

ARTICLES

A Wrong Turn in the Law of Deceit

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This Article discusses how the requirement of justifiable reliance in the law of deceit came to be turned into a requirement of reasonable reliance. Courts can and do use the reasonable reliance requirement to dismiss on the pleadings deceit claims involving what the court considers to be unreasonable reliance by a plaintiff. This was the fate of most of the claims against lower-tier law schools for publishing misleading employment statistics. I argue that the equation of justifiable reliance with reasonable reliance was an unintended consequence of a loosening of the tort's scienter rule in the middle of the twentieth century to eliminate a requirement of intended reliance. The goal of the change was to make the law tougher on fraudsters by making a fraudster liable to a predictable but unintended victim of a fraud. The proponents of the change did not realize that the rules of justifiable reliance flowed from the old intended reliance rule. A later generation of judges and legal scholars made sense of the rules of justifiable reliance by equating justifiable reliance with reasonable reliance, creating a worse injustice than that which was created by the old intended reliance rule. The reasonable reliance rule allows a fraudster to escape liability if he can persuade a court that a reasonable person would not have fallen for his fraud. Under the old rule, a claim involving unreasonable reliance ordinarily could not be dismissed on the pleadings, affording the plaintiff an opportunity to establish culpable intent by proving that the defendant purposefully exploited the plaintiff's unreasonable disposition and beliefs.

I identify the functions served by the rules of justifiable reliance and argue that the intended reliance rule serves these functions as well as the reasonable reliance rule, while allowing fewer frauds to escape punishment. I conclude that courts should restore the intended reliance rule and eliminate the reasonable reliance rule in the law of deceit. The rules of justifiable reliance can be kept as they are, but they will return to being presumptions that a plaintiff can overcome by showing that a defendant had culpable intent.

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INTRODUCTION

This Article argues that a wrong turn was taken in the law of deceit in the United States in the middle of the twentieth century. The turn in the law led to the requirement of justifiable reliance being converted into a requirement of reasonable reliance.¹ As a consequence, in the United States today, a fraudster can avoid liability by persuading a court that a reasonable person would not have fallen for his fraud.² This is not the law anywhere else in the common law world,³ and it used not to be the law in the United States.⁴ The requirement of reasonable reliance enables a fraudster to prey on a victim’s vulnerabilities by creating the functional equivalent of a defense of contributory negligence in the law of deceit. This violates basic morality. Even a small child understands that it is wrong to exploit someone’s gullibility or frailty.

The mid-century turn in the law led to other changes in the law of deceit that favor fraudsters. U.S. courts sometimes invoke the requirement of justifiable reliance to dismiss a deceit claim involving unreasonable reliance on the pleadings without giving the plaintiff an opportunity to establish the defendant had culpable intent. This was the fate of most of the lawsuits brought by graduates of lower-tier law schools against their schools for publishing mislead-

1. For an explanation of how this came to be, see *infra* Part II.

2. For illustrative example cases in which courts dismissed on the pleadings fraud claims against lower-tier law schools for publishing misleading placement statistics by finding the students’ reliance on the published statistics in choosing to enroll at the school to be unreasonable as a matter of law, see *infra* Part III. For a particularly egregious case in which a court held that the plaintiff was unreasonable in relying on her fiancée’s valuation of her engagement ring, see *infra* Part IV.

3. See, e.g., *Bottin (Int’l) Invs. Ltd. v. Venson Grp.* [2006] EWHC (Ch) 3112 [301] (Eng.) (“[I]t is well established that it is no defence to an action for deceit that it was foolish or unreasonable of the Claimant to have relied on the dishonest representation in question.”); see also PETER MACDONALD EGGERS, *DECEIT: THE LIE OF THE LAW* 182–87 (2009) (concluding that a plaintiff’s apparent negligence in relying on a representation can be considered by a court in deciding whether a plaintiff in fact relied on a representation).

