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WARRANTY AND DECEIT—REMEDY FOR MISREPRESENTATION IN CONTRACT NEGOTIATIONS

I. SCOPE OF ARTICLE

The tort action of deceit and the contract or, more properly, quasi-tort¹ action for breach of warranty are closely allied. It is the purpose of this article to show the similarities between the two insofar as they provide a remedy for misrepresentations made during the course of contractual negotiations. In the area of deceit, therefore, this article will consider only those cases in which this type of misrepresentation is involved. The relation between strict liability for facts misrepresented in an action for breach of warranty and a tendency toward strict liability for facts misrepresented in the course of contractual negotiations in a deceit will be shown. Finally a defense of the special treatment of this type of deceit cases will be made.

II. HISTORICAL BACKGROUND

The action for damages resulting from misrepresentation was a quite limited one under the early common law. In 1603 the oft-quoted case of *Chandler v. Lopus*,² in which defendant sold a product falsely stating it to be a bezoar stone, stated: "The bare affirmation that it was a bezoar stone, without warranting it to be so, is no cause; and although he knew it to be no bezoar stone, it is not material. . ."³ At this time there was no recovery for a misrepresentation made during the course of contractual negotiations unless the fact was specifically warranted by the vendor using the words warrant or warranty. At this stage in the development of the law, the action for breach of warranty was a tort action. The first reported case where an action for breach of warranty was brought in *assumpsit* did not occur until 1778.⁴ The tort action however, prior to this time, evolved significant modifications to the *Chandler v. Lopus* rule. In 1689 Lord Holt decided that one who made a mere affirmation as to ownership, which was untrue, would be liable and *scienter*, or knowledge of the falsity, was not a necessary allegation.⁵ Eleven years later, in a case where the defense was the seller's good faith in making an affirmation of title, Lord Holt stated: "the plea [good faith] is ill and the action well lies. Where a man is in possession of a thing which is a colour of title an action will lie upon a bare affirmation that the goods sold are his own."⁶

Hence, besides the specific warranty recognized by *Chandler v. Lopus*, it now became sufficient to charge the vendor on a mere affir-

¹ WILLISTON, SALES §197 (rev. ed. 1948), see p. 41.

² Cro. Jac. 4.

³ *Ibid.*

⁴ *Stuart v. Wilkins*, 1 Dougl. 18 (1689).

⁵ *Cross v. Garnet*, 3 Mod. 261; also under name *Crosse v. Gardner*, 1 Show. *68, Carthew 90 (1700).

⁶ *Medina v. Stoughton*, 1 Ld. Raym. 593, 1 Salk. 210 (1778).

mation if it was an affirmation of ownership. Mere affirmations of fact other than title (i. e., warranties of quality, had not yet been held to be sufficient, nor had the action been extended to include misrepresentations other than those relating to the product itself. It is at this stage in their development that the causes of action became separate. After a dearth of cases during most of the eighteenth century, the first reported case where action on a warranty was brought in *assumpsit* occurred in 1778.⁷ Eleven years later *Pasley v. Freeman*⁸ recognized the validity of a tort action of deceit in which no warranty situation was involved.⁹ From this point on the two concepts developed separately, and different principals were applied to each. Their common origin must, however, be kept in mind.

III. WARRANTY—STRICT LIABILITY

As was noted above, the courts never required *scienter* or knowledge of the falsity of the representation as an element in a breach of warranty action. They did require an intent to warrant. This requirement, however, was not acceptable to most of the American jurisdictions and such a requirement was specifically negated by the Uniform Sales Act¹⁰ which has been enacted in 36 states.¹¹ It is made even more explicit in the Uniform Commercial Code.¹² The abolition of this requirement coupled with the fact that knowledge of the falsity had never been required resulted in imposing strict liability upon a vendor for material affirmations of fact relating to the product sold.

Wisconsin had maintained the position taken by the Uniform Sales Act even before the enactment of the statute in 1911.¹³ After its adoption the court merely continued to apply it in the same way as it had the prior law.¹⁴

IV. DECEIT—KNOWLEDGE AS AN ELEMENT OF LIABILITY

For about a century after the decision of *Pasley v. Freeman*¹⁵ there

⁷ Cited at note 5, *supra*.

