

1948

CONTRACTS-REMEDIES FOR MISREPRESENTATION-MEASURE OF RECOVERY

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Recommended Citation

Richard J. Archer S.Ed., *CONTRACTS-REMEDIES FOR MISREPRESENTATION-MEASURE OF RECOVERY*, 46 MICH. L. REV. 952 (1948).

Available at: <https://repository.law.umich.edu/mlr/vol46/iss7/6>

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CONTRACTS—REMEDIES FOR MISREPRESENTATION—MEASURE OF RECOVERY*—In a preceding comment in this series, the various remedies affording relief for misrepresentation were examined for the purpose of determining what remedies are available in case of an innocent misrepresentation.¹ Discussion was directed toward actions for damages for deceit, actions at law and in equity for restitution, the recovery of damages for breach of warranty, and the action based on the enforcement of representations on a theory of estoppel. The purpose of the present comment is to re-examine these remedies to determine what relief can be obtained by each of them, assuming for this purpose that all of the remedies will be available in each case. Another remedy, reformation of a written instrument, will also be considered.

Before considering specific situations something should be said in the way of classification and further explanation of these remedies. The courts have frequently stated that upon discovery of a fraudulent misrepresentation alternative courses are open to the defrauded party: he may either affirm or rescind the contract.² Upon affirming the contract

*This is the sixth and last in the series of related comments in the Law of Contracts and Restitution published in Volume 46 of the REVIEW.

¹ 46 MICH. L. REV. 810 (1948).

² *Adams v. Fada Realty Co.*, 305 Ky. 194, 202 S.W. (2d) 439 at 440 (1947); *Goldsmith v. National Container Corp.*, 287 N.Y. 438 at 442, 40 N.E. (2d) 242 (1942); 5 WILLISTON, CONTRACTS, rev. ed., § 1523 (1937). †

his relief lies in the actions for damages for deceit, damages for breach of warranty, reformation of a written instrument in some situations, or enforcement of the representations by estoppel. Remedies upon rescinding are actions to recover specific property at equity³ or by replevin at law,⁴ and in case specific restitution is not desired or possible restitution may take the form of a monetary award. This latter may be called "value restitution." In granting relief by an affirmance remedy an attempt is made to enforce against the one who made the representation the kind of bargain he appeared to be making,⁵ and this is sometimes explained as an endeavor to place the defrauded party in the position in which he would have been had the representation been true. The objective in rescission remedies is to place the parties in the positions which they occupied before the fraudulent misrepresentation occurred.⁶ At this point one exception should be noted; relief in the affirmance remedy of deceit may be granted either on a tort theory of restoring the status quo or on a contract theory of placing the defrauded party in the position in which he would have been had the misrepresentation been true.⁷ In either case the action is considered to be an affirmance remedy, and in many instances the remedy for damages for breach of warranty is confused with or indistinguishable from the deceit action awarding damages on a contract theory. An understanding of all the remedies can best be obtained by applying them to various situations in which the defrauded party to a contract for the sale or exchange of goods or services desires relief.

A. *Application of Various Remedies and Theories of Relief*

The first situation to consider is that in which, induced by fraudulent misrepresentations, there has been a sale or exchange of property, the value of the performance on the side of the innocent party exceeding that received with no change in value of the property following the transfer. Typical of this situation would be the sale of an automobile in which the vendor fraudulently misrepresented the date of its manufacture and the purchaser paid five hundred dollars more than the market value at that time, the purchase price also being one hundred dollars more than market value of a car of the represented vintage. In

³ 3 SCOTT, TRUSTS, c. 13 (1939); RESTATEMENT, RESTITUTION, § 160 (1937).

⁴ Griggs v. Meek, 37 Wyo. 282, 264 P. 91 (1928).

⁵ 5 WILLISTON, CONTRACTS, rev. ed., § 1523 (1937).

⁶ Merry Realty Co. v. Shamokin and Hollis Real Estate Co., 230 N.Y. 316, 130 N.E. 306 (1921); McCleary, "Damages as Requisite to Rescission for Misrepresentation," 36 MICH. L. REV. 1, 227, at 3 (1937); 5 WILLISTON, CONTRACTS, rev. ed., § 1523 (1937).