4. See, e.g., 1 MELVILLE M. BIGELOW, *A TREATISE ON THE LAW OF FRAUD: ON ITS CIVIL SIDE* 524 (Boston, Little, Brown, & Co. 1890) (“It may be improbable that a man with the truth in reach should accept a representation made in regard to it, but the improbability can be no more than matter of fact. . . . It matters not . . . that a person misled may be said, in some loose sense, to have been negligent . . . for it is not just that a man who has deceived another should be permitted to say to him, ‘You ought not to have believed or trusted me,’ or ‘You were yourself guilty of negligence.’”).

ing employment statistics on their graduates.⁵ Under the old rules, the plaintiffs in these lawsuits would have been given an opportunity for discovery. Their claims against the schools would have been dismissed on a motion for summary judgment if the plaintiffs could not provide clear and convincing evidence that the officials who published the misleading statistics had culpable intent. Under the new rules, most of the claims instead fell on a motion to dismiss.⁶ The turn in the law also led to the rules on factual and proximate causation being tightened to make it easier for fraudsters to avoid liability for losses that a fraud may have caused.⁷

These changes in the law of deceit occurred without anyone noticing. Ironically, although the changes favor fraudsters, they are the unintended byproducts of a change in the tort's scienter rule in the middle of the twentieth century that was actually intended to make the law *tougher* on fraudsters. The tort's scienter rule used to have two parts. The first part, which remains the law, requires that the defendant knew his representation was false or that the defendant had been conscious of a sufficient risk that his representation was false in such a way as to make his representation reckless.⁸ The scienter rule used to have a second part, which required that the defendant have made his misrepresentation intending to influence the plaintiff to do the alleged act in reliance of the misrepresentation.⁹ I will call this the intended reliance rule.

The intended reliance rule produced widely criticized outcomes. In a notorious case, the officers of a company published false information concerning the

5. See *infra* note 86.

6. For an explanation of how the scienter rule works hand in hand with the clear and convincing evidence standard to enable judges to dismiss most claims involving unreasonable reliance at the summary judgment stage, see *infra* Part III.

7. See *infra* Part IV.

8. RESTATEMENT (THIRD) OF TORTS: LIAB. FOR ECON. HARM § 10 cmt. c (AM. LAW INST., Tentative Draft No. 2, 2014) ("It is sometimes said that a statement is fraudulent if its maker believes it to be false or is reckless as to its truth or falsity. . . . The recklessness sufficient to support a claim of fraud occurs when a speaker acts in conscious disregard of a risk that a statement is false. . . ."). The black letter of section 10 is the same as section 526 of the Second Restatement, which does not use the term reckless. See RESTATEMENT (SECOND) OF TORTS § 526 (AM. LAW INST. 1977). The Restatements also have a three-part scienter rule that requires that the defendant either "knows or believes that the matter is not as he represents it to be," "knows that he does not have the confidence in the accuracy of his representation that he states or implies," or "knows that he does not have the basis for the representation that he states or implies." *E.g.*, RESTATEMENT (THIRD) OF TORTS: LIAB. FOR ECON. HARM § 10. All three parts of the rule require that the defendant be conscious of the respect in which his representation is false or misleading.

The terminology of the Model Penal Code is helpful to distinguish the mental states of knowledge and recklessness with regard to the falsity of a representation. An actor knows a representation is false if it is "practically certain" that it is false. MODEL PENAL CODE § 2.02(2)(b) (AM. LAW INST., Proposed Official Draft 1962). An actor is reckless with regard to a representation's falsity if she "consciously disregards a substantial . . . risk" that the representation is false. *Id.* § 2.02(2)(c). Gross negligence is not a mental state. An actor is negligent with regard to the falsity of a representation if she is unaware but "should be aware of a substantial . . . risk" the representation is false. *Id.* § 2.02(2)(d). Liability for deceit ordinarily requires at least recklessness on the part of the defendant.

