

# Misrepresentation

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In addition to the defense of mistake, a party may claim to be misled by a counterparty in seeking to avoid or rescind a contract. One party can mislead another in a number of ways: through an affirmative misstatement, through active concealment of the truth, and by enabling misunderstanding through silence or partial disclosure. All jurisdictions consider an affirmative false statement of fact to be a misrepresentation and most will treat active concealment as such. To constitute a misrepresentation, the statement of fact must be fraudulent (i.e., intentionally deceptive) or material (i.e., sufficiently significant to the transaction) and standards of materiality differ among courts. A statement must also go beyond hyperbole, or “puffery,” and it must be reasonable for a party to rely on the affirmative statement.

As with claims of mistake, misrepresentation must relate to a fact rather than an opinion. In *Fina Supply, Inc. v. Abilene Nat'l Bank*, 726 S.W. 2d 537 (Tex, 1987), for example, the court asserted that a “representation as to the legal effect of a document is regarded as a statement of opinion rather than of fact and will not ordinarily support an action for fraud.”

The case below illustrates some of the challenges in determining whether a statement supports a defense of misrepresentation.

## **Barrer v. Women's Nat. Bank**

761 F.2d 752 (D.C. Cir. 1985)

HARRY T. EDWARDS, Circuit Judge.

The appellant, Lester A. Barrer, brought this action against Women's National Bank (“the Bank” or “WNB”) for damages he allegedly sustained as the result of the Bank's eleventh hour decision to rescind a loan agreement. WNB defended and moved for summary judgment on the ground that Barrer had made innocent material misrepresentations in his loan application that justified the Bank's avoidance of the contract. The magistrate found that Barrer had made five material representations to the Bank that were not in accord with the facts and, on that basis, granted WNB's motion for summary judgment. We find that the magistrate failed to apply the correct legal test for determining when an innocent material misrepresentation permits the rescission of a contract, and that there are material issues of fact that make summary judgment inappropriate. Accordingly, we reverse and remand for further proceedings consistent with this opinion.

### I. Background

#### A. Factual Background

On June 24, 1981, Lester Barrer's personal home was sold at a tax sale by the Internal Revenue Service ("IRS") because of his inability to pay certain employment taxes. The taxes were owed by Barrer's closely-held corporation, Today News Service, Inc., and had been asserted against him personally as a 100 percent penalty pursuant to 26 U.S.C. § 6672 (1982). At the tax sale, Barrer's home was purchased by Edward L. Curtis, Jr., for \$16,326, subject to the underlying mortgage. The Internal Revenue Code provides for the redemption of real property within 120 days of a tax sale upon payment to the purchaser of the purchase price plus interest. . . . Barrer accordingly was advised by the IRS that he could redeem his home by delivering \$17,400, in cash or its equivalent, to the IRS or to Curtis on or before October 22, 1981.

On October 20, 1981, Barrer went to WNB to discuss a personal loan for the redemption amount. Apparently, on the previous day, Barrer had approached one other bank about the possibility of a loan; however, he had been advised by the President of that bank that it would not be possible to process an application for a loan in the amount sought by Barrer in such a short period of time. Barrer indicated in his deposition statement that he waited until the last minute to seek a bank loan because he had been involved in serious negotiations over the sale of his business and had expected to close on the sale before October 20, 1981, and that he had intended to use the proceeds from that sale to redeem his house.

At WNB, Barrer spoke with Emily Womack, the President of the Bank, with whom he had a professional acquaintance. Barrer's corporation published the *Women Today Newsletter*, a periodical to which the Bank subscribed and which, according to Barrer's deposition statement, had published an article on the Bank. Barrer's corporation also maintained an account with the Bank. Womack gave Barrer a loan application form, which he completed and returned to her the next day, October 21, along with certain supporting documents, including those concerning the tax sale and his efforts to sell the business.

Barrer evidently explained to Womack that he had experienced severe financial difficulties since his wife and long-time professional collaborator died of cancer in 1978. At his deposition, Barrer testified that he told Womack that, for a period after his wife died, he lost his motivation to work and that the business they had jointly owned and managed suffered serious economic reverses as a consequence. Those reverses led to Today News Service, Inc.'s inability to pay its employment taxes and ultimately to the tax sale of Barrer's home. Womack sympathized with Barrer's plight and expressed to one of her bank officers the hope that they could help him.

On October 21, Barrer and Womack reviewed his loan application line by line. With reference to his home mortgage, Barrer told her that his house was worth approximately \$130,000 and

that Columbia First Federal Savings and Loan Association (“Columbia”) held a \$65,000 mortgage on it. When asked whether his mortgage payments were up-to-date, Barrer recalls replying that he “thought” he was two months behind. By contrast, Womack testified that Barrer said he was current. In fact, Barrer was six months behind. Barrer explained that he thought his obligation to pay his mortgage ceased at the time of the tax sale and that he did not realize that he was responsible for more than the two months’ mortgage payments that had been due before the sale.

Because Barrer’s mortgage payments were in arrears, Columbia had begun foreclosure proceedings—also a fact that Barrer did not disclose to Womack. In his deposition statement, Barrer accounted for this failure by stating that on October 21, 1981, he did not know that Columbia had initiated foreclosure proceedings.

On the liability side of the loan application, Barrer revealed that he had borrowed \$40,000 from friends and relatives. Barrer testified that he explained to Womack that he had borrowed this sum to ease the financial difficulties he had encountered since his wife’s death.

Barrer also disclosed the \$38,000 tax liability which was the cause of the tax sale. He did not indicate, however, a contingent liability for an additional \$11,000 in employment taxes owed by his corporation which had not, at that time, been asserted against him personally under 26 U.S.C. § 6672. Barrer seems to argue both that this \$11,000 was included in the \$38,000 figure, and that because the \$11,000 tax liability had not been assessed against him personally it was not a contingent liability that he was obligated to reveal.

Nor did Barrer list as a contingent liability a \$5,300 debt owed by his wife’s estate to IBM. The Bank argues that this debt should have been revealed because Barrer had demonstrated, by requesting the probate court to charge the obligation to him, that he thought himself responsible for the debt. Barrer contends that because the probate court ultimately ruled that the obligation belonged to the estate, his failure to list the amount on the loan application was not a misrepresentation.

Finally, Barrer did not indicate on the loan application that he had approximately \$1,500 in unsatisfied judgments pending against him. However, he answered in the affirmative to a specific question on the application form which inquired whether he was “a defendant in any suits or legal actions.” Barrer also stated at his deposition that he told Womack that he owed small amounts arising out of these lawsuits. He said that he explained to her that these debts involved disputes over medical bills and that he expected his major medical insurance to cover most of them.

After Barrer and Womack finished discussing the content of the completed loan application form and Barrer's financial situation, Womack indicated that, in order for the Bank to grant the loan, the IRS would have to agree to subordinate its claim with respect to Barrer's house to that of WNB. On October 22, 1981, the last redemption day, Barrer obtained the subordination agreement from the IRS and delivered it to the Bank. Barrer then executed a collateral note for \$17,400, payable in 90 days at 15 percent interest, which gave the Bank the right to a security interest in his house. The Bank's Vice President, Emma Carrera, gave Barrer a cashier's check, payable to him, for the loan amount. Prior to granting the loan, neither Womack nor Carrera obtained a credit report on Barrer and neither officer phoned Columbia about the status of his mortgage.

That afternoon, Barrer delivered the endorsed check to the IRS in accordance with the required redemption procedure and returned home, believing that his home had been saved.

In the meantime, the tax sale purchaser, Curtis, phoned WNB and spoke with Carrera. According to her deposition, their conversation was as follows:

He stated that he had some information that he thought would be of interest to me on the loan that the bank had made to Mr. Barrer. I told him at that time that I could not discuss any loan with him in regards to who it was or what it was for. He said he didn't want me to do any discussing, but he just wanted to tell me some facts.