⁷ Annotation in 124 A.L.R. 37 (1940); 5 WILLISTON, CONTRACTS, rev. ed., § 1514 (1937); McCORMICK, DAMAGES, c. 18 (1935).

such case a deceit action allowing damages on a tort theory would allow a purchaser to recover the entire five hundred dollars even though the disparity was not caused solely by the misrepresentation⁸ as long as it could be shown that the fraud was material in inducing the purchaser to enter into the contract.⁹ Recovery on the basis of the lost bargain (placing the defrauded party in the position in which he would have been if the representation had been true) would achieve a recovery of but four hundred dollars, the remaining one hundred dollars not being connected with the date of manufacture.¹⁰ Since the purpose of the loss-of-bargain rule has apparently been to award a larger recovery, the court might be induced to allow the injured party to elect the tort measure in this situation.¹¹ Similarly, the action in assumpsit for damages for breach of warranty to which the deceit action awarding damages on a contract theory has been analogized would be inadequate.¹² Rescission and restitution of the property or its money equivalent would represent approximately the same amount of recovery as in the action for damages based on a tort theory because the difference in value between the auto which the plaintiff would have to restore and the purchase price would be five hundred dollars.¹³

Another situation is that in which the property exchanged does not change in value and in addition no disparity in value exists at the time of the transfer although there is a false representation; for example the sale of an automobile at its market price induced by a misrepresentation as to its date of manufacture where if the representation had been true, the car would have been worth one hundred dollars more than the purchase price. In such case the deceit remedy measuring damages on a tort theory would not afford any relief as the defrauded party

⁸ *Kienle v. MacFulton, Inc.*, 12 N.J. Misc. 697, 174 A. 349 (1934), sale of an auto; *Day v. Horton*, 221 App. Div. 685, 225 N.Y.S. 358 (1927), sale of an auto; *Horning v. Ferguson*, (D.C. D.C. 1947) 52 A. (2d) 116, sale of land; *Menefee v. Blitz*, (Ore. 1947) 179 P. (2d) 550, sale of stock.

⁹ On the problem of materiality see, 3 TORTS, RESTATEMENT, § 538 (1938); 5 WILLISTON, CONTRACTS, rev. ed., §§ 1515, 1516 (1937).

¹⁰ *McCaskill v. Clay*, (Tex. Civ. App. 1926) 284 S.W. 643. In *Cedar v. McCarthy*, (Mass. 1947) 70 N.E. (2d) 698, the defendant vendor who misrepresented the vintage of an automobile successfully challenged the lower court's assessment of damages on a tort theory.

¹¹ See, McCORMICK, DAMAGES, § 121 (1935); also Harper and McNeely, "A Synthesis of the Law of Misrepresentation," 22 MINN. L. REV. 939 (1938).

¹² 5 WILLISTON, CONTRACTS, rev. ed., § 1391 (1937); Uniform Sales Act, § 69 (6), (7).

¹³ *Thompson v. W. C. Howard Motors Co.*, 122 Kan. 339, 252 P. 468 (1927); in *Merry Realty Co. v. Shamokin & Hollis Real Estate Co.*, 230 N.Y. 316, 130 N.E. 306 (1921), a showing of disparity in values of land at the time of exchange on which evidence the lower court had decreed damages was sufficient to justify a decree of rescission.

in this type of case is usually required to show a pecuniary disparity at the time of transfer.¹⁴ On the other hand the warranty action and the analogous deceit action would permit recovery of the one hundred dollars on a loss of bargain theory,¹⁵ and there would seem to be no objection to allowing plaintiff to elect the warranty action in place of a deceit remedy measuring damages on a tort theory.¹⁶ While rescission is sometimes denied where there is no proof of pecuniary damage,¹⁷ this requirement is met even though the harm is in the failure of the representations to be true;¹⁸ and in this case the purchaser could rescind and obtain restitution of the purchase price upon restoration of the automobile,¹⁹ Obviously this would not compensate for the loss of bargain but only for the change in position occasioned by the fraud.

The third situation to consider is that in which there is a sale or exchange induced by fraudulent misrepresentations, and although there was no difference in value at the time of the exchange, the property transferred by the defrauded vendor appreciates in value. An illustration of this is the sale of securities with a subsequent increase in their market value. Even if the increase were caused by some matter relating to the fraud such as a misrepresentation as to the present value of the assets of the corporation issuing the securities, it would seem difficult for the vendor to obtain relief in an action for damages on a tort theory if the damages in this action were to be calculated with reference to the disparity at the time of transfer. However, other methods of calculating damages in the case of commodities which fluctuate rapidly in value have been used in actions for conversion and breach of contract. Either the highest value reached between the time of conversion and

¹⁴ *Menefee v. Blitz*, (Ore. 1947) 179 P. (2d) 550, sale of stock; *Horning v. Ferguson*, (D.C. D.C. 1947) 52 A. (2d) 116, sale of land; *Henschel v. Schreiber*, (Ohio App. 1947) 72 N.E. (2d) 107 (1946), sale of rooming house.