9. For an explanation of the old scienter rule, which remains an element of the tort elsewhere in the common law world, see *infra* Part II.

company's financial condition to persuade investors to purchase the company's bonds.¹⁰ The plaintiffs were people who purchased the company's stock in the secondary market, relying on the same false information. The officers and the company were held not to be liable to the stock purchasers for their loss on the stock investments because they were not the intended victims of the fraud.¹¹ To avoid such unjust results, the law was changed to make a fraudster liable to a victim of a fraud if the fraudster had "reason to expect" the victim's reliance.¹²

The legal scholars and judges who advocated for this seemingly unobjectionable change in the tort's scienter rule did not appreciate that the rules of justifiable reliance flowed from the intended reliance rule. The rules of justifiable reliance cover representations upon which a reasonable person would not rely, such as a sales person's puffing of a good. The rules flowed from the intended reliance rule because often when a plaintiff's reliance on a representation is unreasonable the defendant does not intend the plaintiff to rely on it.¹³ The elimination of the intended reliance rule left the requirement of justifiable reliance and its attendant rules without a rationale. A later generation of legal scholars and judges found a way to make sense of the requirement—and to give effect to the attendant rules—by equating justifiable reliance with reasonable reliance. Under the old rule, a court asked whether the plaintiff's reliance was intended by the defendant, and under the new rule, a court asked whether the plaintiff's reliance was reasonable. The new requirement of reasonable reliance led to an even worse injustice than that created by the old rule. The reasonable reliance rule lets some fraudsters escape liability entirely whereas the intended reliance rule limits the class of persons to whom a fraudster is liable.

These changes altered the character of the tort in a fundamental way. Deceit used to be an intensely personal tort: one individual trying to get into the mind of another individual to influence the other's action by giving him misleading information. It has become an impersonal wrong: knowingly disseminating

10. See *Greenville Nat'l Bank v. Nat'l Hardwood Co.*, 217 N.W. 786, 786–87 (Mich. 1928).

11. See *id.*

12. For an explanation of why the old rule was changed, see *infra* Part II. The academic and juristic assaults on the old rule are contemporaneous with public action in the 1930s that led to what Edward J. Ballesin describes as "a turning point in the policing of business fraud in the United States," which included at the federal level the creation of the SEC and an expansion of the jurisdiction of the FTC. EDWARD J. BALLEISEN, *FRAUD: AN AMERICAN HISTORY FROM BARNUM TO MADOFF* 245 (2017). The reasonable reliance requirement crystallized in the last few decades during a period of what Ballesin describes as growing skepticism of the "Antifraud State." See *id.* at 334–42. Perhaps these developments are connected.

13. See, e.g., *Hord v. Envtl. Research Inst. of Mich.*, 617 N.W.2d 543 (Mich. 2000) (per curiam). In that case, an employer gave a prospective employee a dated financial statement in a large packet of information about the company, but did not include recent negative financial information about the company. See *id.* at 545–46. No one called the statement to the employee's attention, and the employee never inquired about the statement. See *id.* There is a good chance that the employer did not intend the employee to rely on the statement. Under the old rule a court could grant the employer's motion for summary judgment because the employee could not establish culpable intent by clear and convincing evidence. See *infra* Section III.B.

information that is likely to mislead a reasonable person.¹⁴ The other changes in the law of deceit favoring fraudsters flowed from the abolition of the intended reliance rule. The shift from the intended reliance rule to the reasonable reliance rule made it possible to dismiss a deceit claim involving unreasonable reliance on the pleadings because it substituted an objective inquiry into the reasonableness of the plaintiff's reliance for a subjective inquiry into the defendant's intent. The elimination of the intended reliance rule also created a need for tighter rules on causation and scope of liability.

Parts I through IV document these changes in the law and explain how they came about. Because the changes in the law were unnoticed, no one has addressed the normative question: what functions are served by the intended reliance rule and by the reasonable reliance rule that justifies making either rule an element of a claim for deceit? Another way to put the question is: what functions are served by the rules of justifiable reliance? The rules of justifiable reliance flow from either the old intended reliance rule or the new reasonable reliance rule. Part V addresses this normative question. It argues that the rules of justifiable reliance serve the functions of reducing information costs and claim-processing costs in cases in which claim-processing costs are high and in which the social cost of undeterred fraud is low.

