepresentation. A third case, Turnbull v. Gadsden, 2 Strobh. Eq. (S. C.) 14 (1848), merely repeats the observation made in Bacon v. Bronson, supra. This case was carried in the sixth to the twelfth editions, inclusive. Furthermore, the case was one of fiduciary relations.

None of the authorities which he cites to support him in his proposition does so. Polhill v. Walter, 3 B. & Ald. 114, 110 Eng. Rep. 43 (1832), is a tort action. Fellows v. Lord Gwydyr, 1 Sim. 63, 57 Eng. Rep. 502 (1826), decided that there was no material misrepresentation. In Cadman v. Horner, 18 Ves. Jun. 10, 34 Eng. Rep. 221 (1810), the phrase that the falsehood must “operate to a small, though a certain, extent,” simply means that it must in part induce the plaintiff to contract. In support of this interpretation of the cases, see Moncreiff, Law of Fraud 309 (1891). It seems quite clear that Kerr was influenced by Story.

The emphasis upon the last word in the definition indicates that one other element of fraudulent misrepresentation yet remains to be noticed, viz., that the party complaining must have been injured thereby. Fraud without damage is no ground for relief at law or in equity. But any damage, however small, will be enough to set the court in motion.” Kerr, Fraud and Mistake, 1st ed., (1868), is cited for his authority.

The decisions cited in support of this statement are California cases which were among the very first to be decided on the authority of Story. In the edition appearing in 1888, Fasley v. Freeman, 3 T. R. 51, 100 Eng. Rep. 450 (1789), is the only authority cited.

in the doctrinal treatises is to be seen the influence of a renowned scholar who seemed to have confused misrepresentation for liability in tort and misrepresentation for rescission in equity, when he relied on a tort case in deceit for his proposition.

Pomeroy, also, has exercised a great influence in the decisions. His statement on the problem is a combination of Story and Kerr, and his authorities are a mixture of those used by Kerr, certain additional tort cases, and a sprinkling of rescission cases which were based on Story. He states the proposition:

"The last element of a misrepresentation, in order that it may be the ground for any relief, affirmative or defensive, in equity or law, is its materiality. The statement of facts of which it consists must not only be relied upon as an inducement to some action, but it must also be so material to the interests of the party thus relying and acting upon it, that he is pecuniarily prejudiced by its falsity, is placed in a worse position that he otherwise would have been. The party must suffer some pecuniary loss or injury as the natural consequence of the conduct induced by the misrepresentation. In short, the representation must be so material that its falsity renders it unconscientious in the person making it to enforce the agreement or other transaction which it has caused. Fraud without resulting pecuniary damage is not a ground for the exercise of remedial jurisdiction, equitable or legal; courts of justice do not act as mere tribunals of conscience to enforce duties which are purely moral. If any pecuniary loss is shown to have resulted, the court will not inquire into the extent of the injury; it is sufficient if the party misled has been very slightly prejudiced, if the amount is at all appreciable."

51 For example, see Spreckels v. Gorrill, 152 Cal. 383, 92 P. 1011 (1907); Wainscott v. Occidental Bldg. & Loan Assn., 98 Cal. 253, 33 P. 88 (1893) (on these decisions are based many subsequent California cases); Wright v. Spencer, 39 Idaho 60, 226 P. 173 (1924); Struve v. Tatge, 285 Ill. 103, 120 N. E. 549 (1918); Stillwell v. Rankin, 55 Mont. 130, 174 P. 186 (1918); Jakway v. Proudfit, 76 Neb. 62, 106 N. W. 1039, 109 N. W. 388 (1906); American Bldg. & Loan Assn. v. Bear, 48 Neb. 455, 67 N. W. 500 (1896); Young v. Taylor, (N. J. Ch. 1914) 90 A. 1053; Ziegler v. Stinson, 111 Ore. 243, 224 P. 641 (1924) (overlooking earlier Oregon decisions for the authority of Pomeroy and tort decisions); Russell v. Industrial Transportation Co., 113 Tex. 441, 251 S. W. 1034, 258 S. W. 462 (1924) (the leading case for a long list of subsequent Texas decisions).

52 2 POMEROY, EQUITY JURISPRUDENCE, 1st ed., § 898 (1881). This treatise is cited in the cases for this proposition more often than any other. See cases cited supra, note 51. A later treatise which is receiving considerable mention in the more recent decisions is BLACK, RESCISSION AND CANCELLATION, 2d ed. (1929). While this writer seems to have had in mind something of the same idea as will be developed in this paper, the distinctions which he has attempted to draw between the types of harms
While the decisions have been considerably influenced by the language of textwriters, it may be contended that they were, after all, more directly influenced by the deceit cases. Whether the courts made more direct use of the tort cases for their authority, or of the texts which in turn were also based on the tort cases, the fact remains that Pasley v. Freeman gave birth to a lusty remedy which has played a most important part in the rescission cases in determining the necessary factors which must be shown before relief may be had for misrepresentation.