¹⁵ Annotation in 124 A.L.R. 37 at 50 (1940), citing cases which hold that damages on a warranty theory are available even though the property transferred is worth the price paid.

¹⁶ In *Donovan v. Aeolian Co.*, 270 N.Y. 267, 200 N.E. 815 (1936), a case involving the fraudulent failure to disclose that a piano was used, the New York court, which generally follows the tort theory as to damages, denied rescission suggesting that the proper remedy was an action for damages for breach of warranty.

¹⁷ Annotation in 106 A.L.R. 125 (1937); contra, 2 *CONTRACTS RESTATEMENT*, § 476 (1932).

¹⁸ *Darrow v. Houlihan*, 205 Cal. 771, 272 P. 1049 (1928), suggesting that failure to get what was bargained for would justify rescission; McCleary, "Damages as Requisite to Rescission for Misrepresentation," 36 *MICH. L. REV.* 1, 227, at 229-235 (1937); rescission for breach of warranty is provided for in the *Uniform Sales Act*, § 69 (1) (d).

¹⁹ *Colt Co. v. Freitas*, 76 Cal. App. 278, 244 P. 916 (1926), allowing rescission as a defense to an action for the purchase price even though the property was worth the contract price.

time of trial or the highest value in the interim between the date on which the fraud was discovered and the date by which a substitute could reasonably have been procured are possible alternatives.²⁰ What measure of damages a jurisdiction which ordinarily follows a contract theory would allow to a defrauded vendor is not too clear although one such jurisdiction adopted the tort theory, allowing the difference between amount received and actual value.²¹ Rescission and specific restitution would permit the defrauded party to recover any intermediate gain occurring before judgment.²² Such course of action may not be open, however, if the property is made unavailable by the defrauder's resale to an innocent purchaser, and if such relief is sought at law, recovery may also be prevented in some jurisdictions if the defendant posts a replevin bond.²³ In providing value restitution the proper date for valuation would again be in question with a tendency to follow analagous damage actions.²⁴

But suppose the defrauded party is faced with a situation in which the property he has transferred has fallen in value, and relief is desired due to the decline in value of the property he has received or for other reasons. Such a condition would exist where an automobile is transferred and declines in value due to use and market changes. The damage actions would provide adequate relief only to recover a disparity at the time of transfer or a decline in value of the property received. But on the rescission side of the picture restitution of the auto may be obtained without suffering for the loss in the hands of the defrauder. This can be accomplished by suing for value restitution in which case the court will probably evaluate the property at a time advantageous to

²⁰ McCORMICK, DAMAGES, §§ 48, 49, 123 (1935); annotations in 161 A.L.R. 316 at 338 (1946); 108 A.L.R. 1060 (1937), securities; 87 A.L.R. 817 (1933) and 40 A.L.R. 1282 (1926) as to chattels generally.

²¹ Helming v. Kashak, 122 Conn. 641, 191 A. 525 (1937); see annotation in 124 A.L.R. 37 at 48 (1940) and Voellmeck v. Harding, 166 Wash. 93, 6 P. (2d) 373 (1931), allowing the defrauded vendor the difference between the amount he actually received and what he would have received but for the fraudulent misrepresentations.

²² Ripka v. Philco Corp., (D.C. N.Y. 1945) 65 F. Supp. 21, *affd.*, (C.C.A. 2d, 1946) 154 F. (2d) 501, awarding restitution to a defrauded vendor of stock which had increased in value almost fivefold at time of discovery and at the time of fixing the supersedeas bond was worth twelve and one half times the market value at time of sale; Munroe v. Harriman, (C.C.A. 2d, 1936) 85 F. (2d) 493, disregarding a large intermediate gain pending final decree; Williams v. Logue, 154 Miss. 74, 122 S. 490 (1929), allowing replevin of an \$8.00 calf which had become a \$75.00 cow at time of judgment.

²³ The statutes vary as to whether the successful party in replevin will have an election between specific delivery or an alternative money judgment upon posting of bonds, see 54 C.J., Replevin, § 334.