He then told me he was the purchaser of the property at the tax sale. He couldn't believe that a bank would make a loan to a man who was in the credit position that he was in; that there were liens and judgments and so forth against him ....

I quickly looked through the file and found there wasn't a credit report in the file. At that time I told [the secretary] to pull a credit report on him, which she did, and brought it to me within just a couple of minutes.

In the meantime, Mr. Curtis . . . put me on a conference call with a gentleman who identified himself as an official of the mortgage company [Columbia] that held the mortgage on Mr. Barrer's property. He [Mr. Ford] asked me at that time who, in his organization, had given us a credit report.

... I ... answer[ed] him ... that it was my understanding that all of the savings and loan associations required a written request for credit rating [sic] on any of the mortgages that they held and it had always been, to my knowledge, their policies not to give a reference by phone.

[Mr. Ford] said at that point he thought it was important that we know that Mr. Barrer's mortgage was six months in arrears and they were prepared to go to foreclosure on the property. He excused himself and Mr. Curtis stayed on the line.

[Mr. Curtis] said that he had knowledge that IRS had not made an agreement with Mr. Barrer to repay the balance of the taxes; that they were ready to go back to another tax sale as soon as this \$17,400 was paid.

Based on the information furnished by Curtis, Ford, and the credit report, the Bank decided to stop payment on the cashier's check. The Bank's counsel called Barrer later that day to inform him that the check would not be honored. When Curtis, to whom the IRS had turned over the check, presented it for payment the Bank refused to cash it. Barrer, therefore, did not effect the redemption of his home within the statutory period and Curtis became the owner....

## Analysis

### A. Standards for Summary Judgment

...the magistrate failed both to apply the correct legal test for determining whether an "innocent" misrepresentation justifies the rescission of a contract and to recognize that with regard to each of the five alleged misrepresentations there exist legally probative, material issues of fact in dispute. Thus, the award of summary judgment in favor of the Bank was erroneous and must be reversed.

### B. Elements of Innocent Material Misrepresentation

It is well established that misrepresentation of material facts may be the basis for the rescission of a contract, even where the misrepresentations are made innocently, without knowledge of their falsity and without fraudulent intent.<sup>25</sup> The rationale supporting this rule, which has its origins in equity,<sup>26</sup> is that, as between two innocent parties, the party making the representation should bear the loss.<sup>27</sup> Stated another way, the rule is based on the view that "one who has made a false statement ought not to benefit at the expense of another who has

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<sup>25</sup> See, e.g., *Lockwood v. Christakos*, 181 F.2d 805, 807 (D.C.Cir.1950); *Cousineau v. Walker*, 613 P.2d 608, 611 (Alaska 1980); *Creamer v. Helferstay*, 294 Md. 107, 116, 448 A.2d 332, 337 (1982); *First Nat'l Bank & Trust Co. v. Notte*, 97 Wis.2d 207, 220–21, 293 N.W.2d 530, 537–38 (1980); E. Farnsworth, *Contracts* § 4.12, at 242 (1982); *Restatement (Second) of Contracts* § 164 and comment b (1981) (hereinafter cited as "Restatement (Second)").

<sup>26</sup> *James & Gray, Misrepresentation—Part II*, 37 Md. L. Rev. 488, 534 (1978).

<sup>27</sup> *Notte*, 97 Wis.2d at 220, 293 N.W.2d at 537.

been prejudiced by relying on the statement.”<sup>28</sup> This rule may be employed “actively,” as in a suit at equity or law for rescission and restitution, or “passively,” as a defense to a suit for breach of contract.<sup>29</sup>

It is generally understood that four conditions must be met before a contract may be avoided for innocent misrepresentation. The recipient of the alleged misrepresentation must demonstrate that the maker made an assertion: (1) that was not in accord with the facts, (2) that was material, and (3) that was relied upon (4) justifiably by the recipient in manifesting his assent to the agreement.<sup>30</sup> District of Columbia law adds a fifth condition, i.e., that the recipient relied to his detriment.<sup>31</sup>

Unfortunately, the applicable precedent does not elaborate on the meaning of these conditions. In trying to give them content, we have found that the *Restatement (Second) of Contracts* (“Restatement (Second)”) provides helpful guidance concerning the first four conditions.

### 1. Misrepresentation

Section 159 of the *Restatement (Second)* defines a misrepresentation as “an assertion that is not in accord with the facts.”<sup>33</sup> Comment c explains that an “assertion must relate to something that is a fact at the time the assertion is made in order to be a misrepresentation. Such facts include past events as well as present circumstances but do not include future events.” Comment d observes that a person’s state of mind is a fact and that an assertion of one’s opinion constitutes a misrepresentation if the state of mind is other than as asserted.

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<sup>28</sup> James & Gray, *supra* note 26, at 535.

<sup>29</sup> See, e.g., James & Gray, *Misrepresentation—Part I*, 37 Md. L. Rev. 286, 315 (1977). In some jurisdictions, including the District of Columbia, recipients of innocent material misrepresentations may, under certain circumstances, choose between the mutually exclusive options of rescission of the contract accompanied by restoration of the parties to the *status quo ante*, and a cause of action for damages in tort. . . . In this jurisdiction, [certain] cases suggest that, under certain circumstances, tort liability for honest material misrepresentation may lie: *Isen v. Calvert Corp.*, 379 F.2d 126 (D.C.Cir.1967); *Darnell v. Darnell*, 200 F.2d 747 (D.C.Cir.1952); *Stein v. Treger*, 182 F.2d 696 (D.C.Cir.1950). See generally Hill, *Damages for Innocent Misrepresentation*, 73 Colum. L. Rev. 677, 747 (1973) (concluding that the jurisdictions that recognize tort liability for innocent misrepresentations remain a minority).

<sup>30</sup> See, e.g., *Lockwood*, 181 F.2d at 807; *Cousineau*, 613 P.2d at 612; *Notte*, 97 Wis.2d at 222, 293 N.W.2d at 538; E. Farnsworth, *supra* note 25, § 4.10, at 236; Restatement (Second), *supra* note 25, § 164(1) and comment a.

<sup>31</sup> *Lockwood*, 181 F.2d at 807; see also E. Farnsworth, *supra* note 25, § 4.13, at 245–46.

<sup>33</sup> *Accord Greene v. Gibraltar Mortgage Inv. Corp.*, 488 F. Supp. 177, 179 (D.D.C.1980); *Notte*, 97 Wis.2d at 222, 293 N.W.2d 538.

According to section 161, the only non-disclosures that may be considered assertions of fact for purposes of misrepresentation analysis<sup>34</sup> are non-disclosures of facts known to the maker where the maker knows that disclosure: (a) is necessary to prevent a previous assertion from being a misrepresentation or from being fraudulent or material, (b) would correct a mistake of the other party as to a basic assumption on which that party is making the contract, if non-disclosure amounts to a failure to act in good faith and in accordance with reasonable standards of fair dealing, or (c) would correct a mistake of the other party as to the contents or effect of a writing. The section also provides that where the other person is entitled to know the non-disclosed facts because a relation of trust and confidence exists between the parties, non-disclosure is equivalent to an assertion of facts.

## 2. Materiality

In section 162, comment c, the *Restatement (Second)* explains that a misrepresentation is material “if it would be likely to induce a reasonable person to manifest his assent.” The court in *Cousineau v. Walker* elaborated on the materiality requirement, noting that it is a mixed question of law and fact that asks whether the assertion is one to which a reasonable person might be expected to attach importance in making a choice of action.<sup>35</sup> A material fact is one that could reasonably be expected to influence a person’s judgment or conduct concerning a transaction.<sup>36</sup>

The justification for the materiality requirement is that it is believed to encourage stability in contract relations. It prevents parties who become disappointed at the outcome of their bargain from seizing upon any insignificant discrepancy to void the contract.<sup>37</sup>

## 3. Reliance

Section 167 requires that the misrepresentation be causally related to the recipient’s decision to agree to the contract—that it have been an inducement to agree. Inducement, as comment a explains, is shown through actual reliance. Comment a goes on to state that this reliance need not, however, be the sole or predominant factor influencing the recipient’s decision.