⁸ *Pasley v. Freeman*, 3 Term Rep. 51, 100 Eng. Rep. 450 (1789).

⁹ In fact this decision was more concerned with plaintiff's right to recover from defendant because of the absence of any contractual relation between the parties. It recognized such right.

¹⁰ Uniform Sales Act, §12; Wis. Stats. §121.12 (1957). "Any affirmation of fact or any promise by the seller relating to the goods is an express warranty if the natural tendency of such affirmation or promise is to induce the buyer to purchase the goods, and if the buyer purchases the goods relying thereon."

¹¹ Uniform State Laws Handbook, p. 287 (1958).

¹² Uniform Commercial Code, §2-313 (1957 official text). "(2) It is not necessary to the creation of an express warranty that the seller use formal words such as 'warrant' or 'guarantee' or that he have a specific intention to make a warranty. . ."

¹³ *Smith v. Justice*, 13 Wis. *600 (1861); *Hahn v. Doolittle*, 18 Wis. *196 (1864); *Neave v. Arntz*, 56 Wis. 174, 14 N.W. 41 (1882); *White v. Stelloh*, 74 Wis. 435, 43 N.W. 99 (1889); *Barnes v. Burns*, 81 Wis. 232, 51 N.W. 419 (1892); *Hoffman v. Divon*, 105 Wis. 315, 81 N.W. 491 (1900).

¹⁴ *Kimball Clark Co. v. Crosby*, 175 Wis. 337, 185 N.W. 172 (1921); *Valley Refrigeration Co. v. Lange Co.*, 242 Wis. 466, 8 N.W. 2d 294 (1943).

¹⁵ Cited at note 8, *supra*.

was no definitive announcement of the exact definition of the requirement of knowledge as an element of deceit liability. Such an announcement finally came in 1889 when the House of Lords handed down their decision in the landmark case of *Derry v. Peek*.¹⁶ In this case the defendants were directors of a company whose shares plaintiff had been induced to purchase through false statements contained in the company's prospectus which defendants had prepared. The trial court found that the defendants did not know of the falsity of the statements and denied relief to plaintiff. On appeal the Court of Appeals reversed the trial court and held that the honesty of defendants' beliefs was no defense since there were no reasonable grounds for such beliefs. The House of Lords reversed the Court of Appeals and affirmed the trial court, Lord Herschell ruling that: "First, in order to sustain an action of deceit there must be proof of fraud, and nothing short of that will suffice. Secondly, fraud is proved when it is shown that a false representation has been made (1) knowingly, or (2) without belief in its truth, or (3) recklessly, careless whether it be true or false."¹⁷ In effect this ruling held that there could be liability only if the defendant knew the statement was false or did not believe it was true or did not care whether it was true or false. The case made this statement as a general rule and did not differentiate between cases involving parties having a contractual relation and other cases.

Many American jurisdictions had by this time (1889) already developed their own rules on this subject. Especially in cases where the misrepresentation occurred in the course of contractual negotiations, some courts, influenced by the law relating to warranties, had developed a strict liability theory obviating the necessity of proving either intent to deceive or knowledge of the falsity of the misrepresentation.¹⁸ Many jurisdictions profess to follow the *Derry v. Peek* rule.¹⁹ However many of these have engrafted minor modifications. Another group holds liable a defendant who is doubtful whether his statement is true or false. Such a situation comes under the *Derry v. Peek* rule, since there can be no honest belief in the truth of one's statement if one is doubtful whether it is true or false.²⁰ Still other jurisdictions hold that regardless of whether defendant honestly believes his statement is true, he will be liable if he affirms it to be true of his *own* knowledge when, in fact, his belief rests on some other basis. These cases also hold that the affirmance be the defendant of the fact as a fact, without disclosing the source of his information, presupposes that

¹⁶ *Derry v. Peek*, 14 App. Cas. 333 (1889).

¹⁷ *Ibid.*

¹⁸ 23 AM. JUR., Fraud and Deceit, §120 (1939).

¹⁹ *Id.*, §115.