²⁴ Stewart v. Joyce, 205 Mass. 371, 91 N.E. 555 (1910), rescission in equity; Hoff v. Lester, 75 Wash. (2d) 86, 168 P. (2d) 409 (1946), replevin.

the defrauded party.²⁵ If specific restitution is sought, it may be possible to obtain compensation for the decline in value; in claim and delivery actions this has been allowed on the principle of compensation for wrongful detention even where the defendant is an innocent holder.²⁶ Textual authority on a similar problem indicates that the equitable lien device can be used to throw an intermediate loss on the defrauder by declaring traceable proceeds of wrongfully acquired property to be only a pro tanto satisfaction of a liability equal to the original worth of the property transferred.²⁷ Case authority for this procedure is found where a rescinding purchaser is allowed to impose a lien on the property to which the purchase price can be traced and to obtain a personal judgment for the remainder.²⁸ This would seem to indicate that the defrauded vendor of the car could obtain a sale of car and a personal judgment to satisfy the difference so as to equal the original value of the car. In case of a sale the defrauded vendor might achieve this result by restoring something less than the full purchase price.²⁹

Perhaps the commonest situation in which relief is desired by the defrauded party is that in which the property received by him depreciates in value subsequent to the exchange. Recovery in such cases could not be obtained in an action for deceit for tort damages because the relief is usually limited to a disparity existing at the time of the exchange except where the fraud remains undiscovered³⁰ or there is a continuing fraud inducing the retention of the goods received.³¹ Recovery in the breach of warranty action or in the damage action would be adequate only if the loss related to the fraud as, for example, a misrepresentation in regard to the financial condition of the corporation whose securities are purchased.³² In the deceit action where the fraud does not relate to the condition, use or value of the property, it must be shown that the representation is not promissory in character. If it

²⁵ Notes 20 and 24, *supra*; *RESTITUTION RESTATEMENT*, § 151 (1937).

²⁶ *Spencer Kennelly, Limited v. Bank of America Nat. Trust and Savings Assn.*, 19 Cal. (2d) 586, 122 P. (2d) 552 (1942).

²⁷ 3 *SCOTT, TRUSTS*, § 508.2 (1939); *RESTITUTION RESTATEMENT*, § 161 (1937).

²⁸ *General Motors Acceptance Corp. v. Larson*, 110 N.J. Eq. 305, 159 A. 819 (1932).

²⁹ *Phoenix Iron Works v. McEvony*, 47 Neb. 228, 66 N.W. 290 (1896); 5 *WILLISTON, CONTRACTS*, § 1530 (1937); annotation in 29 *COL. L. REV.* 791 at 794, note 24 (1929).

³⁰ Annotation in 108 *A.L.R.* 1060 at 1064 (1937).

³¹ *Schied v. Bodinson Mfg. Co.*, (Cal. App. 1947) 179 P. (2d) 380 (1947), waiver of continuing fraud; *Hotaling v. Leach & Co.*, 247 N.Y. 84, 159 N.E. 870 (1928); annotation in 108 *A.L.R.* 1060 (1937); *McCORMICK, DAMAGES*, § 122 (1935).

³² *Smith v. Middle States Utilities Co. of Delaware*, 224 Iowa 151, 285 N.W. 158 (1937).

were promissory, the action would have to be on the promise and might be barred by the parol evidence rule in the case of a written contract.³³ Nevertheless, the courts have found fraud in the making of promises with no intent to perform.³⁴ By restoring property the depreciation in the value of which may not be related to nor proportionate to the fraud, one can obtain by restitution a more adequate recovery on a theory of rescission than may be available in the warranty type action. In *Seneca Wire & Manufacturing Co. v. A. B. Leach & Co.*³⁵ a cause of action for return of the purchase price on a theory of rescission was sustained where the misrepresentation of the vendor related to the listing of corporate securities. At the commencement of the action the corporation had become bankrupt, but the court found it sufficient for the plaintiff to restore the devalued securities without considering whether the securities could have been listed or whether the reasons for failure to list them related to the subsequent failure of the corporation. It was sufficient that the representations were "material" in that they were a partial inducement to enter into the contract.³⁶ Thus a result may be reached which is similar to that in cases of fraudulent breach of a fiduciary relation in which there is the added element of enforcement of such duties.³⁷ This may be an additional reason why some courts require a showing of pecuniary damage as a prerequisite to rescission.³⁸ But even in such cases no attempt is made to have the amount of damage correspond to the loss which will be thrown on the defrauding party; a minimum of pecuniary damage is sufficient to obtain rescission even though there has been a great independent devaluation in the property to be restored by the defrauding party.³⁹ The harshness of this result is mitigated to some extent by estoppel doctrines which require the defrauded party to act promptly upon discovery of the fraud.⁴⁰ and by preventing rescission where there has been too great a change

³³ Note 70, *infra*.