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<sup>34</sup> The *Restatement (Second)* distinguishes between nondisclosures, § 161 and comment a, and actions that are equivalent to assertions (concealment), § 160

<sup>35</sup> 613 P.2d at 613.

<sup>36</sup> *Id.*; see also *Homelite v. Trywilk Realty Co.*, 272 F.2d 688, 691 (4th Cir.1959).

<sup>37</sup> *Cousineau*, 613 P.2d at 613; see also *James & Gray*, *supra* note 26, at 500

Comment b indicates that circumstantial evidence is often important in determining whether there was actual reliance.<sup>38</sup>

#### 4. Justifiability of Reliance

Section 172 of the *Restatement (Second)* provides that a recipient's fault in not knowing or discovering the facts before making the contract does not make his reliance unjustified unless it amounts to a failure to act in good faith and in accordance with reasonable standards of fair dealing.<sup>39</sup>

While section 169 suggests that reliance on an assertion of opinion often is not justified, section 168(2) and the accompanying comment d make clear that in some situations the recipient may reasonably understand a statement of opinion to be more than an assertion as to the maker's state of mind. Where circumstances justify it, a statement of opinion may also be reasonably understood as carrying with it an assertion that the maker knows facts sufficient to justify him in forming it.<sup>40</sup>

#### 5. Detriment

Because the *Restatement (Second)* does not require a showing of detriment for rescission, it does not define it.<sup>41</sup> We think that, in the innocent material misrepresentation context, a recipient is appropriately considered to have relied to his detriment where he receives something that is less valuable or different in some significant respect from that which he reasonably expected.<sup>42</sup>

### C. Application of Legal Standards

Application of the foregoing principles to the facts of this case requires that the case be remanded for trial. The magistrate tested Barrer's alleged misrepresentations against only two of the five elements necessary for rescission—he asked only if the representations were in accord with the facts and if they were material. In making this inquiry, the magistrate failed to consider the legal distinctions between assertions of fact and nondisclosure and between

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<sup>38</sup> In *Cousineau*, for example, the court relied on circumstantial evidence to find reliance. 613 P.2d at 612–13.

<sup>39</sup> *Accord Notte*, 97 Wis.2d at 224, 293 N.W.2d at 539.

<sup>41</sup> See section 164, comment c (“In general, the recipient of a misrepresentation need not show that he has actually been harmed by relying on it in order to avoid the contract.”).

<sup>42</sup> See, e.g., E. Farnsworth, *supra* note 25, § 4.13, at 245–46; McCleary, *Damage as Requisite to Rescission for Misrepresentation: II*, 36 Mich. L. Rev. 227, 227–44 (1937).

assertions of fact and statements of opinion. He neglected to investigate whether the Bank actually relied on the representations in deciding to make the loan; whether that reliance, if it existed, was justifiable; and whether the Bank relied to its detriment. Furthermore, the magistrate incorrectly concluded that there were no legally probative, material issues of fact in dispute.

#### 1. Elements the Magistrate Failed to Consider

Initially, assuming for a moment that Barrer actually “misrepresented” certain facts, the materiality of the representations is hardly obvious. After deciding which representations meet the legal definition of misrepresentation, the trial court must determine with regard to each individual misrepresentation whether it was “likely to induce a reasonable [bank] to manifest [its] assent”<sup>43</sup> to the loan agreement. If no single misrepresentation is found to be material, the court may consider, after ascertaining the assertions upon which WNB justifiably relied, whether those assertions are material when taken together.

All five alleged “misrepresentations” also raise serious factual questions as to whether the Bank actually and justifiably relied on them. Womack’s expressed sympathy for Barrer combined with the fact that the loan was issued in a very short time, without either a credit check, which was obtainable in minutes, or an inquiry into the status of Barrer’s mortgage, and the fact that the loan was withdrawn only when the Bank was placed in an embarrassing position by the tax sale purchaser—all these circumstances could suggest that the Bank was not very interested in the particulars of Barrer’s financial condition. Indeed, it was clear from the loan application that Barrer did admit that he was experiencing financial difficulties, yet WNB chose to make no further inquiry into the details of these problems. These facts could be construed to show that Womack’s sympathy for Barrer’s predicament was the real inducement for the loan. If the trial court finds that the Bank actually relied on Barrer’s alleged “misrepresentations,” it nonetheless must proceed to decide whether that reliance was justified.

The trial court must also determine whether the Bank’s reliance on Barrer’s alleged “misrepresentations” caused it any detriment. Did WNB receive as its benefit of the bargain something less valuable or significantly different from what it reasonably expected? In addition, the trial court should consider whether the subordination agreement, in combination

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<sup>43</sup> Restatement (Second), *supra* note 25, § 162 comment c.

with the right to a security interest in Barrer's house granted by the collateral note, fully satisfied the Bank's expectations.

The magistrate also made individual errors with respect to the five representations. These errors are outlined below.

## 2. Delinquency in Mortgage Payments

Barrer and Womack disagree over whether he told her that he "thought" he was two months behind in his mortgage payments or whether he said that he was current. Because this case is before us on appeal from the magistrate's grant of summary judgment for the Bank, we must accept Barrer's statement of the facts. The Bank argues that even if Barrer's version is accepted, a misrepresentation still occurred because Barrer was actually six months behind. The Bank's position is not necessarily correct.

Barrer's statement that he "thought" he was in arrears by two months initially raises the factual question whether he made any misrepresentation. On the surface, the fact asserted by Barrer was his state of mind—what he thought. No finding was made below that Barrer's state of mind was other than what he declared. On remand, before it may determine that this statement constituted a misrepresentation, the court must find either that Barrer misstated his thoughts, in accordance with the rule laid out in section 159, comment d of the Restatement (Second), or that Barrer's statement could reasonably have been understood as carrying with it an assertion that Barrer knew sufficient facts that justified him in forming his opinion, in accordance with section 168(2). . . .

## 3. Failure to Disclose Mortgage Foreclosure Proceedings

Although the Bank evidently did not ask Barrer directly whether his mortgage was being foreclosed upon, it contends that he had an obligation to volunteer that information and that his failure to do so is tantamount to a misrepresentation. Barrer argues that he had no duty to reveal the existence of the foreclosure proceedings because he did not know about them. The Bank maintains that he must have known, because before Barrer applied for the loan his teenage daughter signed for a certified letter from Columbia notifying him of the foreclosure.

The magistrate erred in finding on summary judgment that this non-disclosure is equivalent to a misrepresentation. The *Restatement (Second)* provides that a non-disclosure may be considered an assertion of fact for purposes of misrepresentation analysis only if the non-

disclosed fact is known<sup>46</sup> to the maker and if certain other conditions are met. Because there exists a material issue of fact as to whether Barrer knew that Columbia had begun to foreclose, summary judgment was inappropriate.

