

Michigan Law Review

Volume 34 | Issue 3

1936

CONTRACTS - FRAUD - WAIVER OF DECEIT ACTION BY CONTINUED PERFORMANCE

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Recommended Citation

CONTRACTS - FRAUD - WAIVER OF DECEIT ACTION BY CONTINUED PERFORMANCE, 34 MICH. L. REV. 384 (1936).

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CONTRACTS — FRAUD — WAIVER OF DECEIT ACTION BY CONTINUED PERFORMANCE — Legal protection in contracts induced by fraud¹ is subject to the important qualification that continued performance after discovery of the fraud may result in a “waiver” of the damage remedy for deceit. This doctrine, well established in modern law,² is not based on any supposed inconsistency between continued performance and damages for deceit.³ Both continued performance and the deceit remedy are predicated upon the theory of affirmance of the contract, and no election between them is required.⁴ Nor is the doctrine of “waiver” of damages in deceit to be confused with the totally different rule that continued acceptance of the benefits of a

¹ This term will be used throughout the discussion in the sense of “fraud in the inducement” as distinguished from “fraud in execution.” See 3 WILLISTON, CONTRACTS, §§ 1487-1489 (1931).

² Cases collected in 8 L. R. A. (N. S.) 452 (1907). See also *Simon v. Goodyear Metallic Rubber Shoe Co.*, (C. C. A. 6th, 1900) 105 F. 573; *Thompson v. Libby*, 36 Minn. 287, 31 N. W. 52 (1886); *Kingman & Co. v. Stoddard*, (C. C. A. 7th, 1898) 85 F. 740.

Expressions of opinion to the contrary are to be found in some of the cases. See *Parker v. Marquis*, 64 Mo. 38 (1876); *Pryor v. Foster*, 130 N. Y. 171, 29 N. E. 123 (1891).

³ 20 Cyc. 92-94 (1906). See also 27 C. J. 24 (1922).

⁴ It should be observed that an action for deceit is not necessarily based on a theory of affirmance, as the cases have too readily assumed. There is abundant authority for deceit actions *after* rescission to recover for losses suffered through reliance on contracts induced by fraud. See discussion, *infra*, in connection with note 23.

fraud-induced contract,⁵ or even mere delay,⁶ may result in an "affirmance" of the contract and a forfeiture of the rescission remedy.⁷

The doctrine of "waiver" of damages in deceit is a product of the law of damages. Having the privilege of rescission on the ground of fraud, the defrauded party is at liberty to abandon performance and recover any payments or transfers previously made. Hence, any loss suffered through continued performance after discovery of the fraud may be described as "self-inflicted injuries," not traceable to the original misrepresentation.⁸ In practice, therefore, the defrauded party is compelled to rescind in many cases, in order to protect himself against loss. Even though the contract might be advantageous to him despite the existence of misrepresentation, he is forced to abandon it and pursue the often wasteful course of rescission.⁹

1. *Executory Contracts*

The extreme hardship which may be imposed upon the defrauded party by forcing him to rescind becomes apparent by considering a few illustrative cases. In *McDonough v. Williams*¹⁰ a vendor under an executory contract to sell corporate stock received certain information, prior to delivery of the stock, leading him to believe that the vendee had perpetrated a fraud. In an action for fraud and deceit the court

⁵ 77 A. L. R. 1165 (1932).

⁶ A fairly complete annotation is found in 72 A. L. R. 726 (1931). See also 30 L. R. A. (N. S.) 872 (1911).

⁷ An example of the confusion of the doctrine of "waiver" of damages in deceit with that of waiver of the right of rescission is seen in *Estes v. Reynolds*, 75 Mo. 563 (1882), where the action was for fraud and deceit, and relief was denied on the ground that plaintiff did not, upon discovering the fraud, promptly rescind the contract. The rule is stated that "A party cannot affirm a contract in part, and repudiate it in part." It is obvious that the court applied to an action for deceit the formula applicable to an action for rescission.

⁸ In *Thompson v. Libby*, 36 Minn. 287 at 289, 31 N. W. 52 (1886), Mitchell, J., states the rationale of the rule as follows:

"... to allow a person who has discovered the fraud while the contract is still wholly executory to go on and execute it, and then sue for the fraud, looks very much like permitting him to speculate upon the fraud of the other party. It is virtually to allow a man to recover for self-inflicted injuries. The fraud is really consummated, and the damages incurred, by the acceptance of the property and paying for it. And if this is done after the fraud is discovered, the purchaser cannot say that he sustained this damage by reason of the fraud."

