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Proximate Cause As a Primary Element of Fraud

Karl P. Seuthe*

The New York City Better Business Bureau reports a 10% rise in complaints of unfair business practices in 1958. This allegedly is the first statistical upturn in complaints since 1953.¹ The philosopher Hobbes stated in his celebrated book "Leviathan" that men tend to prey on their fellowmen for their own gain.² It is for this reason, primarily, that government and a judicial system are necessary features of a civilized society—that these wrongs may be eliminated or controlled.³ The legal criterion by which fraudulent or predatory motivation is judged is not the "conscience" of the actor. Rather the external manifestations of conscience constitute the test of this motivation. Conduct, rather than subjective thought, is most frequently the standard or test employed by the community.⁴

In modern legal systems, conduct is of small significance unless it has some outward consequence which is actually or potentially harmful to the actor or others; fraud is such a consequence.

The law of fraud, as presently construed by the courts, is based in part on the Law Merchant and in part on well established parts of the law of torts. The proposed Uniform Commercial Code assumed that the legal standard of interpretation of commercial contracts should be the mores of the merchant. Of course, these mores may be contrary to the mores of some larger or other competing group or class. When such a conflict does exist, which "law" is the court to apply? "Law is the word of him that by right has command over others."⁵ The law of the merchant is well established in our American legal system. The law of fraud, in part, also stems from criminal law. This involves

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³ Patterson, Jurisprudence, Men and Ideas of the Law, 31 (1953).
⁴ Gerseta Corp. v. Wessex-Campbell Silk Co., 3 F. 2d 236 (2d Cir. 1924).
⁵ Hobbes, supra n. 2.
application, by Courts, of the stricter (criminal law kind) rules of evidence and proof.6

Yet if we now are in the area of "Socialization of Law" as described by Roscoe Pound, how then can we reconcile the hesitancy of the law of fraud in following principles found in other torts? The legislatures have seen fit to impose liability without fault in many areas, as witness workmen's compensation laws. Yet in the light of these developments the law of fraud is hesitant to follow the same kind of evolution in respect to fraud.

In the area of fraud, perhaps the part slowest to evolve is the requirement that there must be reasonable reliance by the person who claims that a fraud has been committed. The law sets standards to guide courts in determining whether the recipient has acted reasonably.

Certain basic premises must first be stated, as this paper hardly intends to expound on the entire area of fraud. We may start with certain assumptions, for simplicity's sake. That the communication complained of was untrue, here will not be questioned. That the representation was material, is not here to be questioned. That the recipient of the misrepresentation acted, or refrained from acting, to his detriment, is not here to be questioned.7 We do not mean to say that the law of fraud is completely archaic. There are certain instances which display the interest of courts and government in changing the law governing some areas of fraud. For example, the courts now seem inclined to impose liability on public accountants who issue to the party relying on them.8

The courts have stated, though, that parties may fall into a class which cannot avail itself, for legal action purposes, of a misrepresentation.9 The courts have gone so far as to say that, even

6 Ohio Const. Art. VIII, § 15: "No person shall be imprisoned for debt in any civil action, on mesne or final process, unless in cases of fraud." Soinski v. Wardaszko, 38 Ohio App. 388, 176 N. E. 460 (1930).
though false representations were made directly to a recipient, he could not properly rely on them.\textsuperscript{10}

It is in this area that there is little display of human compassion. The courts apply the rule that the man has no right properly to rely on a misrepresentation where he does not display average intelligence and prudence.\textsuperscript{11} The insistence by courts that a person be \textit{reasonable} in his reliance sometimes works harsh results. Where a fraud has been perpetrated by communication of ideas of such a nature as to contravene natural laws, one court stated that it was too preposterous to believe that anyone in the possession of sound judgment should be allowed to predicate fraud upon a representation of such a character.\textsuperscript{12}

Logically, there is more occasion to extend the protection of the courts to those who are \textit{not} capable of exercising the care and knowledge of a man of average prudence and intelligence. Surely it is as much a wrong to deceive an ignorant, incompetent, or gullible person as to deceive a man of average intelligence. But, for a jury in effect to be allowed to administer an I. Q. test, or to give substance to a plaintiff's protestation of general ignorance, may seem impractical.\textsuperscript{13}

In the Uniform Sales Act the writers \textit{have} seen fit to construe a warranty in the deceitful statements of a vendor. But the damages then lie in contract, not tort.