#### 4. \$11,000 Contingent Liability

The magistrate also erred in finding on summary judgment that Barrer's alleged failure to list as a personal contingent liability an \$11,000 tax debt owed to the IRS by his corporation constituted a misrepresentation. First, summary judgment is precluded by the existence of a factual dispute over whether this \$11,000 was included in the \$38,000 tax liability that Barrer did list. Barrer seems to contend that at least some of this amount was included in the \$38,000 figure; the Bank seems to dispute this contention. Second, there is a mixed question of law and fact as to whether the IRS had, at the time of the loan application, taken any action to assert the \$11,000 tax debt owed by Today News Service, Inc., against Barrer personally and, if not, whether the corporation's liability may be considered Barrer's contingent liability. If the \$11,000 tax debt could not at that time have been considered Barrer's liability, his failure to list such a debt was not a misrepresentation.<sup>48</sup>

#### 5. \$5,300 Debt Owed to IBM

The magistrate found that Barrer's failure to reveal as a personal liability a \$5,300 debt owed to IBM for equipment purchased by his wife was a misrepresentation. We disagree as a matter of law. Although Barrer asked the probate court handling his wife's estate to charge him with the debt, the court refused, ruling that the debt was hers alone. Contrary to the Bank's protestations, it makes no difference to the determination whether a misrepresentation occurred that Barrer asked the probate court to charge him with the debt before, and the court refused after, Barrer submitted the loan application. A misrepresentation is "an assertion that is not in accord with the facts."<sup>49</sup> The fact is that a court decided that this debt never legally belonged to Barrer. Barrer's thoughts or wishes on the matter are irrelevant. He made no legal misrepresentation to the Bank on this subject.

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<sup>46</sup> We do not consider the presumption of knowledge of the truth about one's own business or property that this court has employed in actions for damages caused by material misrepresentations, *see Isen*, 379 F.2d at 129–30; *Darnell*, 200 F.2d at 748, to be pertinent to *non-disclosures*. Where non-disclosure is alleged to constitute a misrepresentation, actual knowledge of the non-disclosed fact must be demonstrated.

<sup>48</sup> According to the *Restatement (Second)*, a misrepresentation includes past and present events, but not future ones. *See* § 159 comment c. . . .

<sup>49</sup> *Restatement (Second)* . . . § 159.

## 6. \$1,500 in Judgments

Finally, the magistrate determined that Barrer's failure to list \$1,500 in judgments that were outstanding against him constituted a misrepresentation. This issue should not have been resolved on summary judgment. Barrer disclosed on the loan application that he was a defendant in some lawsuits. Furthermore, in his deposition he stated that he had informed Womack that he owed some small judgments arising out of these suits and that he expected his health insurance to cover most of them. Accepting Barrer's version of the facts, as we must in reviewing a grant of summary judgment, he revealed both his defendant status and the existence of judgments against him. It is true that he did not list them on the application form. Because, however, Barrer contends that he adequately disclosed these debts in connection with the question concerning lawsuits and in his discussion with Womack, there exists a dispute over whether he actually revealed these debts; consequently the magistrate should not have resolved this issue on summary judgment. On remand, two factual questions must be decided. First, what information concerning these judgments did Barrer give to Womack? Second, was that information sufficient to give the Bank notice of them?<sup>52</sup> If it was sufficient, then Barrer made no misrepresentation.

## III. Conclusion

The magistrate both failed to utilize the correct legal test for determining when an innocent material misrepresentation permits the rescission of a contract and to recognize that this case presents disputed material issues of fact that render summary judgment inappropriate.<sup>53</sup> We reverse and remand for further proceedings consistent with this opinion.

## Notes and Questions

1. As the court in Barrer notes in footnote 29, parties may seek relief for misrepresentation under either tort or contract principles, but they must choose which

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<sup>52</sup>We note that, as counsel for the Bank conceded at oral argument, Barrer was not represented by an attorney when he filled out the loan application or when he discussed it with Womack. In considering whether adequate notice was given, it should be kept in mind that a layman might not appreciate the distinction urged by the bank between being a defendant in an ongoing lawsuit and having a judgment entered against one. The substance of the information concerning the judgment debts should therefore be given greater weight than its form.

<sup>53</sup> We wish to emphasize that in this opinion we are not holding banks to a new, high level of responsibility for checking the truthfulness of loan applications before we will furnish them ordinary contract law protection. We merely decide here that the magistrate did not apply the correct legal standard and that there exist disputes over material facts that render the case inappropriate for disposition on summary judgment.

they are pursuing. For a claim in tort, a plaintiff must establish that the defendant knew the misrepresentation to be false or made it with scienter, reckless disregard for the truth. Under contract doctrine, a party could prevail in asserting misrepresentation and avoid a contract even in a case involving an innocent misrepresentation by a counterpart. Why might this be the case?

2. The court in *Barrer* applied a materiality standard to the misrepresentation rather than considering if the misrepresentation was fraudulent. Considering the definition of fraudulent misrepresentation below, why did you think the court took the approach it did?
  - (1) A misrepresentation is fraudulent if the maker intends his assertion to induce a party to manifest his assent and the maker
    - (a) knows or believes that the assertion is not in accord with the facts, or
    - (b) does not have the confidence that he states or implies in the truth of the assertion, or
    - (c) knows that he does not have the basis that he states or implies for the assertion.

Restatement (Second) §162 (1)

3. The court in *Barrer* remanded the case to the magistrate to determine, among other things, whether Barrer sufficiently disclosed the outstanding judgements against him. How does the approach in this case allocate risk and responsibilities between the parties, and which facts prove critical to the court's analysis? Should the fact, for example, that the bank failed to run a credit check that could be done in minutes impact a court's approach to nondisclosure?
4. Consider the court's assertion that whether Barrer "thought" he was behind in his mortgage payments is not a misrepresentation if this statement was consistent with his state of mind, regardless of the factual state of his mortgage payments at the time. How does this approach allocate risk between the parties? What actions might it incentivize on the part of banks?
5. What do you think about the court requiring the bank to show that is reasonably relied on the misrepresentations (if they were indeed made)? Doesn't it go without saying that banks rely on the statements made by potential borrowers concerning those borrowers?

financial affairs? Why else would the bank ask the borrower for such statements? Does Barrer mean that when a borrower intentionally lies to a lender the contract might not be voidable if a reasonable lender would have detected the lie? Does this allocation of risk make sense?

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A common scenario in which many courts impose a duty to disclose is when a buyer sells property that contains a latent defect (meaning, one that is not readily apparent). Typical cases involve infestations and similar defects that cannot be readily discerned. In *Swinton v. Whitinsville Savings Bank*, 42 N.E.2d 808 (Mass. 1942), for example, a plaintiff bought a house from the defendant, which the plaintiff later found to be infested with termites.

The court rejected the claim of fraudulent concealment and held there was no liability for non-disclosure. As the court saw it, there was “no allegation of any false statement or representation, or of the uttering of half truth which may be tantamount to a falsehood. There is no intimation that the defendant by any means prevented the plaintiff from acquiring information as to the condition of the house.” In addition, there was “no fiduciary relation between the parties, or [evidence] that the plaintiff stood in a position of confidence toward of dependence upon the defendant.” As such, the court characterized the situation as involving “concealment and nothing more.” It rejected the idea that the law imposes a duty to disclose any material “nonapparent,” or latent, defect, just as it does not impose a duty on a buyer to “disclose any nonapparent virtue known to him in the subject of the purchase which materially enhances its value and of which the seller is ignorant.”

In contrast, in the case below, the New Jersey court rejected the approach taken by the Massachusetts court in *Swinton*.

**Weintraub v. Krobatsch**

64 N.J. 445, 317 A.2d 68 (Supreme Court of New Jersey 1974)

JACOBS, J.

The judgment entered in the Law Division, as modified in an unreported opinion of the Appellate Division, directed that the appellants Donald P. Krobatsch and Estella Krobatsch, his wife, pay the sum of \$4,250 to the plaintiff Natalie Weintraub and the sum of \$2,550 to the defendant The Serafin Agency, Inc. We granted certification on the application of the appellants. 63 N.J. 498, 308 A.2d 663 (1973). . . .

Mrs. Weintraub owned and occupied a six-year-old Englishtown home which she placed in the hands of a real estate broker (The Serafin Agency, Inc.) for sale.