Part VI argues that the intended reliance rule is superior to the reasonable reliance rule because it serves these functions as well as the reasonable reliance rule while allowing fewer frauds to escape punishment. Most U.S. courts define reasonable reliance as objectively reasonable reliance, which makes it possible for a court to dismiss a claim involving objectively unreasonable reliance on the pleadings, if

14. Under the old *scienter* rule, liability turned on a subjective inquiry into the defendant's purposes for making the misrepresentation, the plaintiff's disposition and beliefs regarding the misrepresentation, and the defendant's knowledge of the plaintiff's disposition and beliefs regarding the misrepresentation. The reason-to-expect reliance rule and the reasonable reliance rule substitute objective inquiries for the old subjective inquiries on each of these points. There is only one general element of deceit that still involves a subjective inquiry: the inquiry into the defendant's state of mind regarding the falsity of the representation. Ultimately, the old rule's inquiries were "intersubjective"—the relevant mental states involved the defendant's consciousness of the plaintiff's consciousness. Under the new rules, the plaintiff is treated as an object of the misrepresentation; under the old rules, the plaintiff was treated as the subject of the misrepresentation.

Because of these changes in the law, Gregory Klass is correct when he describes the modern tort of deceit as being "interpretive" rather than "purpose-based." See Gregory Klass, *Meaning, Purpose, and Cause in the Law of Deception*, 100 GEO. L.J. 449, 455, 460–61 (2012) ("I call laws that target misrepresentation, as distinguished from other forms of deception, 'interpretive' because they require decision makers charged with applying the rule to interpret the meaning of what was said."). Unlike purpose-based laws, "[i]nterpretive laws define the object of regulation without reference to the actor's state of mind." *Id.* at 463. Klass remarks on the curious dearth of interpretive rules in the law of deceit, contrasted with contract law, which has numerous interpretative rules. See *id.* at 455–56. The dearth of interpretive rules in the law of deceit is because such rules were unnecessary for much of the history of the tort because the tort used to be "purpose-based," using Klass's terminology. Klass recognizes that some rules in the law of deceit still reflect its old purpose based character. His example is an exception to the general rule that sales talk or puffery is not actionable, see *id.* at 459, for cases in which "the plaintiff can show that the defendant intended her words to deceive." *Id.* at 465.

a judge concludes a claim is not worth litigating.¹⁵ U.S. courts have chosen to let possible frauds go unexamined to reduce claim-processing costs, choosing efficiency over deterrence and fairness in cases in which the plaintiff's reliance on a fraud appears to be unreasonable. In sum, the intended reliance rule is superior to a rule requiring objectively reasonable reliance because the intended reliance rule provides greater deterrence and lets fewer frauds escape punishment at comparable information costs and not much greater claim-processing costs.

Thus, I conclude that U.S. courts should restore the intended reliance rule and eliminate the reasonable reliance rule in the law of deceit.¹⁶ The rules of justifiable reliance may be kept as they are, but they should return to being presumptions that a plaintiff can overcome by presenting clear and convincing evidence that a defendant had culpable intent. Restoring the intended reliance rule would eliminate the need for tighter rules on causation and scope of liability, and it would make it harder to dismiss claims involving unreasonable reliance on the pleadings. Most deceit claims involving unreasonable reliance would still be likely to fail, but a plaintiff who pleads fraud with sufficient specificity would be given an opportunity for discovery and a chance to establish by clear and convincing evidence that the defendant had culpable intent.