A jury often doles out harsh justice to a plaintiff where it cannot understand how a person did indeed rely on a blatant lie, using their own standards as the basis for the verdict. The determination should turn rather on the statement of the plaintiff that \textit{he did rely} subject to proof by the defendant that plaintiff indeed \textit{had} knowledge of the fact that there had been misrepresentation. This would tend to hold a plaintiff accountable for his \textit{actual} knowledge, not his \textit{presumed} knowledge.\textsuperscript{14}

\begin{itemize}
  \item \textsuperscript{10} Wells v. Cook, 16 U. S. 67, 88 Am. Dec. 436 (1863); also see McCracken v. West, 17 Ohio 16 (1948), and Duncan v. Willis, 51 Ohio St. 433 (1894).
  \item \textsuperscript{12} H. Herschberg Optical Co. v. Machaelson, 95 N. E. 461 (Nebr. 1901).
  \item \textsuperscript{13} Teter v. Shultz, 39 N. E. 2d 802 (Ind. 1942).
  \item \textsuperscript{14} The author realizes that the method of jury determination in cases of minors aged 6-14, and the application of standards of "reasonableness" to humans without legal incapacities 15 years or older in age, is in conflict with this discussion of fraud. The author in no way subscribes to the application of these standards.
\end{itemize}
Intent to defraud, generally, lowers the standards of reasonableness for which the plaintiff is accountable. Yet, if a plaintiff were held accountable to prove intent, in order to justify his ignorance, we might have a comedy of errors. As Chief Justice Bryant stated:

The thought of man shall not be tried, for the devil himself knowes not the thought of man.\textsuperscript{16}

The primary consideration should be directed to the damage sustained by the plaintiff, and not to the intent of the defendant.\textsuperscript{16} Proving that the communication was made, without the requirement that intent to defraud be annexed to the communication, seems proper and just. Also it would seem more proper to emphasize the change of position, and that this change of position was properly brought about by that communication. The words "properly brought about" serve to eliminate cases in which plaintiffs knowingly take advantage of the benefits of a defendant's communication which is incorrect and unwittingly made.

This is a theory similar to the concept of causation in tort. The relation of the parties is taken into important account. The act complained of must be shown to have been done. The exercise of a proper degree of care by the plaintiff himself must be shown, and resulting damage must be proved. The plaintiff's conduct must not be so entirely unreasonable (in the light of the information available to him) that the law may properly say that his loss is truly his own responsibility. Of course the evidence must not show that the plaintiff in actuality did not rely on, or was not induced by, the defendant's misrepresentation. Unquestionably the plaintiff is barred from relief from the moment when actual knowledge of the fact of misrepresentation is imparted to him.\textsuperscript{17} Where there is later renegotiation with the principal, for example, after prior negotiation with an agent has been had, this may not be the basis for claiming fraud on the part of the agent.\textsuperscript{18} If the representation is so incredible that ordinary ignorant people would not believe it, there would be

\textsuperscript{15} Y. B. 7 Edw. IV, f. 2, pl. 2.

\textsuperscript{16} Lambert v. Bessey, T. Raym. 421 (1681).

\textsuperscript{17} Kilieel v. Motor Haulage Co., 140 N. Y. S. 2d 51, affd. 149 N. Y. S. 2d 224, 1 A. D. 2d 782 (1955).