The Krobatsches were interested in purchasing the home, examined it while it was illuminated and found it suitable. On June 30, 1971 Mrs. Weintraub, as seller, and the Krobatsches, as purchasers, entered into a contract for the sale of the property for \$42,500. The contract provided that the purchasers had inspected the property and were fully satisfied with its physical condition, that no representations had been made and that no responsibility was assumed by the seller as to the present or future condition of the premises. A deposit of \$4,250 was sent by the purchasers to the broker to be held in escrow pending the closing of the transaction. The purchasers requested that the seller have the house fumigated and that was done. A fire after the signing of the contract caused damage but the purchasers indicated readiness that there be adjustment at closing.

During the evening of August 25, 1971, prior to closing, the purchasers entered the house, then unoccupied, and as they turned the lights on they were, as described in their petition for certification, 'astonished to see roaches literally running in all directions, up the walls, drapes, etc.' On the following day their attorney wrote a letter to Mrs. Weintraub, care of her New York law firm, advising that on the previous day 'it was discovered that the house is infested with vermin despite the fact that an exterminator has only recently serviced the house' and asserting that 'the presence of vermin in such great quantities, particularly after the exterminator was done, rendered the house as unfit for human habitation at this time and therefore, the contract is rescinded.' On September 2, 1971 an exterminator wrote to Mr. Krobatsch advising that he had examined the premises and that 'cockroaches were found to have infested the entire house.' He said he could eliminate them for a relatively modest charge by two treatments with a twenty-one day interval but that it would be necessary to remove the carpeting 'to properly treat all the infested areas.'

Mrs. Weintraub rejected the rescission by the purchasers and filed an action in the Law Division joining them and the broker as defendants. Though she originally sought specific performance she later confined her claim to damages in the sum of \$4,250, representing the deposit held in escrow by the broker. The broker filed an answer and counterclaim seeking payment of its commission in the sum of \$2,550. There were opposing motions for summary judgment by the purchasers and Mrs. Weintraub, along with a motion for summary judgment by the broker for its commission. At the argument on the motions it was evident that the purchasers were claiming fraudulent concealment or nondisclosure by the seller as the basis for their rescission. Thus at one point their attorney said: 'Your honor, I would point out, and it is in my clients' affidavit, every time that they inspected this house prior to this time every

light in the place was illuminated. Now, these insects are nocturnal by nature and that is not a point I think I have to prove through someone. I think Webster's dictionary is sufficient. By keeping the lights on it keeps them out of sight. These sellers had to know they had this problem. You could not live in a house this infested without knowing about it.'

The Law Division denied the motion by the purchasers for summary judgment but granted Mrs. Weintraub's motion and directed that the purchasers pay her the sum of \$4,250. It further directed that the deposit monies held in escrow by the broker be paid to Mrs. Weintraub in satisfaction of her judgment against the purchasers. . . .

Before us the purchasers contend that they were entitled to a trial on the issue of whether there was fraudulent concealment or nondisclosure entitling them to rescind; if there was, then clearly they were under no liability to either the seller or the broker and would be entitled to the return of their deposit held by the broker in escrow. See *Keen v. James*, 39 N.J. Eq. 527, 540 (E. & A. 1885) where Justice Dixon, speaking for the then Court of last resort, pointed out that 'silence may be fraudulent' and that relief may be granted to one contractual party where the other suppresses facts which he, "under the circumstances, is bound in conscience and duty to disclose to the other party, and in respect to which he cannot, innocently, be silent." 39 N.J. Eq. at 540—541. . . .

Mrs. Weintraub asserts that she was unaware of the infestation and the Krobatsches acknowledge that, if that was so, then there was no fraudulent concealment or nondisclosure on her part and their claim must fall. But the purchasers allege that she was in fact aware of the infestation and at this stage of the proceedings we must assume that to be true. She contends, however, that even if she were fully aware she would have been under no duty to speak and that consequently no complaint by the purchasers may legally be grounded on her silence. She relies primarily on cases such as *Swinton v. Whitinsville Sav. Bank*, 311 Mass. 677, 42 N.E.2d 808, 141 A.L.R. 965 (1942), and *Taylor v. Heisinger*, 39 Misc. 2d 955, 242 N.Y.S. 2d 281 (Sup. Ct.1963). Taylor is not really pertinent since there the court found that the seller had 'no demonstrated nor inferable knowledge of the condition complained of.' 242 N.Y.S. 2d at 286. Swinton is pertinent but, as Dean Prosser has noted (Prosser, *Supra* at 696), it is one of a line of 'singularly unappetizing cases' which are surely out of tune with our times.

In Swinton the plaintiff purchased a house from the defendant and after he occupied it he found it to be infested with termites. The defendant had made no verbal or written representations but the plaintiff, asserting that the defendant knew of the termites and was under a duty to speak, filed a complaint for damages grounded on fraudulent concealment. The Supreme Judicial Court of Massachusetts sustained a demurrer to the complaint and

entered judgment for the defendant. In the course of its opinion the court acknowledged that ‘the plaintiff possesses a certain appeal to the moral sense’ but concluded that the law has not ‘reached the point of imposing upon the frailties of human nature a standard so idealistic as this.’ 42 N.E.2d at 808—809. That was written several decades ago and we are far from certain that it represents views held by the current members of the Massachusetts court. See *Kannavos v. Annino*, 356 Mass. 42, 247 N.E.2d 708, 711 (1969). In any event we are certain that it does not represent our sense of justice or fair dealing and it has understandably been rejected in persuasive opinions elsewhere. See *Obde v. Schlemeyer*, 56 Wash.2d 449, 353 P.2d 672 (1960); *Logbry v. Capel*, 257 Iowa 285, 132 N.W.2d 417 (1965); *Williams v. Benson*, 3 Mich. App. 9, 141 N.W.2d 650 (1966); *Sorrell v. Young*, 6 Wash. App. 220, 491 P.2d 1312 (1971); *Lawson v. Citizens & Southern National Bank of S.C.*, 259 S.C. 477, 193 S.E.2d 124 (1972); Cf. *Clauser v. Taylor*, 44 Cal. App.2d 453, 112 P.2d 661 (1941); *Simmons v. Evans*, 185 Tenn. 282, 206 S.W.2d 295 (1947); *Piazzini v. Jessup*, 153 Cal.App.2d 58, 314 P.2d 196 (1957); *Rich v. Rankl*, 6 Conn. Cir. 185, 269 A.2d 84, 88 (1969); *Ford v. Broussard*, 248 So.2d 629 (La.App.1971). See also Restatement 2d, Torts s 551 (Tent. Draft No. 12 (1966)); Keeton, ‘Rights of Disappointed Purchasers,’ 32 Tex. L. Rev. 1 (1953); Cf. Bixby, ‘Let the Seller Beware: Remedies for the Purchase of a Defective Home,’ 49 J. Urban Law 533 (1971); Haskell, ‘The Case for an Implied Warranty of Quality in Sales of Real Property,’ 53 Geo. L. J. 633 (1965); Note, ‘Implied Warranties in Sales of Real Estate—The Trend to Abolish Caveat Emptor,’ 22 DePaul L. Rev. 510 (1972).