I. TWO CHANGES IN THE LAW OF DECEIT

This Part documents two significant changes that occurred in the law of deceit in the latter half of the twentieth century, highlighting the more significant of the two changes: the emergence of a rule that the plaintiff's unreason-

15. The Third Restatement draft proposes defining reasonable reliance as reckless reliance or as subjectively reasonable reliance, taking the plaintiff on his own terms, to avoid the harsh implications of having a defense of contributory negligence in the law of deceit. *See* RESTATEMENT (THIRD) OF TORTS: LIAB. FOR ECON. HARM § 11 cmt. d (AM. LAW INST., Tentative Draft No. 2, 2014). A test of subjectively reasonable reliance or reckless reliance would provide deterrence comparable to the intended reliance requirement, but it would be achieved at the expense of a considerable increase in claim-processing costs and some increase in information costs. *See infra* Part VI.

16. My argument is limited to the law of deceit or common law fraud. The law of negligent misrepresentation has a requirement similar to intended reliance. *See infra* note 31. However, intent often is determined by formal or objective rules. I criticize the tendency of courts to transplant rules on scienter, factual causation, proximate causation, and damages from the law of securities fraud to the law of deceit. *See* Section IV.D. But I do not criticize the application of these rules in the domain of the law of securities fraud.

The FTC has gone beyond the two common law options (a requirement of intended reliance or a requirement of reasonable reliance) and in a regulatory action focuses on whether a significant portion of the audience of an advertisement is deceived or would be deceived. I thank Gregory Klass for calling this to my attention. Klass describes the FTC's approach as "causal-predictive" and provides other examples of laws that take this approach in the law of deception. *See* Klass, *supra* note 14, at 466–67. Klass goes on to observe that even under these laws evidence of deceptive intent can establish liability without proof of a deceptive effect. *See id.* at 485–86 (citing *U-Haul Int'l, Inc. v. Jartran, Inc.*, 601 F. Supp. 1140, 1147 (D. Ariz. 1984), *aff'd in part, modified in part, rev'd in part*, 793 F.2d 1034 (9th Cir. 1986)).

able reliance precludes a claim in deceit. I begin with a case that illustrates that the law used to be that it was no defense to a claim for deceit that a plaintiff was unreasonable or even reckless in relying upon a misrepresentation.

A. THE SPIRITUALIST AND THE PROFESSOR

History professor Albert Hyma believed Reverend Lillian Lee could speak with the dead.¹⁷ He was a frequent participant in her séances and a member of her Detroit church. In 1936 he invited her to conduct a séance before his Renaissance history class at the University of Michigan, Ann Arbor. We can only speculate what Professor Hyma and Reverend Lee thought as Reverend Lee channeled Thomas Carlyle, Francis of Assisi, Thomas Aquinas, and other dead souls before the class. Perhaps the students were amused. It was reported that they were respectful. Her appearance in the class attracted a fair amount of humorous attention in the press. The Dean was not amused. He reprimanded the professor and instructed him not to invite Reverend Lee back to save the University of Michigan from further public embarrassment.

The Dean's rebuke and whatever professional embarrassment he suffered did not shake Professor Hyma's faith in Reverend Lee. He continued to seek to commune with the dead through her. Their association ended badly with litigation more than a decade later because Professor Hyma occasionally sought financial advice from the spirits through Reverend Lee.¹⁸ In 1937, a year after her appearance in his class, the spiritualist advised the professor to hang on to the stock in a failing paint company, telling him she had spoken to God, who told her the company was going to come into great wealth. Professor Hyma held on to the stock. In 1947 she advised the professor to drill for oil on land he owned, telling him the spirits reported there was a pool of oil under his land. The professor invested in an exploratory well on his land. Later in 1947 the professor sought the spiritualist's advice regarding a letter he had received from a stranger. The stranger claimed he was wrongfully imprisoned in Mexico and asked for \$8,500 cash to help secure his freedom. The letter promised great financial reward if the professor would send the cash to a post office box in Texas. The professor thought the offer suspicious so he brought the letter to Reverend Lee for the spirits' advice. The spiritualist told him the spirits vouched for the letter. The professor took out a mortgage on his house to get money to mail to Texas.