³⁴ *Seidman v. Bades*, (Queens Co. S.Ct. 1947) 74 N.Y.S. (2d) 883; 4 TORTS RESTATEMENT, § 530 (1938); 2 CONTRACTS RESTATEMENT, § 473 (1932); *contra*: *Rice v. Allen*, 318 Mich. 245, 28 N.W. (2d) 91 (1947).

³⁵ 247 N.Y. 1, 159 N.E. 700 (1928).

³⁶ Similarly, RESTITUTION RESTATEMENT, § 9 (1937); see 5 WILLISTON CONTRACTS, § 1516 (1937) and 2 CONTRACTS RESTATEMENT, § 470 (2) (1932), indicating that a "wider meaning" is given to reliance in avoiding contracts.

³⁷ In *Vice v. Thacker*, (Cal. 1947) 180 P. (2d) 4 (1947), the California court, which usually requires a showing of damages for rescission, allowed rescission for fraud by an agent although no injury was shown.

³⁸ *Molfino v. Levinson Produce Co.*, 79 Cal. App. (2d) 587, 180 P. (2d) 365 (1947).

³⁹ *Spreckles v. Gorrill*, 152 Cal. 383, 92 P. 1011 (1907).

⁴⁰ *Johns v. McGenty*, 222 Minn. 84, 23 N.W. (2d) 289 (1946), in which an extended delay induced by assurances of the defrauder was not unreasonable; 2 CONTRACTS RESTATEMENT, § 483 (1932).

in circumstances. In *Bankers Trust Co. v. Hall*⁴¹ the court found that the change in conditions of a farm held by the plaintiffs as a result of foreclosing on securities which they had been induced by fraud to purchase could prevent adequate restoration although in the same case it had been previously held⁴² that the cause of action was not barred by laches.

B. Collateral Costs—Accounting

In addition to the cases just considered there are situations in which the economic positions of the parties have changed due to expenditures, profits, and losses in regard to the property exchanged. In the case of *Baylies v. Vanden Boom*⁴³ the court considered a situation in which the defrauded party received a ranch in exchange for a hotel. In seeking a complete restoration after a period of time had elapsed the court granted additional relief in the form of an accounting which allowed the plaintiff the value of his services as hotel manager⁴⁴ and the amount of unpaid taxes and interest on a mortgage on the ranch, stipulated to be equivalent to the defendant's use; the defendant was allowed compensation for his expenses on the ranch. It should be noted that the court intimated that if the plaintiff had sought relief by a constructive trust remedy emphasizing the delict of the defendant rather than an accounting, the defendant might not have been allowed compensation for his expenses.⁴⁵ Yet there are cases which allow such compensation to the defendant,⁴⁶ and this would seem to be equitable.

Is this result consistent with the situations previously discussed in which changes in market value of property were not considered in attempting to restore the status quo by specific restitution? The cases seem to ignore differences in market value particularly where there has been a decline in value of the property which the defrauded party

⁴¹ 116 Colo. 566, 183 P. (2d) 986 (1947); the court had reviewed the evidence of fraud in *Bankers Trust Co. v. International Trust Co.*, 108 Colo. 15, 113 P. (2d) 656 (1941).

⁴² *Hall v. Bankers Trust Co.*, 101 Colo. 449, 74 P. (2d) 720 (1937).

⁴³ 40 Wyo. 411, 278 P. 551 (1929).

⁴⁴ Presumably the plaintiff would have had to restore profits from the operation of the hotel had there been any; see *Kruger v. Block*, 114 Neb. 839, 211 N.W. 173 (1926), in which the rescinding party had to restore rents he had received.

⁴⁵ See, *Plummer v. Lasson*, 352 Mo. 316, 177 S.W. (2d) 455 (1944); *Warner v. Warner*, 199 App. Div. 159, 191 N.Y. S. 612 (1921); 3 SCOTT, TRUSTS, § 479.1 (1939).