In *Obde v. Schlemeyer*, 56 Wash.2d 449, 353 P.2d 672, the defendants sold an apartment house to the plaintiff. The house was termite infested but that fact was not disclosed by the sellers to the purchasers who later sued for damages alleging fraudulent concealment. The sellers contended that they were under no obligation whatever to speak out and they relied heavily on the decision of the Massachusetts court in *Swinton* (311 Mass. 677, 42 N.E.2d 808, 141 A.L.R. 965). The Supreme Court of Washington flatly rejected their contention, holding that though the parties had dealt at arms length the sellers were under ‘a duty to inform the plaintiffs of the termite condition’ of which they were fully aware. 353 P.2d at 674; Cf. *Hughes v. Stusser*, 68 Wash.2d 707, 415 P.2d 89, 92 (1966). In the course of its opinion the court quoted approvingly from Dean Keeton's article *Supra*, in 15 Tex. L. Rev. 1. There the author first expressed his thought that when Lord Cairns suggested in *Peek v. Gurney*, L.R. 6 H.L. 377 (1873), that there was no duty to disclose facts, no matter how ‘morally censurable’ (at 403), he was expressing nineteenth century law as shaped by an individualistic philosophy based on freedom of contracts and unconcerned with morals. He then made the following comments which fairly embody a currently acceptable principle on which the holding in *Obde* may be said to be grounded:

In the present stage of the law, the decisions show a drawing away from this idea, and there can be seen an attempt by many courts to reach a just result in so far as possible, but yet maintaining the degree of certainty which the law must have. The statement may often be found that if either party to a contract of sale conceals or suppresses a material fact which he is in good faith bound to disclose then his silence is fraudulent.

The attitude of the courts toward nondisclosure is undergoing a change and contrary to Lord Cairns' famous remark it would seem that the object of the law in these cases should be to impose on parties to the transaction a duty to speak whenever justice, equity, and fair dealing demand it. This statement is made only with reference to instances where the party to be charged is an actor in the transaction. This duty to speak does not result from an implied representation by silence, but exists because a refusal to speak constitutes unfair conduct. 15 Tex. L. Rev. at 31.

In *Sorrell v. Young*, Supra, the Court of Appeals of Washington recently applied the holding in *Obde v. Schlemeyer*, Supra, to a case where the sellers sold a residential lot to the buyers without disclosing that the lot had been filled. The buyers' evidence indicated the following: when the sellers originally acquired the lot it was below street grade and had been partially filled. They completed the filling and kept the lot until they considered it salable. At the time of the sale the fact that the land had been filled was not apparent. The sellers did not mention it at all and the buyers made no inquiry. The buyers sought a building permit and were told that expensive soil tests would be required, that piling would be necessary and that there was no assurance that a house could be built even if piling was installed. The court held that the buyers' evidence, if accepted, would support a right to rescind. In the course of its opinion it had this to say:

. . . by the turn of the century, Washington had recognized that 'the tendency of the more recent cases has been to restrict rather than extend the doctrine of Caveat emptor.' *Woody v. Benton Water Co.*, 54 Wash. 124, 127, 102 P. 1054, 1056 (1909). And, '(a)s would be expected when change in the law is taking place, there is no unanimity' in the decisions of other jurisdictions. Keeton, Rights of Disappointed Purchasers, 32 Tex. L. Rev. 1, 4 (1953). However, there is an 'amorphous tendency' on the part of most courts to grant relief to a purchaser for nondisclosure of facts which would probably affect the purchaser's decision to purchase. W. Prosser, Torts s 101 (3d ed. 1964). And consistent with Restatement of Torts s 551, comment B (1938), relief by way of rescission is more readily granted than damages. W. Prosser, Torts s 105 (3d ed. 1964). 491 P.2d at 1314.

In *Logbry v. Capel*, Supra, the plaintiffs purchased a duplex from the defendants. They examined the house briefly on two occasions and signed a document stating that they accepted the property in its 'present condition.' 132 N.W.2d at 419. They made no inquiry about the subsoil and were not told that the house had been constructed on filled ground. They filed an action for damages charging that the sellers had fraudulently failed to disclose that the duplex was constructed on improperly compacted filled ground. The jury found in their favor and the verdict was sustained on appeal in an opinion which pointed out that 'fraud may consist of concealment of a material fact.' 132 N.W.2d at 419. The purchasers' stipulation that they accepted the property in its present condition could not be invoked to bar their claim. See *Wolford v. Freeman*, 150 Neb. 537, 35 N.W.2d 98 (1948), where the court pointed out that the purchase of property 'as is' does not bar rescission grounded on fraudulent conduct of the seller. 35 N.W.2d at 103.

In *Simmons v. Evans*, Supra, the defendants owned a home which was serviced by a local water company. The company supplied water during the daytime but not at night. The defendants sold their home to the plaintiffs but made no mention of the limitation on the water service. The plaintiffs filed an action to rescind their purchase but the lower court dismissed it on the ground that the defendants had not made any written or verbal representations and the plaintiffs had 'inspected the property, knew the source of the water supply, and could have made specific inquiry of these defendants or ascertained from other sources the true situation and, therefore, are estopped.' 206 S.W.2d at 296. The dismissal was reversed on appeal in an opinion which took note of the general rule that "one may be guilty of fraud by his silence, as where it is expressly incumbent upon him to speak concerning material matters that are entirely within his own knowledge." 206 S.W.2d at 296. With respect to the plaintiffs' failure to ascertain the water situation before their purchase the court stated that the plaintiffs were surely not required 'to make a night inspection in order to ascertain whether the water situation with reference to this residence was different from what it was during the day.' 206 S.W.2d at 297. . . .

If the trial judge finds such deliberate concealment or nondisclosure of the latent infestation not observable by the purchasers on their inspection, he will still be called upon to determine whether, in the light of the full presentation before him, the concealment or nondisclosure was of such significant nature as to justify rescission. Minor conditions which ordinary sellers and purchasers would reasonably disregard as of little or no materiality in the transaction would clearly not call for judicial intervention. While the described condition may not have been quite as major as in the termite cases which were concerned with structural impairments, to the purchasers here it apparently was of such magnitude and was so repulsive as to cause

them to rescind immediately though they had earlier indicated readiness that there be adjustment at closing for damage resulting from a fire which occurred after the contract was signed. We are not prepared at this time to say that on their showing they acted either unreasonably or without equitable justification.

Our courts have come a long way since the days when the judicial emphasis was on formal rules and ancient precedents rather than on modern concepts of justice and fair dealing. While admittedly our law has progressed more slowly in the real property field than in other fields, there have been notable stirrings even there. . . . .

[W]e are satisfied that current principles grounded on justice and fair dealing, embraced throughout this opinion, clearly call for a full trial below; to that end the judgment entered in the Appellate Division is:

Reversed and Remanded.

### Notes and Questions

1. The New Jersey court noted a shift in the legal standard and characterized the approach taken in *Swinton* and similar cases in which the court failed to impose a duty to disclose latent material defects as “surely out of tune with our times.” What are the benefits approach taken by the court? What objectives does this approach serve?
2. The parties in this case entered into a contract that “provided that the purchasers had inspected the property and were fully satisfied with its physical condition, that no representations had been made and that no responsibility was assumed by the seller as to the present or future condition of the premises.” What role does the contract language play in circumstances such as this? How would you advise a client involved in the sale or purchase of a house as to the risk or benefits of such contract terms?
3. The court notes that the purchasers requested that the house be fumigated prior to closing and that the sellers complied. Imagine the sellers made a statement thereafter and prior to closing, confidently asserting, “The house has been fumigated!” How might courts treat that fact? Note that courts may consider partial and thus potentially misleading disclosure as constituting a misrepresentation.

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The case below involves an especially unusual manifestation of the question of misrepresentation and disclosure.

**Stambovsky v. Ackley**

169 A.D.2d 254 (New York Supreme Court, Appellate Division 1991)

RUBIN, Justice.

Plaintiff, to his horror, discovered that the house he had recently contracted to purchase was widely reputed to be possessed by poltergeists, reportedly seen by defendant seller and members of her family on numerous occasions over the last nine years. Plaintiff promptly commenced this action seeking rescission of the contract of sale. Supreme Court reluctantly dismissed the complaint, holding that plaintiff has no remedy at law in this jurisdiction.