But the most curious result of all these statements to the effect that damage is necessary for rescission based on misrepresentation is that they have been applied to one type of harm only, namely, where the representee has acquired the thing he expected, only it did not have the value that it was represented to have. If so limited, these statements can be put to their proper use and brought into their proper place in a rescission case. That is, where the compliance by the representor is alleged to have fallen short in respect to value qualities, damage is the only means for measuring the truth of this allegation. Instead of being used as a rule of decision, as the cases and doctrinal writers which have been set forth would seem to require, damage becomes an aid to be employed by the court in rescission cases where the harm is restricted to this particular kind. Of course, there is no indication in the authorities which have just been discussed that they would agree with this limitation. But, as will be shown presently, if these statements which may result from a misrepresentation cannot be accepted. See infra, note 67. At section 20 the very undiscriminating statement is made that the same elements of a fraud or deceit are essential to warrant an action for deceit or rescission. In listing these elements he not only includes damages but also scienter. But the requirement of scienter for rescission has never been the law long in any jurisdiction. Also, see John W. Smith, Fraud, §§ 126, 286 (1907). But the cases cited in support of his proposition that damage is necessary to rescission for misrepresentation are either tort cases, or decisions which were based on tort cases, or cases based upon the authority of Story. In a few of the early decisions is seen the influence of Parsons. Although approaching rescission from the position of a writer in the field of contracts, rather than of equity, he is to be listed with the group of jurists who are responsible for this development as found in the cases. All of his authorities, however, are liability cases for deceit—actions for damages. 2 Parsons, Contracts, 1st ed., 268 (1853). For cases in which the full influence of textwriters is seen, see Jakway v. Proudfit, 76 Neb. 62, 106 N. W. 1039, 109 N. W. 388 (1906) (setting forth in full Story, Pomeroy, and Bispham); Russell v. Industrial Trans. Co., 113 Tex. 441, 251 S. W. 1034, 258 S. W. 462 (1924).

In subdivision III, which will appear in a subsequent installment, the decisions will be analyzed and grouped according to the sort of harm which may result from a misrepresentation.
are used in this limited way, it is quite possible to explain away much of the asserted differences which are to be found in the cases and textbooks.

The third line of development began around 1890 in New York and Minnesota. A partial explanation of this group of decisions may lie in the fact that, after a hundred years of growth and application, the deceit action was more fully understood in its function, and the tests developed around a damage remedy were no longer applied indiscriminately to both damage liability and rescission. These courts appreciated the distinction between the two means for restoring the balance in the relations between the parties, following a misrepresentation. The distinction was first set forth by a New York court in *Stewart v. Lester*,\(^4\) in which there was an action for breach of contract and the defense of misrepresentation. The court, in answering the plaintiff’s contention that there could be no fraud without damage, said:

“"The rule invoked by the plaintiff that fraud, without damage resulting therefrom, never gives a right of action in favor of the defrauded party, applies to those cases where the injured party is seeking to recover damages from the wrong-doer in an action on the case *ex delicto* as an indemnity against the injury which he has sustained by reason of the fraud, and has no just application to a case like the one in hand, where the fraud is relied upon as a defense to the enforcement of an executory contract.\(^5\)"

The court said further that if the false statement relates to a material fact, the law implies that the defrauded party has suffered an injury sufficient to defeat a recovery; and showing that the misstatement was a material one, relative to the subject matter of the contract, was proof that damages in some degree have been sustained by the defrauded party, but he was not called upon to give direct proof of the nature and extent of his damage. There is a curious mixture of statements here, but the court applied the distinction it had drawn.\(^6\)

\(^4\) 49 Hun 58 at 63, 1 N. Y. S. 699 (1888). The court by way of dictum adopted curious reasoning in distinguishing between rescission by suit and informal rescission by way of defense: "Where a party is seeking *affirmative* relief upon the ground of fraud, whether it be legal or equitable, then he is called upon to prove that he has sustained damages in some tangible amount." For this proposition, the court cited Pomeroy as its authority, quoting at length from the text. But this is not fair to Pomeroy.