See also *Kingman & Co. v. Stoddard*, (C. C. A. 7th, 1898) 85 F. 740.

⁹ Though "waiver" of fraud is frequently described as a matter of intention on the part of the defrauded party, it has nevertheless been held that an express reservation of the right to maintain the deceit action at a later time will be ineffectual if the defrauded party continues to perform after discovery of the fraud. *Simon v. Goodyear Metallic Rubber Shoe Co.*, (C. C. A. 6th, 1900) 105 F. 573.

¹⁰ 77 Ark. 261, 92 S. W. 783 (1905).

strongly intimated that the subsequent transfer to the vendee would "waive" damages in deceit,¹¹ in spite of the fact that the vendor might have exposed himself to liability for breach of contract, had he chosen to abandon the contract on the basis of a mere suspicion of fraud.

Even where the defrauded party is fully cognizant of the fraud, the result is no more satisfactory. In *Ponder v. Altura Farms Co.*¹² a vendee of land had gone into possession and made substantial improvements on it prior to discovery of the fraud. After making further payments he sought to recover damages for deceit. The court denied relief,¹³ treating the contract as *executory*, and applying the general rule applicable to executory contracts, notwithstanding the fact that the defrauded vendee by making improvements on the land had been placed in such a position that mere rescission of the contract clearly would not have afforded him complete and adequate relief.¹⁴

Further, in the case of *Nouman v. Sutter County Land Co.*,¹⁵ plaintiff, a contractor, had undertaken to construct a levee, but did not discover the fraud of the contractee until a fair portion of the work had been completed. The court held that the contractor had "waived" damages in deceit by going on with the work, insisting that he should have abandoned performance promptly upon learning of the fraud.¹⁶ In view of the outlays of capital and labor involved in such cases, the rule requiring a rescission of the contract, far from promoting the important commercial interests concerned, has the effect of placing the defrauded party in a hopeless dilemma.

Instances where preservation of the contract may be advantageous to the defrauded party in spite of the element of fraud are of common

¹¹ The case came up on exceptions to instructions of the court below. After holding erroneous the instructions given, the court sent the case back for a new trial with language indicating that the confidential relationship between the parties might still justify the plaintiff's continued reliance.

¹² 57 Colo. 519, 143 P. 570 (1914).

¹³ Cf. *Van Natta v. Snyder*, 98 Kan. 102, 157 P. 432 (1916), holding that where the vendee under a land contract had paid a part of the purchase price at the time the contract was made, and on the same day ascertained that the vendor had defrauded him, the fact that the vendee thereafter paid some of the notes given did not constitute a "waiver" of damages in deceit. But a Michigan case on similar facts holds to the contrary. *Van Scherpe v. Ulberg*, 232 Mich. 699, 206 N. W. 323 (1925), noted in 26 COL. L. REV. 626 (1926), and 39 HARV. L. REV. 772 (1926).

¹⁴ This feature was apparently not presented to or considered by the court. It seems that the rescinding purchaser might in such cases recover the value of the improvements in quasi-contract restitution. *Farris v. Ware*, 60 Me. 482 (1872).

¹⁵ 81 Cal. 1, 22 P. 515 (1889).

¹⁶ Accord: *Baltimore & O. Ry. v. Jolly Bros.*, 71 Ohio St. 92, 72 N. E. 888 (1904), fraud in a contract for railroad improvements discovered within a short time after the work had been commenced. *Contra*, *Maryland Casualty Co. v. Cincinnati*, (D. C. Ohio, 1923) 291 F. 834.

occurrence. In *Minnesota Thresher Mfg. Co. v. Gruben*¹⁷ plaintiff purchased a threshing machine from defendant. Upon its arrival plaintiff discovered that he had been defrauded, but continued to use the machine on his farm and made further payments. Such conduct was held to constitute a "waiver" of damages in deceit. The fact that the purchaser in such situations may have some special need to retain the chattel bargained for, in order to prevent a disruption of his work, renders a forced rescission unjust and undesirable.¹⁸

Even in the case of an ordinary fraud-induced contract where no special factors operate to magnify the hardship, a forced rescission seems objectionable. Inasmuch as the mere entering into a contract, though procured through fraud, is normally attended by anticipation of benefits to be received, it seems only fair to allow the defrauded party to reap the full fruits of his bargain without thereby forfeiting his right of action for the fraud.¹⁹

Admittedly a different rule should be applied where the defrauded party is not legally bound to perform at the time the fraud is discovered and has merely made a revocable offer which he fails to revoke.²⁰ Likewise where a new contract is entered into after discovery of the fraud, it is possible to find a fact basis both for an abandonment of the fraud-induced contract and for a surrender of the claim for damages in deceit.²¹ But where the defrauded party chooses to stand on the contract, which is complete and fully enforceable before his discovery of the fraud, he should be permitted to continue performance and preserve, in addition, his claim for damages for the deceit.