The unusual facts of this case, as disclosed by the record, clearly warrant a grant of equitable relief to the buyer who, as a resident of New York City, cannot be expected to have any familiarity with the folklore of the Village of Nyack. Not being a “local,” plaintiff could not readily learn that the home he had contracted to purchase is haunted. Whether the source of the spectral apparitions seen by defendant seller are parapsychic or psychogenic, having reported their presence in both a national publication (“Readers’ Digest”) and the local press (in 1977 and 1982, respectively), defendant is estopped to deny their existence and, as a matter of law, the house is haunted. More to the point, however, no divination is required to conclude that it is defendant’s promotional efforts in publicizing her close encounters with these spirits which fostered the home’s reputation in the community. In 1989, the house was included in a five-home walking tour of Nyack and described in a November 27th newspaper article as “a riverfront Victorian (with ghost).” The impact of the reputation thus created goes to the very essence of the bargain between the parties, greatly impairing both the value of the property and its potential for resale. The extent of this impairment may be presumed for the purpose of reviewing the disposition of this motion to dismiss the cause of action for rescission (*Harris v. City of New York*, 147 A.D.2d 186, 188–189, 542 N.Y.S.2d 550) and represents merely an issue of fact for resolution at trial.

While I agree with Supreme Court that the real estate broker, as agent for the seller, is under no duty to disclose to a potential buyer the phantasmal reputation of the premises and that, in his pursuit of a legal remedy for fraudulent misrepresentation against the seller, plaintiff hasn't a ghost of a chance, I am nevertheless moved by the spirit of equity to allow the buyer to seek rescission of the contract of sale and recovery of his downpayment. New York law fails to recognize any remedy for damages incurred as a result of the seller’s mere silence, applying

instead the strict rule of caveat emptor. Therefore, the theoretical basis for granting relief, even under the extraordinary facts of this case, is elusive if not ephemeral.

“Pity me not but lend thy serious hearing to what I shall unfold” (William Shakespeare, Hamlet, Act I, Scene V [Ghost] ).

From the perspective of a person in the position of plaintiff herein, a very practical problem arises with respect to the discovery of a paranormal phenomenon: “Who you gonna’ call?” as the title song to the movie “Ghostbusters” asks. Applying the strict rule of caveat emptor to a contract involving a house possessed by poltergeists conjures up visions of a psychic or medium routinely accompanying the structural engineer and Terminix man on an inspection of every home subject to a contract of sale. It portends that the prudent attorney will establish an escrow account lest the subject of the transaction come back to haunt him and his client—or pray that his malpractice insurance coverage extends to supernatural disasters. In the interest of avoiding such untenable consequences, the notion that a haunting is a condition which can and should be ascertained upon reasonable inspection of the premises is a hobgoblin which should be exorcised from the body of legal precedent and laid quietly to rest.

It has been suggested by a leading authority that the ancient rule which holds that mere non-disclosure does not constitute actionable misrepresentation “finds proper application in cases where the fact undisclosed is patent, or the plaintiff has equal opportunities for obtaining information which he may be expected to utilize, or the defendant has no reason to think that he is acting under any misapprehension” (Prosser, Law of Torts § 106, at 696 [4th ed., 1971]). However, with respect to transactions in real estate, New York adheres to the doctrine of caveat emptor and imposes no duty upon the vendor to disclose any information concerning the premises (*London v. Courduff*, 141 A.D.2d 803, 529 N.Y.S.2d 874) unless there is a confidential or fiduciary relationship between the parties (*Moser v. Spizzirro*, 31 A.D.2d 537, 295 N.Y.S.2d 188, *affd.*, 25 N.Y.2d 941, 305 N.Y.S.2d 153, 252 N.E.2d 632; *IBM Credit Fin. Corp. v. Mazda Motor Mfg. (USA) Corp.*, 152 A.D.2d 451, 542 N.Y.S.2d 649) or some conduct on the part of the seller which constitutes “active concealment” (*see, 17 East 80th Realty Corp. v. 68th Associates*, 173 A.D.2d 245, 569 N.Y.S.2d 647 [dummy ventilation system constructed by seller]; *Haberman v. Greenspan*, 82 Misc.2d 263, 368 N.Y.S.2d 717 [foundation cracks covered by seller] ). Normally, some affirmative misrepresentation (*e.g., Tabini Invs., Ltd. v. Bobrowsky*, 99 A.D.2d 489, 470 N.Y.S.2d 431 [industrial waste on land allegedly used only as farm]; *Jansen v. Kelly*, 11 A.D.2d 587, 200 N.Y.S.2d 561 [land containing valuable minerals allegedly acquired for use as campsite] ) or partial disclosure (*Junius Constr. Corp. v. Cohen*, 257 N.Y. 393, 178 N.E. 672 [existence of third unopened street concealed]; *Noved Realty Corp. v. A.A.P. Co.*, 250 App. Div. 1, 293 N.Y.S. 336 [escrow agreements securing lien concealed] ) is required to impose

upon the seller a duty to communicate undisclosed conditions affecting the premises (*contra, Young v. Keith*, 112 A.D.2d 625, 492 N.Y.S.2d 489 [defective water and sewer systems concealed] ).

Caveat emptor is not so all-encompassing a doctrine of common law as to render every act of non-disclosure immune from redress, whether legal or equitable. “In regard to the necessity of giving information which has not been asked, the rule differs somewhat at law and in equity, and while the law courts would permit no recovery of *damages* against a vendor, because of mere concealment of facts *under certain circumstances*, yet if the vendee refused to complete the contract because of the concealment of a material fact on the part of the other, equity would refuse to compel him so to do, because equity only compels the specific performance of a contract which is fair and open, and in regard to which all material matters known to each have been communicated to the other” (*Rothmiller v. Stein*, 143 N.Y. 581, 591–592, 38 N.E. 718 [emphasis added] ). Even as a principle of law, long before exceptions were embodied in statute law (*see, e.g.*, UCC 2–312, 2–313, 2–314, 2–315; 3–417[2][e] ), the doctrine was held inapplicable to contagion among animals, adulteration of food, and insolvency of a maker of a promissory note and of a tenant substituted for another under a lease (*see, Rothmiller v. Stein, supra*, at 592–593, 38 N.E. 718 and cases cited therein). Common law is not moribund. *Ex facto jus oritur* (law arises out of facts). Where fairness and common sense dictate that an exception should be created, the evolution of the law should not be stifled by rigid application of a legal maxim.

The doctrine of caveat emptor requires that a buyer act prudently to assess the fitness and value of his purchase and operates to bar the purchaser who fails to exercise due care from seeking the equitable remedy of rescission (*see, e.g., Rodas v. Manitaras*, 159 A.D.2d 341, 552 N.Y.S.2d 618). For the purposes of the instant motion to dismiss the action pursuant to CPLR 3211(a)(7), plaintiff is entitled to every favorable inference which may reasonably be drawn from the pleadings . . . specifically, in this instance, that he met his obligation to conduct an inspection of the premises and a search of available public records with respect to title. It should be apparent, however, that the most meticulous inspection and the search would not reveal the presence of poltergeists at the premises or unearth the property's ghoulish reputation in the community. Therefore, there is no sound policy reason to deny plaintiff relief for failing to discover a state of affairs which the most prudent purchaser would not be expected to even contemplate (*see, Da Silva v. Musso*, 53 N.Y.2d 543, 551, 444 N.Y.S.2d 50, 428 N.E.2d 382).