A year later, a Minnesota court took the same view in the case of *Martin v. Hill*. In that case the plaintiff sought to rescind the purchase of stock in a mining enterprise. The misrepresentations related to the coal area of the company. In discussing the damage problem, the court pointed out that the fundamental problem in rescission cases was the materiality of the representation and not the damage. After stating its finding that the land and the stock were much less valuable than if the facts had been as represented, the court said that it was to be borne in mind that the evidence as to the variance between the representations and the facts was not for the purpose of assessing damages, but only for the purpose of ascertaining if the lands as coal lands were in fact so much less valuable that plaintiffs had a right to believe and did believe them to be free from representations made to them by defendants; and that, had they known the truth, they would not have made the purchase. As a basis for the assessment of damages, the difference in value must be shown so that it can be estimated in dollars and cents. But in this case, said the court, it is only necessary to show it so material as to justify the conclusion that, had the purchasers known it, they would not have made the purchase.

Beginning with these two decisions, a long list of cases in the two jurisdictions follows on the question. One of the most complete expositions of this view is given by the Minnesota court in the case of *Kirby v. Dean*, where the action was on a promissory note given


*56* 41 Minn. 337, 43 N. W. 337 (1890). A long list of Minnesota decisions has given steady support to the principle stated in this case. Magnuson v. Bouck, 178 Minn. 238, 226 N. W. 702 (1929); Hirschman v. Healy, 162 Minn. 328, 202 N. W. 734 (1925); Kirby v. Dean, 159 Minn. 451, 199 N. W. 174 (1924); Fawkes v. Knapp, 138 Minn. 384, 165 N. W. 236 (1917); Ludowese v. Amidon, 124 Minn. 288, 144 N. W. 965 (1914); Pennington v. Robert, 122 Minn. 295, 142 N. W. 710 (1913); Knappin v. Freeman, 47 Minn. 491, 50 N. W. 533 (1891); MacLaren v. Cochran, 44 Minn. 255, 46 N. W. 408 (1890).

*57* 159 Minn. 451, 199 N. W. 174 (1924).
in payment of an insurance policy. The defendants had set up the defense of rescission, based on a misrepresentation regarding the cash surrender value of the policy. In holding the trial court to be in error in charging the jury that damage was necessary to a verdict for the defendants, the court pointed out that, in a case of rescission, there are no damages to talk about. Whether the fraud damages its intended victim by giving him a less value than he bargained for is immaterial. The law is not concerned with that question. The only inquiry is whether the party rescinding or seeking to rescind a contract induced by fraud is not getting, or will not get, in substance at least, what he contracted for, and was by the fraudulent misrepresentation induced to believe he would get. If he cannot get that, it is enough, and his right to rescind is complete.

"He may rescind even though the proffered substitute for the thing or performance promised by the misrepresentations is of greater value than the thing or performance so promised. It is not a question of adequate value, but one of substantial compliance, and although there be adequate value, there is a clear right of rescission where there is a material lack of compliance otherwise with the standards fixed by the misrepresentations complained of.

"So here, on defendants' evidence, they had a clear right of rescission, even though the policies tendered had been altogether more desirable than those for which they applied." 58

The same clear-cut distinction is seen, also, in many decisions from jurisdictions other than New York and Minnesota.60 The various courts may have discussed the problem from different positions and with varying emphasis, but they indicate that the tort cases have been strongly pressed on them.60

This has been the position taken by the English courts, although

58 159 Minn. 451 at 454, 199 N. W. 174 (1924).
60 King v. Lamborn, (C. C. A. 9th, 1911) 186 F. 21 (stating that no federal decision was in conflict with this view); Mather v. Barnes, Keighley & Greer, (C. C. Pa. 1906) 146 F. 1000; Stern v. Kirby Lumber Co., (C. C. N. Y. 1904) 134 F. 509; Fuller v. Chenault, 157 Ala. 46, 47 So. 197 (1908); Barnes v. Century Sav. Bank, 149 Iowa 367, 128 N. W. 541 (1910); Larsen v. Lootens, 102 Ore. 579, 194 P. 699, 203 P. 621 (1922); McGowan v. Willamette Valley Irrigation Land Co., 79 Ore. 454, 155 P. 705 (1916); Winedahl v. Harris, 37 S. D. 7, 156 N. W. 489 (1916).
the problem does not seem to have been presented very frequently.\textsuperscript{61} It is interesting to see how consistently they have refused to be confused with the tort decisions in rescission cases. But they had the background of experience with rescission cases long before \textit{Pasley v. Freeman} brought in the action of deceit in its present form. The judicial experience in this country was quite the reverse. \textit{Pasley v. Freeman} was in the books before our courts were asked to consider rescission.