²⁰ Harper and James, TORTS, §7.3 at 534 (1956).

the truth of that fact has been ascertained by his own knowledge.²¹ This rule is an obvious departure from *Derry v. Peek* since under it a defendant may honestly and even reasonably believe his statement is true but if it is a belief founded on some source other than his own knowledge, which source he does not reveal, and the representation turns out to be false, he will be liable.²² Such a rule closely approaches the same reasoning which underlies liability for breach of warranty.²³

Unfortunately, in applying the above rules, most courts do not explicitly differentiate between actions where there is a contractual relationship between the parties and cases where such a relationship does not exist. Particularly is this true in Wisconsin where the court's statements in deceit cases seem, at first glance, irreconcilable. A closer examination of the cases, however, shows that the court does in fact apply one rule in controversies between contracting parties and a different rule in cases where there is no contractual relationship.

In an early Wisconsin case it was held that defendant was not liable if he believed the representation to be true at the time he made it, but the court explicitly pointed out that there was no contractual relation between the parties.²⁴ However in the first deceit action which involved contracting parties the court stated: ". . . where a vendor undertakes to point out to the purchaser the boundaries of his land, he is under obligation to point them out correctly, and has no right to make a mistake, except under the penalty of responding in damages."²⁵ This case was followed in the two subsequent cases in which the parties had a contractual relationship.²⁶

In *Barndt v. Frederick*²⁷ the court made a statement which is capable of more than one interpretation. "In the action to recover damages for the alleged fraud and deceit, the plaintiff must . . . aver and prove that the defendant knew they [representations] were false and had no good reason to believe they were true. . . ." ²⁸ If by "no good reason" the court means that they were based on a source other than defendant's own knowledge, then this case is in accord with the subsequent cases on the subject. Such a view of the Wisconsin cases was expressed in the next case decided by the court where it held: "If the statements are in fact untrue, it is legal fraud, although not then known to be untrue, for the falsehood consists in stating that the party

²¹ 23 AM. JUR., Fraud and Deceit, §119 (1939).

²² Williston, *Liability for Honest Misrepresentation*, 24 HARV. L. REV. 415 (1910).

²³ Harper and James, *op. cit. supra* at 535.

²⁴ *Lakin v. Tibbets*, 1 Wis. *500 (1853); see also *Smith v. Mariner*, 5 Wis. *551 (1856).

²⁵ *Bird v. Kleiner*, 41 Wis. 134 (1876).

²⁶ *Cotzhausen v. Simon*, 47 Wis. 103, 1 N.W. 473 (1879); *Davis v. Nuzun*, 72 Wis. 439, 40 N.W. 497 (1888).

²⁷ *Barndt v. Frederick*, 78 Wis. 1, 47 N.W. 6 (1890).

²⁸ *Id.* at 6.

knew the facts when he did not. . . ."²⁹ Hence Wisconsin holds that the affirmation of the fact presupposes that defendant knows the statement is true and he is liable if the statement is false. Even though he may believe it is true, it is no defense.

The following three cases, likewise, held that *scienter* was not necessary.³⁰ In *Benolkin v. Guthrie*³¹ the court again enunciated the Wisconsin rule as follows: ". . . false representations of material facts . . . if made knowingly or without *knowing* whether they are true or false . . . are actionable. . . ." (emphasis added).³² Hence defendant's belief in these cases is immaterial. If he does not actually know, of his own knowledge, that his statement is true he will be liable. After three more cases which followed this rule,³³ the court, in *First National Bank v. Hackett*,³⁴ clarified the basis for the rule when it stated: "It was not necessary that Mr. Hackett should vouch for the truthfulness of the statement made. It was sufficient that he made a positive statement of the facts and did not state it as being made upon information."³⁵ The similarity between this reasoning and the reasoning in warranty law which differentiates between affirmation and opinion is evident.