⁴⁶ *Kimmel v. Peach*, 240 Mich. 697, 216 N.W. 374 (1927), noted in 26 COL. L. REV. 670 (1928); *Kruger v. Block*, 114 Neb. 839, 211 N.W. 173 (1926). In *Lang v. Girardo*, 311 Mass. 132, 40 N.E. (2d) 707 (1942), the court held that the defendant could collect compensation for disbursements for existing liens and necessary repairs, but could receive no credit for new improvements; see, RESTITUTION RESTATEMENT, § 158 (1937).

desires to restore though allowing an accounting for expenses, profits and losses. Illustrative of this distinction is the case of *Marr v. Tu-multy*⁴⁷ in which the question of the amount of recovery in a suit for rescission was raised in regard to the restoration to be made to the defendant.⁴⁸ In this case stock had been purchased from a corporation by the plaintiff and his associates in reliance on the fraudulent representations of the corporation which had already corrupted the plaintiff's agents. The plaintiff had resold his stock almost immediately so as to realize a profit, but on discovery of the fraud he had purchased similar shares which had declined in value to a nominal price. The court held that, in order to rescind, the proceeds from resale had to be restored to the receivers of the corporation; however, it was sufficient for the plaintiff's associates who had retained their original shares to restore only such shares with dividends received. While the result in this case is commendable from the standpoint of damage to the plaintiff,⁴⁹ it should be noted that the court did not consider whether the defendant's fraud had caused the decline in value of the shares but only whether the misstatement was material in inducing the purchase.

In recovery for collateral expenditures one aspect of the doctrine of election of remedies deserves particular attention. The courts often state that while mere election of a party to rescind will not prevent recovery in a deceit action, the successful rescission and restitution will prevent the use of the affirmance remedy.⁵⁰ There is, however, the exceptional situation in which the rescinding party has incurred expenses in reliance upon the fraudulent misrepresentations which cannot be compensated by restitution of the property he has transferred and which do not relate to the disparity in value of the properties. Such was the case in *Waldman Produce, Inc. v. Frigidaire Corporation*⁵¹ in which the purchaser of an inadequate refrigerator lost the goods he stored therein. The buyer rescinded and on one cause of action recovered the purchase price; in a second cause of action for deceit he was allowed to recover the value of the spoiled goods in the same suit. The result is supported by the weight of authority.⁵² Com-

⁴⁷ 256 N.Y. 15, 175 N.E. 356 (1931) noted in 30 MICH. L. REV. 306 (1931).

⁴⁸ As to the necessity for restoration see, 3 SCOTT, TRUSTS, § 479 (1939); 5 WILLISTON, CONTRACTS, rev. ed., §§ 1529, 1530 (1937); RESTITUTION RESTATEMENT, § 177 (1937); comment in 29 COL. L. REV. 791 (1929).

⁴⁹ See *Smith v. Johnson*, 47 Idaho 468, 276 P. 320 (1921), reduction in plaintiff's loss by profitable resale.

⁵⁰ *Campanella v. Campanella*, 204 Cal. 515, 269 P. 433 (1928); 5 WILLISTON, CONTRACTS, rev. ed., § 1528 (1936).

⁵¹ 157 Misc. 438, 284 N.Y.S. 167 (1935).

⁵² See authority collected in *Waldman Produce, Inc. v. Frigidaire*, 157 Misc. 438, 284 N.Y.S. 167 (1935); annotation in 120 A.L.R. 1154 (1939); 5 WILLISTON, CONTRACTS, rev. ed., § 1528A (1937); note in 32 MICH. L. REV. 113 (1933).

pensation for collateral losses can also be recovered in an action for rescission for breach of warranty.⁵³

C. *Insolvency of the Defrauder*

A situation in which the restitution remedy has proved extremely helpful in obtaining relief is that in which the defrauder becomes bankrupt. In such cases the specific property transferred can usually be reclaimed at law and in equity,⁵⁴ the theory of rescission being that the transaction is undone so that the property reverts in the original holder. Inasmuch as the effect of fraud inducing the transfer is to make the transaction voidable, not void;⁵⁵ specific property cannot be reclaimed if it has found its way into the hands of a bonafide purchaser.⁵⁶ When such interim transfers prevent recovery of the original res, constructive trust or equitable lien may enable the defrauded party to reach the proceeds.⁵⁷ Probably no one challenges this if it goes no further than a claim upon the immediate product of the claimant's original property, but further tracing may become tenuous so as to allow what may be an unjustified preference.⁵⁸ An interesting application indicating the effectiveness of this remedy arises in cases where a borrower obtains a loan through fraud. Instead of bringing suit on the debt the creditor can have the insolvent debtor declared a trustee and trace the proceeds into specific property.⁵⁹

D. *Fraud as a Defense, Cross-Claim, or Reply*

Although fraud is usually a basis for commencement of an action by the defrauded party, it can frequently be employed to advantage as a defense to an action for the purchase price⁶⁰ or specific performance;⁶¹

⁵³ Rogge, "Damages upon Rescission for Breach of Warranty," 28 MICH. L. REV. 26 (1929).