Curiously enough, the textwriters who have supported this distinction in this country have come from the law side of the picture, while the equity writers, as have been discussed, supported the other position. It would seem that the situation might well be reversed, since equity in this type of case has never been vitally concerned with damage. In their treatises on the law of contracts, both Williston and Page deny that damage is required for rescission. Williston, however, gives no discussion of the problem.\textsuperscript{62} Referring to the different holdings on the question and stating that in some cases rescission is refused where no actual damage exists, Page says:

\begin{quote}
"This rule cannot be sustained on sound principle. To hold that one must accept a legal right different from that promised him because it is as valuable in money is to ignore a fundamental principle of contract law. Accordingly, many courts hold that false representations made knowingly with intent to deceive, causing deception and thereby inducing one to make a contract that he would not otherwise have made, are grounds for rescission though no actual damage follows. In this connection the term ‘damage’ does not imply financial loss, but only legal injury; that is, a failure to obtain the thing as it was represented."
\end{quote}

The \textit{Contracts Restatement} has taken this position in stating that "it is immaterial whether damage is caused," where the avoidance of the contract is based upon misrepresentation.\textsuperscript{64} But no discussion is given to the problem.

In the absence of decided cases before the English courts, the


\textsuperscript{62} 3 \textit{WILLISTON, CONTRACTS}, § 1525, p. 2713 (1920). His single authority is Barnes v. Century Sav. Bank, 149 Iowa 367, 128 N. W. 541 (1910), which was decided on the authority of 1 \textit{PAGE, CONTRACTS}, 1st ed., § 128, 146 (1905).

\textsuperscript{63} 1 \textit{PAGE, CONTRACTS}, 2d ed., § 335 (1920). 1 \textit{ELLIOTT, CONTRACTS}, § 91 (1913), attempts to combine both views.

\textsuperscript{64} Sec. 476, comment (c) (1932).
English textwriters have, in general, omitted any treatment of this question. Moncreiff briefly refers to the suggestion made by Fry "that rescission could not be asked for unless the plaintiff has been prejudiced," and says that the "idea seems to be mistaken." Bower, in restating the law of misrepresentation in code form, deals with the problem in contrasting the two remedies of rescission and damages; he contends that damage, which is as vital as fraud to other forms of action for misrepresentation, is irrelevant to proceedings for rescission, and that the relative advantages or disadvantages of adhering to, or of repudiating, a contract induced by an incorrect statement are matters for the consideration of the representee.

Significant as it is to find that the cases in which damage was declared to be essential to rescission had to deal with misrepresentations pertaining to value qualities, it is almost as significant to discover that, with few exceptions, the courts which have taken the opposite position have had to do with cases in which the misrepresentations pertained to differences in character qualities so that the representee may be said to have obtained something substantially different from what he expected. This is the type of case which Page, Williston, and Elliott seemed to have in mind, in so far as the authorities which they cite may be used to throw light on the idea which they were seeking to convey. But it may be a little unfair to generalize to the extent that these authorities would limit the principle which they have enunciated to harms of this class only. There is nothing to indicate, in the decisions and doctrinal treatises, that such a limitation would be admitted. Both types of case are clearly included within

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65 MONCREIFF, FRAUD AND MISREPRESENTATION 309 (1891). He shows that the cases cited by Fry, SPECIFIC PERFORMANCE OF CONTRACTS, 2d ed., 299 (1881), do not involve the question. See his interpretation of the cases cited by Fry, supra, note 47. Fry took his language and his citations bodily from KERR, FRAUD AND MISTAKE, 1st ed., 51 (1868). See note 47, supra, where the influence of Story on Kerr is suggested.

66 BOWER, ACTIONABLE MISREPRESENTATION, 2d ed., 241 (1927), and Article 33 of his Draft Code (ibid., p. 16).

67 These, cases will be discussed in the next part of this paper. Perhaps BLACK, RESCISSION AND CANCELLATION, 2d ed. (1929), would be the only authority to agree with this limitation. However, 7 ELLIOTT, CONTRACTS, § 91 (1913), seems to have had some such distinction in mind. Black says, at § 112:

"The foregoing rules and principles, as we have stated, are those which apply in an action of deceit or other similar action. Many decisions have applied them equally in cases where the relief sought was the rescission of a contract, or the setting aside or cancellation of a conveyance or other obligation, holding that such relief cannot be granted unless it is shown that the party defrauded
the scope of the textwriters' broad proposition that if the thing offered is different, either as to value qualities or as to character qualities, the representee is asked to accept a legal right different from that promised him. But the fact that there is little overlapping in the application of the two principles in the decisions makes it possible to explain what have seemed to be extreme differences, and to subordinate both to their proper place under the one guiding principle: whether or not there was a substantial compliance with the reasonable expectations of the representee induced by the representations. In this manner, "damage" becomes relevant in determining whether or not the thing expected was as valuable as it was represented to be; while differences in character qualities will apply to those instances where it cannot be said that the representee did receive the thing he expected to get from the transaction.