In 1919 the court quoted and approved the *Derry v. Peek*³⁶ rule. In the case before the court, however, it found that defendant's statements as to the value of stock which plaintiff was induced to buy were made recklessly, careless whether they were true or false.³⁷ Thus the question of the reasonableness of defendant's beliefs as a defense was not considered and hence the decision is not in conflict with the previous cases. In a subsequent case, however, the court explicitly reaffirmed its reasoning on the subject. In *Lee v. Bielefeld*,³⁸ the lower court found that because defendant's statements were not recklessly made there could be no recovery. This holding was reversed on appeal, the court holding that regardless of defendant's good faith, if he makes a positive statement of fact, he will be liable for damages resulting to plaintiff if the statement turns out to be actually untrue.

In the case which followed the court stated that intent to defraud must be established. In the instant case, however, the court found

²⁹ *The Montreal River Lumber Co. v. Mihills*, 80 Wis. 540, 50 N.W. 507 (1891).

³⁰ *Gunther v. Ullrich*, 82 Wis. 222, 52 N.W. 88 (1892); *Beetle v. Anderson*, 98 Wis. 5, 73 N.W. 560 (1897); *Krause v. Busacker*, 105 Wis. 350, 81 N.W. 406 (1900).

³¹ *Benolkin v. Guthrie*, 111 Wis. 554, 87 N.W. 466 (1901).

³² *Ibid.*

³³ *Matteson v. Rice*, 116 Wis. 328, 92 N.W. 1109 (1903); *Palmer v. Goldberg*, 128 Wis. 103, 107 N.W. 478 (1906); *Helberg v. Hosmer*, 143 Wis. 620, 128 N.W. 439 (1910).

³⁴ *First National Bank v. Hackett*, 159 Wis. 113, 149 N.W. 703 (1914).

³⁵ *Ibid.*

³⁶ Cited at note 16, *supra*.

³⁷ *Bechman v. Salzer*, 168 Wis. 277, 169 N.W. 279 (1919).

³⁸ *Lee v. Bielefeld*, 176 Wis. 225, 186 N.W. 587 (1922).

that there was such an intent and the question of defendant's knowledge or belief was not discussed and thus there was no true departure from the established rule.³⁹ In the next case in which the question was discussed the court held that the honesty of defendant's belief was no defense, if the statement was of an existing fact of which the defendant had no actual knowledge.⁴⁰ In *Graff v. Tinkham*⁴¹ the court once again distinguished between positive statements of fact and statements made only upon information. "If the defendant disclosed the source of his information and had no knowledge of the falsity of such information, or, not knowing it to be true, did not fraudulently or recklessly make the representation that it was true, or if both parties were equally informed, then the defendant would not be liable."⁴²

The most recent Wisconsin decisions, by way of dicta, seem to show dissatisfaction with the Wisconsin rule.⁴³ None of these cases were decided on this particular point, however, and hence the established Wisconsin rule is still intact. In order to apply a different test, the Wisconsin court would have to overrule a long and continued line of precedent. In the discussion which follows, a defense of the established rule will be made and an argument presented, not only for its retention, but also for its clarification.

V. SUMMARY AND CONCLUSION

As can be seen from the definition of warranty,⁴⁴ its scope is limited to affirmations of fact or promises relating to the goods sold. Other affirmations, regardless of their importance as an inducing factor in making the contract, must be treated under deceit law. The similarity of such different affirmations, insofar as they (1) induce the contract, (2) result in a detriment to one party, and (3) confer a benefit on the other party may best be illustrated by a comparison of deceit cases with warranty cases. In *Bird v. Kleiner*⁴⁵ defendant pointed out land belonging to another and told plaintiff it was his own land. In reliance thereon plaintiff took a deed of defendant's land and brought an action

³⁹ *International Milling Co. v. Priem*, 179 Wis. 622, 192 N.W. 68 (1923).

⁴⁰ *De Swarte v. First National Bank of Wauwatosa*, 188 Wis. 455, 206 N.W. 887 (1925).

⁴¹ *Graff v. Tinkham*, 202 Wis. 141, 231 N.W. 593 (1930).

⁴² *Ibid.*

⁴³ *Tews v. Marg*, 246 Wis. 245, 16 N.W. 2d 795 (1944), "To support an action for fraud and deceit, knowledge of the falsity of the statement. . . or proof that the statement was made recklessly without regard to accuracy, must be shown." (The case decided that the real issues had not been tried and it was sent back to the lower court for a new trial.); *Benz v. Zobel*, 255 Wis. 542, 39 N.W. 2d 713 (1949), "No proof was offered in the case nor were there any findings by the jury or by the court to the effect that the statements were known by the appellant to be false or that they were made with intent to deceive or defraud." (The case was decided on the issue of reliance by plaintiff on the representations.)