Nor is this argument seriously weakened by the recognition in modern law of the availability of the deceit remedy *after* rescission. The deceit action in this situation is confined to supplementing the otherwise incomplete relief afforded by rescission and restitution. It does not purport to give the defrauded party the profit he would have made if the facts misrepresented had been true,²² its purpose being

¹⁷ 6 Kan. App. 665, 50 P. 67 (1897).

¹⁸ A similar test of "necessity" was interestingly applied in *Pryor v. Foster*, 130 N. Y. 171, 29 N. E. 123 (1891), involving a lease of premises. See text in connection with note 33, *infra*. Likewise, in *King v. Dobbs*, 30 Ga. App. 441, 118 S. E. 428 (1923), where an ice machine was sold under the representation that it would keep the vendee's meat from spoiling, held, the fact that the vendee made subsequent payments and retained the machine did not constitute a "waiver" of damages in deceit.

¹⁹ See 39 HARV. L. REV. 772 (1926) and 26 COL. L. REV. 626 (1926).

²⁰ *Ankeney v. Brenton*, 214 Iowa 357, 238 N. W. 71 (1931), where defrauded party under a revocable option to sell stock completed the contract after discovery of the optionee's fraud.

²¹ *Burne v. Lee*, 156 Cal. 221, 104 P. 438 (1909).

²² This is the usual measure of recovery in deceit actions based on a true affirmance

merely to accomplish a more complete restoration of the status quo.²³

That the result reached in fraud cases was by no means inevitable is shown in the closely related field of warranty in sales of goods. At common law the authorities in this country were divided on the question whether acceptance of the goods by the purchaser precluded a subsequent action for breach of warranty for inferior quality.²⁴ Section 49 of the Uniform Sales Act²⁵ adopts the view that acceptance does not bar an action for damages, subject, however, to the limitation that notice of defects must be communicated to the seller within a reasonable time.²⁶

2. *Partially Executed Contracts*

Greater leniency is shown where the defrauded party has partly performed before discovery of the fraud.²⁷ Logically the damages incurred through continued performance after discovery are as much "self-inflicted" in these cases as in cases of executory contracts,²⁸ but strict logic gave way to some overriding considerations of economic policy in this instance in at least five situations: (1) where a forced rescission would deprive the defrauded party of a profit he would have enjoyed in the absence of the fraud; (2) where restoration to his original position is impossible; (3) where forced rescission would subject the defrauded party to further injury; (4) where the defrauded party has almost completely performed; and (5) where rescission would result in serious inconvenience.

A recent case combining the first two situations is *Grosgebauer v.*

of the contract. The same measure of recovery is found in actions for breach of warranty. See 3 WILLISTON, CONTRACTS, § 1391 (1931).

²³ *Faris v. Lewis*, 41 Ky. 375 (1842); *McCrae v. Lonsby*, (C. C. A. 6th, 1904) 130 F. 17; *Hill v. Stephen Motor & Aero Co.*, [1910] 3 Dom. L. R. (Saskatchewan) 676; *Copeland v. Reynolds*, 86 N. H. 110, 164 A. 215 (1933), noted in 32 MICH. L. REV. 113 (1933).

²⁴ 2 WILLISTON, SALES, §§ 488 and 489 (1924).

²⁵ "In the absence of express or implied agreement of the parties, acceptance of the goods by the buyer shall not discharge the seller from liability in damages or other legal remedy for breach of any promise or warranty in the contract to sell or the sale. But if, after acceptance of the goods, the buyer fail to give notice to the seller of the breach of any promise or warranty within a reasonable time after the buyer knows, or ought to know of such breach, the seller shall not be liable therefor."

²⁶ Section 69 of the Uniform Sales Act lists various remedies for breach of warranty (*inter alia*): ". . . the buyer may, at his election (a) accept or keep the goods and set up against the seller the breach of warranty by way of recoupment in diminution or extinction of the price: (b) accept or keep the goods and maintain an action against the seller for damages for the breach of warranty. . . ."

