

- A **misrepresentation** is an assertion that is not in accord with the truth. When a person enters a contract because of his justifiable reliance on a misrepresentation about some important fact, the contract is voidable.
- Misrepresentations can be either:
 1. “innocent” (not intentionally deceptive) or
 2. “fraudulent (made with the knowledge of falsity and intent to deceive).
- Contracts induced by misrepresentation or fraud are generally considered **voidable**. This means that the person whose consent was not real has the power to **rescind** (cancel) the contract.
- The **elements** of misrepresentation and fraud are as follows - *notice the similarities.* (author’s addition)

Innocent misrepresentation	Fraud
1. Untrue assertion of fact (or equivalent)	1. Untrue assertion of fact (or equivalent)
2. Assertion relates to material fact	2. Assertion made with knowledge of falsity and intent to deceive
3. Actual reliance	3. Actual reliance
4. Justifiable reliance	4. Justifiable reliance
	5. Economic loss (in a tort action for damages)

1. Untrue Assertion of Fact or Equivalent (author’s addition)

To have misrepresentation, one of the parties must have made:

1. an untrue assertion of fact **or**
 2. engaged in conduct that is equivalent to an untrue assertion of fact.
 - The **fact** must be a *past or existing fact*, as distinguished from:
 1. an opinion or
 2. a promise or prediction about some future happening.
- The **concealment** of a fact through some active conduct intended to prevent the other party from discovering the fact is considered the **equivalent of an assertion**. For example, if Summers is offering his house for sale and paints the ceilings to conceal the fact that the roof leaks, his active concealment constitutes an assertion of fact.
 - **Nondisclosure** can also be the **equivalent of an assertion of fact**. Nondisclosure is the failure to volunteer information. Disclosure of a fact is required when:
 1. the person has already offered *some* information but further information is needed to give the other party an accurate picture or
 2. there is a relationship of trust and confidence between the parties or

¹ Source of materials: Mallor, et al., *Business Law and the Regulatory Environment: Concepts and Cases* (McGraw Hill/Irwin, 11th Edition, 2001). Bold print, bullets, and numbers have been added to the Mallor text to indicate particular emphasis.

3. a party has access to information that is not readily available to the other party.

Transactions involving the sale of real estate are among the most common situations in which the duty to disclose arises. Most states hold that a seller who knows about a latent (hidden) defect that materially affects the value of the property has the obligation to speak up about the defect. *For example, in a recent case a buyer contracted to purchase a house that was reputed, according to the sellers, to be possessed with ghosts. The sellers did not tell the buyer this fact. When the buyer learned of the house's reputation, he was granted the right to sue for rescission. (author's addition)*

2. Materiality

Innocent misrepresentation

- If the misrepresentation was **innocent**, the person seeking to rescind the contract must establish that the fact asserted was material.
- A fact will be considered **material** if it is:
 1. likely to play a significant role in inducing a reasonable person to enter the contract or
 2. if the person asserting the fact knows that the other person is likely to rely on the fact.

For example, Roger, who is trying to sell his car to Ferguson and knows that Ferguson idolizes professional bowlers, tells Ferguson that a professional bowler once rode in the car. Relying on that representation, Ferguson buys the car. Although the fact Rogers asserted might not be important to most people, it would be material here.

Fraud

- Even if the fact is not material, the contract may be rescinded if the misrepresentation was fraudulent. Fraud is the type of misrepresentation that is committed **knowingly**, with the **intent to deceive**. The rationale for this rule is that a person who fraudulently misrepresents a fact should not be able to profit from his intentionally deceptive conduct.
- A person making a misrepresentation would be considered to do so “knowingly” if she:
 1. knew her statement was false or
 2. knew that she did not have a basis for making the statement or
 3. made the statement without being confident that it was true.
- The intent to deceive can be inferred from the fact that the defendant knowingly made a misstatement of fact to a person who was likely to rely on it.

3. Actual Reliance

- Reliance means that a person pursues some course of action because of his faith in the assertion made to him.
- There must have been a causal connection between the assertion and the complaining party's decision to enter the contract.
- If the complaining party (1) knew that the assertion was false or (2) was not aware that an assertion had been made, there is no reliance.

4. Justifiable Reliance

- Courts also scrutinize the reasonableness of the behavior of the complaining party by requiring that his reliance be *justifiable*.
- A person does **not** act justifiably if he relies on an assertion that is:
 1. obviously false or
 2. not to be taken seriously.
- One problem involving the justifiable reliance element is determining the extent to which the relying party is responsible for investigating the accuracy of the statement on which he relies.
 - Classical contract law held that a person who did not attempt to discover readily discoverable facts (*e.g. public records - author's addition*) generally was not justified in relying on the other party's statements about them.
 - The extent of the responsibility placed on a relying party to conduct an independent investigation has declined in modern contract law. Today's courts tend to place a greater degree of accountability on the person who makes the assertion rather than the person who relies.

5. Economic loss

In tort actions in which the plaintiff is seeking to recover damages for **fraud**, the plaintiff would have to establish a *fifth* element: injury. He would have to prove that he had suffered actual economic injury because of his reliance on the fraudulent assertion. In cases in which the injured person seeks only rescission of the contract, however, proof of economic injury usually is not required.

Remedies

Rescission

- As is true for **innocent misrepresentation**, the contract remedy for **fraudulent misrepresentation** is **rescission**. A person who rescinds a contract is entitled to the return of anything he gave the other party. He must offer to return anything he has received from the other party.
- **Necessity for prompt and unequivocal rescission** Suppose Johnson, who recently bought a car from Sims Motors, learns that Sims Motors made fraudulent statements to her to induce her to buy the car. She believes the contract was induced by fraud and wants to rescind. She must:
 1. object promptly upon learning the facts and

2. must clearly express her intent to cancel.

She must also avoid any behavior that would suggest that she affirms or **ratifies** the contract, such as:

1. an unreasonable delay in notifying the other party or
2. continuing to accept benefits from the other party or
3. behaving in a way that is inconsistent with her expressed intent to rescind.

Damages

- The **tort liability** of a person who commits **fraud** is different from that of a person who commits innocent misrepresentation. A person who commits fraud may be liable for **damages**, possibly including punitive damages, for the tort of deceit.
- In some states, a person injured by fraud cannot rescind and sue for damages for deceit; he must elect (choose) between the remedies. In other states, however, an injured party may pursue both rescission and damage remedies. In addition, a person injured by fraud in a contract for the *sale of goods* can both rescind and sue for damages.

Innocent misrepresentation	Fraud
Rescission	rescission and/or tort action in damages