\textsuperscript{18} Levin v. Zeeman, 94 N. Y. S. 2d 441 (1949).
ground for the jury to decide only if the plaintiff actually did believe and rely.19

Where the plaintiff (e.g., buyer) has caused an inspection to be made, then he has not the right to claim reliance on statements of the vendor.20 But undoubtedly, where the inspection was made by a vendee who lacked the educational background and experience of the vendor, then the vendee may still have cause to rely on the statements of a vendor who is of superior education and experience.21 If the vendee hires an expert to inspect, he may not avail himself of reliance on the vendor's misrepresentation.22 In some cases it is not incumbent upon the vendee personally to inspect, and he may properly rely on statements of the vendor.23 Where parties are both guilty of negligence, neither can avail himself of the other party's wrong, as they are said to be in pari delicto.24 For the purposes of this discussion, plaintiff can be guilty of contributory negligence. Nor can a vendee close his eyes to patent facts, and instead rely on the misrepresentation of a vendor.25 It is simple sense to say that no rogue should enjoy ill-gotten plunder for the simple reason that his victim is a fool.

Falsehood of a tortfeasor's representations, rather than the credulity of his victims, is to be condemned.26 Proof of the misrepresentation of material facts, made to the plaintiff, where there was a proper reliance on the misrepresentation, is the crux of an action of fraud.27 Courts have at times alluded to the proximate causation theory in regard to fraud, in cases where the fraud was perpetrated in a situation not directly aimed at the plaintiff. Thus, where a part of the total effort of the defendant was to mislead the plaintiff the courts have held this type of effort to be actionable.28

19 Barndt v. Frederich, 78 Wis. 1, 47 N. W. 6, 11 L. R. A. 199 (1890); also see Prosser on Torts (2d Ed. 1955).
25 Farr v. Peterson, 91 Wis. 182, 64 N. W. 863 (1895).
26 Morrill v. Madden, 35 Minn. 493, 29 N. W. 193 (1886); Busterud v. Farrington, 36 Minn. 320, 31 N. W. 360 (1887); M. St. P. & S. S. M. Ry. Co. v. Chisholm, 55 Minn. 374, 57 N. W. 63 (1893).
The proximate causation theory might be best extended to the areas where there have been misrepresentations of law. It is incumbent upon all members of society to know the law, in theory. It is for this reason that a misrepresentation of the law, even though intentional, usually is not basis for recovery.\footnote{29} Is it not reasonable that, even in non-fiduciary cases, that a person may be entitled to act on the assumption that there exists no intention to cheat or defraud him?\footnote{30} No one has a right to complain that another has placed too great reliance on the truth of what he himself has stated.\footnote{31} The fraudulent vendor cannot escape liability by asking the court to applaud his guile and to condemn his victim for credulity.\footnote{32} Therefore the meaning given to fraud should be synonymous with "unconscionable" or "inequitable."\footnote{33}

Various tests can be evolved, to apply the proximate causation theory to this area of tort. The test of whether the plaintiff did act in reliance on the misrepresentation of the defendant, for example, would be adequate for a jury to determine. Also, as to the materiality of the misrepresentation, a test for the jury to apply would be whether or not the plaintiff would have acted in the absence of the misrepresentation. These are areas in which a jury may easily determine the essence of the actions of the parties. These are areas of contention which, if fully implemented by the courts, would perhaps minimize fraudulent transactions.

It is easy to say that most people desire a large return on small investments. But to allow scoundrels to take advantage of this propensity of mankind is indeed unjust.\footnote{34}

The federal government has seen fit to enter the area of fraud in regard to use of the United States mails to defraud.\footnote{35}

\footnote{29} Chamberlain v. Fuller, 9 A. 832 (S. Ct., Vt., 1887).
\footnote{32} Tracy v. Smith, 175 Cal. 161, 165 P. 535 (1917); also see Peter W. Kero Inc. v. Terminal Const. Corp., 6 N. J. 36, 78 A. 2d 814 (1951).
\footnote{34} Durland v. U. S., 161 U. S. 306 (1895).
It has attempted to protect the *trusting* as well as the suspicious. It is time to extend this social philosophy to larger areas of fraud. This might be done simply by making proximate causation, rather than reasonableness of reliance, the primary test of actionable fraud.