It is somewhat striking to notice that in a few jurisdictions the courts have been called upon to consider the necessity of damage with relation to the two sets of harms and have followed the distinction which has been suggested. But in no instance is there much indication that the court reached different conclusions upon any realization of the differences between the two sets of harms. Where this has occurred, has suffered some actual loss or injury in direct consequence of the fraud. . . .

"But many other decisions repudiate altogether the rule requiring a showing of actual damage, in so far as it applies to the rescission of contracts. Admitting the necessity of such a showing where the action is in tort, they yet maintain that misrepresentations made willfully with intent to deceive and to induce one to enter into a contract which he would not otherwise have made furnish ground for its rescission, irrespective of the question whether or not the complaining party has sustained any loss, injury, or damage. . . .

"The soundest reason, however, appears to support those decisions which discriminate between cases where the deception is as to the identity or character of the subject-matter and those where the deception concerns some collateral matter, and which hold that there must be proof of loss or injury in the latter class of cases, but not in the former. . . .

"But on the other hand, where a purchaser receives what he has actually bargained for, and based his right to rescind on some false representation as to quality, condition, or matter affecting its value, he must show that such representation was material, that he was misled by it, and that he has thereby sustained some loss or damage."

The difficulty with this classification is with the distinction which is drawn between deception as to the identity or character of the subject-matter, deception as to a collateral matter, and deception concerning value. In the last two types, according to this treatment, damage is necessary. No authorities are cited to show what this writer would include within the second type of deception, namely, collateral matter. It would seem that this form of deception would not have any bearing on the immediate problem.
there has been no effort to distinguish previous decisions in the same jurisdiction. As a result, the cases in such jurisdictions, without further analysis, appear to be contradictory.88

Many courts have indulged in the fruitless pastime of attempting to refine what is meant by “damage” as required by them for rescission. They have inquired into the question whether it means financial detriment or whether damage may be used in the sense of injury. The result has been only to add confusion to a matter which, after all, is not important and gets nowhere.69 If properly limited to harms of the first sort, there is no reason to refine it further.

In the concluding installment of this article, an analytical study will be made of the decisions involving this problem according to the possible types of harms which may result from a misrepresentation. After pointing out what courts have said they were doing in these cases, it now becomes important to see what, in fact, they have done.

68 Examples may be found in the Alabama decisions. In Rice v. Gilbreath, 119 Ala. 424, 24 So. 421 (1898), and Bomar v. Rosser, 131 Ala. 215, 31 So. 430 (1901), a misrepresentation was set up by way of defense to an action arising out of the transaction and damage was said to be necessary. But in Fuller v. Chenault, 157 Ala. 46, 47 So. 197 (1908), damage was thought not to be necessary. The cases, however, may be explained on other bases. The Oregon decisions afford an interesting study on this point. No damage was necessary in Brooke v. Perfection Tire Co., 110 Ore. 567, 223 P. 939 (1924); Larsen v. Lootens, 102 Ore. 579, 194 P. 699, 203 P. 621 (1922); McGowan v. Williamette Valley Irrigation Land Co., 79 Ore. 454, 155 P. 705 (1916); Steen v. Weisten, 51 Ore. 473, 94 P. 834 (1908); but see the change in Ziegler v. Stinson, 111 Ore. 243, 224 P. 641 (1924), and in Pace v. Edgemont Investment Co., 138 Ore. 32, 4 P. (2d) 633 (1931).

69 For a critical analysis of the various meanings which have been imputed to “damage” in rescission cases, see 48 HARV. L. REV. 480 (1935). There, it is pointed out that damage has been said to exist wherever the fraud has induced a transaction which otherwise would not have occurred. But this definition is one of materiality of the representation instead of damage. Damage has also been said to exist if the transaction is economically less advantageous than represented. But this will almost always result if the representation has been shown to be an inducement. In other cases, damage is said not to exist unless there has been pecuniary loss. But, in fact, this seems to have operated as a limitation where damage is measured as the difference between what the purchaser got and what he gave. These cases are to be discussed in another part of this paper.