The case law in this jurisdiction dealing with the duty of a vendor of real property to disclose information to the buyer is distinguishable from the matter under review. The most salient

distinction is that existing cases invariably deal with the physical condition of the premises (*e.g.*, *London v. Courduff*, *supra* [use as a landfill]; *Perin v. Mardine Realty Co.*, 5 A.D.2d 685, 168 N.Y.S.2d 647 *affd.* 6 N.Y.2d 920, 190 N.Y.S.2d 995, 161 N.E.2d 210 [sewer line crossing adjoining property without owner's consent] ), defects in title (*e.g.*, *Sands v. Kissane*, 282 App. Div. 140, 121 N.Y.S.2d 634 [remainderman] ), liens against the property (*e.g.*, *Noved Realty Corp. v. A.A.P. Co.*, *supra* ), expenses or income (*e.g.*, *Rodas v. Manitaras*, *supra* [gross receipts] ) and other factors affecting its operation. No case has been brought to this court's attention in which the property value was impaired as the result of the reputation created by information disseminated to the public by the seller (or, for that matter, as a result of possession by poltergeists).

Where a condition which has been created by the seller materially impairs the value of the contract and is peculiarly within the knowledge of the seller or unlikely to be discovered by a prudent purchaser exercising due care with respect to the subject transaction, nondisclosure constitutes a basis for rescission as a matter of equity. Any other outcome places upon the buyer not merely the obligation to exercise care in his purchase but rather to be omniscient with respect to any fact which may affect the bargain. No practical purpose is served by imposing such a burden upon a purchaser. To the contrary, it encourages predatory business practice and offends the principle that equity will suffer no wrong to be without a remedy.

Defendant's contention that the contract of sale, particularly the merger or "as is" clause, bars recovery of the buyer's deposit is unavailing. Even an express disclaimer will not be given effect where the facts are peculiarly within the knowledge of the party invoking it (*Danann Realty Corp. v. Harris*, 5 N.Y.2d 317, 322, 184 N.Y.S.2d 599, 157 N.E.2d 597; *Tabini Invs., Ltd. v. Bobrowsky*, *supra* ). Moreover, a fair reading of the merger clause reveals that it expressly disclaims only representations made with respect to the physical condition of the premises and merely makes general reference to representations concerning "any other matter or things affecting or relating to the aforesaid premises". As broad as this language may be, a reasonable interpretation is that its effect is limited to tangible or physical matters and does not extend to paranormal phenomena. Finally, if the language of the contract is to be construed as broadly as defendant urges to encompass the presence of poltergeists in the house, it cannot be said that she has delivered the premises "vacant" in accordance with her obligation under the provisions of the contract rider.

To the extent New York law may be said to require something more than "mere concealment" to apply even the equitable remedy of rescission, the case of *Junius Construction Corporation v. Cohen*, 257 N.Y. 393, 178 N.E. 672, *supra*, while not precisely on point, provides some guidance. In that case, the seller disclosed that an official map indicated two as yet unopened streets which were planned for construction at the edges of the parcel. What was not disclosed

was that the same map indicated a third street which, if opened, would divide the plot in half. The court held that, while the seller was under no duty to mention the planned streets at all, having undertaken to disclose two of them, he was obliged to reveal the third (*see also, Rosenschein v. McNally*, 17 A.D.2d 834, 233 N.Y.S.2d 254).

In the case at bar, defendant seller deliberately fostered the public belief that her home was possessed. Having undertaken to inform the public at large, to whom she has no legal relationship, about the supernatural occurrences on her property, she may be said to owe no less a duty to her contract vendee. It has been remarked that the occasional modern cases which permit a seller to take unfair advantage of a buyer's ignorance so long as he is not actively misled are "singularly unappetizing" (Prosser, *Law of Torts* § 106, at 696 [4th ed. 1971]). Where, as here, the seller not only takes unfair advantage of the buyer's ignorance but has created and perpetuated a condition about which he is unlikely to even inquire, enforcement of the contract (in whole or in part) is offensive to the court's sense of equity. Application of the remedy of rescission, within the bounds of the narrow exception to the doctrine of caveat emptor set forth herein, is entirely appropriate to relieve the unwitting purchaser from the consequences of a most unnatural bargain.

Accordingly, the judgment of the Supreme Court, New York County (Edward H. Lehner, J.), entered April 9, 1990, which dismissed the complaint pursuant to CPLR 3211(a)(7), should be modified, on the law and the facts and in the exercise of discretion, and the first cause of action seeking rescission of the contract reinstated, without costs.

Judgment, Supreme Court, New York County (Edward H. Lehner, J.), entered on April 9, 1990, modified, on the law and the facts and in the exercise of discretion, and the first cause of action seeking rescission of the contract reinstated, without costs.

All concur except MILONAS, J.P. and SMITH, J., who dissent in an opinion by SMITH, J.

SMITH, Justice (dissenting).

I would affirm the dismissal of the complaint by the motion court. . . .

"It is settled law in New York that the seller of real property is under no duty to speak when the parties deal at arm's length. The mere silence of the seller, without some act or conduct which deceived the purchaser, does not amount to a concealment that is actionable as a fraud (*see Perin v. Mardine Realty Co., Inc.*, 5 A.D.2d 685, 168 N.Y.S.2d 647, *aff'd*, 6 N.Y.2d 920, 190 N.Y.S.2d 995, 161 N.E.2d 210; *Moser v. Spizzirro*, 31 A.D.2d 537, 295 N.Y.S.2d 188, *aff'd*, 25 N.Y.2d 941, 305 N.Y.S.2d 153, 252 N.E.2d 632). The buyer has the duty to satisfy himself as

to the quality of his bargain pursuant to the doctrine of caveat emptor, which in New York State still applies to real estate transactions.” *London v. Courduff*, 141 A.D.2d 803, 804, 529 N.Y.S.2d 874, *app. dismissed*, 73 N.Y.2d 809, 537 N.Y.S.2d 494, 534 N.E.2d 332 (1988).

The parties herein were represented by counsel and dealt at arm’s length. This is evidenced by the contract of sale which, *inter alia*, contained various riders and a specific provision that all prior understandings and agreements between the parties were merged into the contract, that the contract completely expressed their full agreement and that neither had relied upon any statement by anyone else not set forth in the contract. There is no allegation that defendants, by some specific act, other than the failure to speak, deceived the plaintiff. Nevertheless, a cause of action may be sufficiently stated where there is a confidential or fiduciary relationship creating a duty to disclose and there was a failure to disclose a material fact, calculated to induce a false belief. *County of Westchester v. Welton Becket Assoc.*, 102 A.D.2d 34, 50–51, 478 N.Y.S.2d 305, *aff’d.*, 66 N.Y.2d 642, 495 N.Y.S.2d 364, 485 N.E.2d 1029 (1985). However, plaintiff herein has not alleged and there is no basis for concluding that a confidential or fiduciary relationship existed between these parties to an arm's length transaction such as to give rise to a duty to disclose. In addition, there is no allegation that defendants thwarted plaintiff's efforts to fulfill his responsibilities fixed by the doctrine of caveat emptor. *See London v. Courduff, supra*, 141 A.D.2d at 804, 529 N.Y.S.2d 874.

Finally, if the doctrine of caveat emptor is to be discarded, it should be for a reason more substantive than a poltergeist. The existence of a poltergeist is no more binding upon the defendants than it is upon this court. . . .

### Notes and Questions

1. As discussed above, typical examples of latent defects include a roach infestation that cannot be readily discerned. While the claim of a poltergeist is unusual, its impact on the buyer—the reason it prompted a claim for rescission—may be more mundane. Why do you think the presence of a poltergeist in this case constituted a defect for the buyer?
2. New York is an unusual jurisdiction in that it imposes the rule of caveat emptor—let the buyer beware. What facts proved most significant to the court’s analysis and its decision to grant rescission of the contract? Note the date of the case. Do you think it would come out the same way today?
3. What role did the written terms of the contract play, in this case? Note that the contract contained an “as is” provision. How does the court treat this provision? Is this

inconsistent with the approach taken by the court in *Lenawee* (above)? If not, how can you explain the court's approach here?

4. The court discusses particular relationships that create a duty to disclose, even in a "caveat emptor" jurisdiction. What are they?