²⁷ For a collection of cases holding that damages for deceit are not "waived" by continued performance after discovery, under partially executed contracts, see L. R. A. 1918A 106ff. and note thereto.

²⁸ 3 WILLISTON, CONTRACTS, § 1524 (1931).

*Schneider*²⁹ where the vendors of land misrepresented the cost of improvements, the prospective income from rentals, and the value of the property. The vendee remained silent for over two years, continuing to accept the benefits of the bargain. In the interim, a house which the vendees had transferred in part payment had been destroyed by fire. In an action by the vendors for unpaid installments the vendee was held not to have "waived" a cross action for damages in deceit, on the ground that rescission would have deprived the vendee of his profits, and, in any event, the vendor was unable to restore the vendee to his original position.

In *Bytovetski v. McDuff's Estate*³⁰ a second mortgagee, induced by fraud to purchase the property at the first mortgage foreclosure sale, contracted to sell the premises to a third person before discovering the fraud. The court held that the second mortgagee did not forfeit his right to recover damages for deceit by having completed the purchase after discovery of the fraud, since rescission might have subjected him to suit for breach of the contract with the third person.

In *Geiger v. Cardwell*³¹ a purchaser of grain had paid a large sum of money on the purchase price before discovering the vendor's fraud. The court held that this payment constituted such part performance as to render the contract no longer executory in a sense affecting the purchaser's right to recover damages for the fraud, though he had completed performance thereafter.

An example of the lengths to which a court may sometimes go in order to salvage the deceit action for the benefit of the defrauded party is seen in the case of *Pryor v. Foster*.³² A lessee had been induced by fraud to accept a lease and went into possession in the midwinter season. He continued to pay rent and later brought an action in deceit. The court, speaking through Haight, J., said:³³

"The plaintiff leased the premises in midwinter and moved into the same with his family. He could not then be compelled to rescind the contract or be deemed to have waived it. . . . It might not have been convenient for him at that season of the year to find another house into which he could move. He had the right to continue to occupy the house . . . and demand the damages that he had suffered by reason of the fraud."

It is apparent that the "self-inflicted injuries" argument plays a minor rôle in the cases of partially executed contracts. The test applied

²⁹ 177 Wash. 43, 31 P. (2d) 90 (1934).

³⁰ 54 R. I. 207, 171 A. 923 (1934).

³¹ 99 Kan. 559, 163 P. 613 (1917).

³² 130 N. Y. 171, 29 N. E. 123 (1891).

³³ 130 N. Y. 171 at 181, 29 N. E. 123 (1891).

in these cases makes the question of "waiver" of damages in deceit turn upon the situation of the defrauded party at the time of discovery of the fraud.³⁴ On principle, however, there appears to be no reason why the same test should not be applied to executory contracts,³⁵ particularly in those cases where a forced rescission would impose an uncalled-for hardship upon the innocent party.

J. H. J.

³⁴ This test is applied in *Bean v. Bickley*, 187 Iowa 689 at 711, 174 N. W. 675 (1919). Salinger, J., said:

"... there should not be a general rule, even in an executory contract, that mere discovery and proceeding bars all rights to redress. That must depend upon the situation of the wronged party. He should not be compelled to refrain from affirming and proceeding further, if rescinding will lose him a profit he would have enjoyed, had he been fairly dealt with—much less, if rescinding will cause him actual injury."

³⁵ Some of the cases have made the defrauded party's right to maintain the deceit action depend upon a purely artificial distinction between executory and partially executed contracts. Thus in *Ponder v. Altura Farms Co.*, 57 Colo. 519, 143 P. 570 (1914) (see text in connection with note 12, supra), the court in one breath simply "labelled" the contract executory, and then denied relief. Assuming (without admitting) that the result is proper, one may seriously quarrel with the superficiality of the court's reasoning. A forceful criticism of the distinction between executory and partially executed contracts is found in *Whitney v. Allaire*, 1 N. Y. 305 (1848), by Gardiner, J., at p. 311:

"But if the agreement was executory, it would not . . . change the right of the parties. It is conceded that if the contract had been partly executed, even in the most trifling particular, the defendant [lessee being sued for rent] would have the right to . . . affirm the contract and have his remedy by way of recoupment when sued for the rent. Why should he not have the same remedies when the contract is executory? In neither case . . . could there be a contract until ratified with a knowledge of the fraud. And if an adoption under such circumstances, of the agreement, is an abandonment by the person defrauded, of his claim to damages for the deceit in the one case, it must be in both. In neither will repudiation of the contract alone . . . restore him to his rights as they existed prior to the agreement."