⁵⁴ In re Penn Table Co., (D.C. W. Va. 1939) 26 F. Supp. 887; Sternberg v. American Snuff Co., (C.C.A. 8th, 1934) 69 F. (2d) 307; American Sugar Refining Co. v. Fancher, 145 N.Y. 552, 40 N.E. 206 (1895); 4 REMINGTON, BANKRUPTCY, 4th ed., § 1450 (1931); 5 id., § 2456.

⁵⁵ 5 WILLISTON, CONTRACTS, rev. ed., § 1488 (1937); 2 CONTRACTS RESTATEMENT, §§ 475, 476 (1932).

⁵⁶ 3 SCOTT, TRUSTS, §§ 474-478 (1939); RESTITUTION RESTATEMENT, §§ 172-176 (1937); 12 A.L.R. 1048 (1921).

⁵⁷ 3 SCOTT, TRUSTS, § 521 (1939); 5 REMINGTON, BANKRUPTCY, 4th ed., §§ 2456, 2464 (1931).

⁵⁸ 4 REMINGTON, BANKRUPTCY, 4th ed., § 1676 (1931); Cunningham v. Brown, 265 U.S. 1, 44 S.Ct. 424 (1924).

⁵⁹ Meier v. Geldis, 148 Neb. 304, 27 N.W. (2d) 215 (1947), noted in 46 MICH. L. REV. 116 (1947); Sliker v. Sliker, 21 Tenn. App. 64, 105 S.W. (2d) 117 (1937).

⁶⁰ Kaluzok v. Brisson, 27 Cal. (2d) 760, 167 P. (2d) 481 (1946); Colt Co. v. Freitas, 76 Cal. App. 278, 244 P. 916 (1926).

⁶¹ 5 WILLISTON, CONTRACTS, rev. ed., § 1435 (1937).

fraud insufficient to found an action for cancellation or damages may nevertheless prevent specific enforcement of a contract by the defrauder.⁶² The defense can also have the effect of a counter claim or cross complaint for damages to recover the difference between the amount paid or due on the contract and the market price,⁶³ and the use of rescission allows the defrauded party to restore the goods received so as to avoid the whole transaction.⁶⁴ In those cases in which specific restitution is impossible and a defrauded vendor desires to rescind and sue for the market price of his property or services instead of the contract price a reply of fraud avoids the defense of the contract or its breach.⁶⁵ Obviously the situation in which this remedy is desirable is that in which the market value exceeds the contract value of that which is to be received. This remedy is frequently employed in construction contracts in which there has been fraud as to the nature of the work to be performed upon the discovery of which the contractor desires to rescind and recover for services already performed.⁶⁶ Similarly, where there has been fraud in procuring the release of a claim, an action can be commenced on the original claim.⁶⁷

E. Fraud and Written Instruments

The remedies previously discussed apply as well to written contracts as to others, but the combination of fraud and a written instrument raises some peculiar problems. Suppose a landlord and tenant agree as to the terms of a lease, the landlord making a material misrepresentation as to the amount of rent paid by other tenants;⁶⁸ and subsequently a lease is drawn to conform to the agreement. The tenant in such case would have to rely on the ordinary damage and rescission remedies and could not obtain reformation because the written agreement represented exactly the previous agreement.⁶⁹ The parole evidence rule would not prevent showing any intentional fraud in actions for rescission or damages as this goes to the state of mind not covered

⁶² Annotations in 87 A.L.R. 1345 (1933) and 121 A.L.R. 1162 (1939).

⁶³ Nevada Land & Investment Corp. v. Sistrunk, 220 Cal. 174, 30 P. (2d) 389 (1934).

⁶⁴ Colt Co. v. Freitas, 76 Cal. App. 278, 244 P. 916 (1926); annotation in 142 A.L.R. 582 at 593 (1943).

⁶⁵ Miller v. McLaglen, (Cal. App. 1947) 186 P. (2d) 48.