⁴⁴ See note 10, *supra*.

⁴⁵ Cited at note 25, *supra*.

in deceit. In *Hoffman v. Dixon*⁴⁶ defendant told plaintiff that certain seed was rape seed when it was actually mustard seed. In reliance thereon plaintiff bought the seed and brought an action for breach of warranty. In both cases plaintiffs bought property relying on false statements as to what they were actually buying. Both plaintiffs suffered a loss because the representation was false and both defendants were benefited. By applying the Wisconsin deceit rule plaintiff was able to recover in the *Bird* case regardless of the honesty of defendant's belief and it was not necessary to establish that the misrepresentation was recklessly or carelessly made, just as defendant's good faith in the breach of warranty case was no defense.

In *The Montreal River Lumber Co. v. Mihills*⁴⁷ plaintiff brought a deceit action to recover damages resulting from a misrepresentation by defendant as to the amount of lumber sold. In *Kimball Clark Co. v. Crosby*⁴⁸ plaintiff brought a breach of warranty action to recover damages resulting from a misrepresentation by defendant as to the amount of machinery belting sold. By applying the Wisconsin rule in the deceit case defendant's good faith was no defense since he stated that he ". . . knew the facts when he did not. . . ." Any other result, considering the similarity in fact situations between these two cases, would be difficult to justify.

The comparisons above, of course, involve misrepresentations relating to the property sold. But even when the misrepresentation is of a different type, the similarity between the two actions is evident. In *Neave v. Arntz*⁴⁹ defendant represented that a reaper he sold to plaintiff would perform satisfactorily. It did not so perform and under warranty law plaintiff recovered without the necessity of showing that defendant knew that his representation was false. In *Benz v. Zobel*⁵⁰ plaintiff alleged that he was induced to enter into a share-cropping contract in reliance upon defendant's representation that the machinery on the farm in question was in good working condition, when in fact it was not. The court held that there was no reliance by plaintiff on the representation and hence based its decision on this ground. However, it stated, by way of dicta, that: "No proof was offered in the case nor were there any findings made by the jury or by the court to the effect that the statements mentioned were known by the appellant to be false. . . ."⁵¹ Under such a rule as this plaintiff would have to show, not merely that defendant made the statements as affirmations of fact when in fact he did not know them to be true of his own knowledge,

⁴⁶ Cited at note 13, *supra*.

⁴⁷ Cited at note 29, *supra*.

⁴⁸ Cited at note 14, *supra*.

⁴⁹ Cited at note 13, *supra*.

⁵⁰ Cited at note 43, *supra*.

⁵¹ *Ibid.*, at 566.

but would have to prove that he knew them to be actually false. What justification can there be for such a rule? In the *Neave*⁵² case plaintiff bought machinery relying on the defendant's representations as to its quality. In the *Benz*⁵³ case plaintiff alleged that he entered into the share-cropping contract relying on the representation as to the machinery's quality. In both cases there would have been no contract had the true facts been known. In both cases the plaintiffs suffered loss and the defendants were benefited as a result of the misrepresentation. To require plaintiff to prove actual knowledge by defendant of the falsity of his representation in the deceit case would be a backward step in the law relating to misrepresentations made in the course of contractual negotiations.

From the discussion of Wisconsin deceit cases above, it can be seen that the court has wavered from time to time in its statement of the rule. Some of the language is capable of varying interpretations and some of the dicta, especially recently, certainly casts doubt upon the stability of the rule. It is submitted that the Wisconsin rule is a proper one when applied to contractual misrepresentations, and by comparing the deceit cases with warranty cases the underlying logic of the rule becomes evident. Rather than change this rule it is hoped that it will be, not only retained, but also revitalized by a thorough review of the precedent cases in this field and a clarification and clear-cut exposition of the rule.

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⁵² Cited at note 13, *supra*.

⁵³ Cited at note 43, *supra*.