⁶⁶ Benjamin Foster Co. v. Massachusetts, 318 Mass. 190, 61 N.E. (2d) 147 (1944), denied because of no reliance on misrepresentations; annotation in 2 A.L.R. 1396 (1919).

⁶⁷ Ricketts v. Penn. R. Co., (C.C.A. 2d, 1946) 153 F. (2d) 757.

⁶⁸ That such may be fraud see, Baloyan v. Furniture, Exhibition Building Co., 258 Mich. 244, 241 N.W. 886 (1932).

⁶⁹ Edythe Nelson, Inc. v. 500 Fifth Ave., Inc., (N.Y. Co. S.Ct. 1947) 73 N.Y.S. (2d) 299; Jones v. Crowell, 164 Kan. 261, 188 P. (2d) 908 (1948).

by the instrument.⁷⁰ But where the parties agree as to the terms of a conveyance and through the fraud of one and the mistake of the other the deed does not conform to the agreement, the deed can be reformed to correspond with the original agreement.⁷¹ In case rescission is desired it may be necessary to resort to an equitable decree as it has been held that a law court cannot admit evidence of fraud in the inducement of a deed or lease of land⁷² although such instruments can be attacked in law or in equity for fraud in the execution where the signature is obtained by misrepresentation as to the nature of the instrument.⁷³

F. Conclusion

Perhaps it is presumptuous to attempt any general observations in the field of misrepresentation because the more cases one reads the more apparent it becomes that results in actions based on fraud depend to a large extent upon the particular facts of each transaction so that when any prognostication is attempted reference should be made to cases with similar fact situations. Repeatedly in the present comment reference has been made to situations involving the sale of an automobile; only the most naïve would anticipate similar results if the subject matter of the contract were a horse. Also the cases involving the stock transactions are somewhat unique. Yet some observations can be made.

A preliminary examination of the various remedies reveals that the two theories of relief for a defrauded party can achieve different amounts of recovery so that a judicious choice is not only advantageous but available in many instances. The variation in quantum of recovery according to the remedy selected is probably the result of the failure to require the plaintiff in actions on a theory of rescission to show a causal connection between the misrepresentation and the damage suffered.⁷⁴ In such actions the defrauded party need show only that he relied on the misrepresentation and that such reliance was reasonable. On the other hand, most affirmance remedies, in enforcing against the one who has made a misrepresentation the kind of bargain he appeared to be making, contemplate a relief which is related to the mispre-

⁷⁰ *New England Foundation Co. v. Elliott & Watrous, Inc.*, 306 Mass. 177, 27 N.E. (2d) 756 (1940); 9 WIGMORE, EVIDENCE, 3d ed., § 2439 (1940).

⁷¹ *Dyke v. Alleman*, (W. Va. 1947) 44 S.E. (2d) 587.

⁷² *Lantis v. Western Oil & Gas Distributing Agency*, 219 Mich. 520, 189 N.W. 47 (1922), lease; *Reser v. Labude*, 103 Wash. 228, 173 P. 1093 (1918), deed.

⁷³ 1 WILLISTON, CONTRACTS, rev. ed., § 95 A (1936); annotation in 20 L.R.A. (n.s.) 915 (1909).

⁷⁴ The possibility that causation is both an element of the justifiable reliance of the defrauded party as well as of his damages is mentioned in *Neuman v. Corn Exchange National Bank & Trust Co.*, 356 Pa. 442, 51 A. (2d) 759 at 765 (1947); and *Seidman v. Bandes*, (Queens Co. S.Ct. 1947) 74 N.Y.S. (2d) 883 at 884.

sensation. Another cause of the discrepancy in amount of recovery under the various remedies is that the plaintiff in an action on a theory of rescission may restore property which has depreciated in value through no fault of the plaintiff but also independent of the misrepresentation of the defendant.

There has been some tendency, however, to apply these various remedies to particular situations so that the actual recovery is the same regardless of the choice of remedy. One factor which has contributed to this result is the flexibility allowed in selecting a date for valuation in case of value restitution. Also, careful application of the election of remedies doctrine allows a defrauded party in one case to rescind and in addition recover damages for collateral losses, and in another situation estoppel doctrines may prevent rescission when too large a loss will be thrown on the defendant. The latter result is also achieved by a doctrine based on change of circumstances.

Finally it must be observed that where the collectibility of the defendant is doubtful the actions on a theory of rescission may represent the only real recovery regardless of the measure of damages.

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