The paint company failed. No oil was found. The letter was a hoax. Perhaps the letter was the final straw. In 1953 Professor Hyma filed a lawsuit against Reverend Lee and her church seeking \$15,400 in damages for his cumulative

17. Most of these facts are from James Tobin, *The Professor and the Spirits*, MICH. TODAY (June 18, 2013), <http://michigantoday.umich.edu/a8644/> [<https://perma.cc/ZN55-US2G>]. Where facts are derived from another source, a footnote will be provided.

18. See *Hyma v. Lee*, 60 N.W.2d 920, 921–22 (Mich. 1953).

losses on the three transactions.¹⁹ He claimed in the litigation that she was a charlatan who used stagecraft to trick him into believing she could speak with spirits.²⁰ The trial court dismissed the claim on a preliminary motion, saying the professor was an intelligent man who had sought advice from the spirits through the spiritualist “with his eyes open.”

The Michigan Supreme Court reversed and reinstated the claim against Reverend Lee.²¹ The Court did not respond directly to the trial court’s reason for dismissing the claim, which was that the professor knew of the risk that Reverend Lee was a charlatan, although it may have responded indirectly when it emphasized that the “pleading avers a relation of trust and confidence.”²² Instead, the brief opinion responds to the spiritualist’s argument that she could not be liable for deceit because she neither sought nor derived any benefit from misleading the professor. All she asked was that the professor donate a portion of the wealth she foretold would be his to her church.²³ The opinion explains that although fraudsters usually seek to gain financially by their trickery, this is not necessary for liability.²⁴

Hyma v. Lee illustrates that it used to be the law that a plaintiff’s unreasonableness or even recklessness in relying upon a misrepresentation was not a defense against a claim of deceit.²⁵ The Michigan Supreme Court also invoked an old rule requiring that a defendant have “made [the representation] with the intention that it should be acted upon by [the] plaintiff.”²⁶ The court explained that so long as this requirement is satisfied it is unnecessary that the spiritualist sought or derived any tangible benefit from the misrepresentation.²⁷ I will call this the intended reliance rule. The rule requires that the defendant supplied the misinformation with a purpose of influencing the plaintiff to do the act that resulted in the loss for which the plaintiff seeks redress.

19. *Id.*

20. Professor Hyma testified at trial that the spirits of the departed talked to him through an aluminum trumpet held by Reverend Lee. *See His \$14,000 Was Sprited Away, He Says*, TOLEDO BLADE, Jan. 18, 1955, at 5.

21. *Hyma*, 60 N.W.2d at 924. On remand, the trial judge awarded Professor Hyma \$4,000 in damages. *See Bob Jones, Hyma Finds New Hope in Lawsuit*, MICH. DAILY, Feb. 27, 1955, at 1. A press report noted that the trial judge denied the other \$9,000 damages claimed on the ground that the professor had been “overly gullible” and that he “virtually ask[ed] the court to believe he made no effort to use his God-given ability to think for himself.” *Id.*

22. *Hyma*, 60 N.W.2d at 924.

23. *See id.* at 922.

24. *See id.* at 923.

25. *See supra* note 4. For an explanation of the rule in the Second Restatement to this effect, see *infra* note 36 and accompanying text. American popular culture tends to be unsympathetic to the unwitting victim of deceit. *See, e.g.*, BALLEISEN, *supra* note 12, at 44–45.

26. *Hyma*, 60 N.W.2d at 923 (quoting *Candler v. Heigho*, 175 N.W. 141, 143 (Mich. 1919), *overruled in part by* *U.S. Fid. & Guar. Co. v. Black*, 313 N.W.2d 77 (Mich. 1981)).

27. *See id.*

B. THE CHANGES

Today the claim in *Hyma v. Lee* would almost certainly be dismissed on the ground that the professor's reliance was unjustifiable as a matter of law. The draft of the Third Restatement of Torts explains: "Justifiable reliance amounts to freedom from recklessness: plaintiffs who close their eyes to a known or obvious danger that a statement is fraudulent cannot recover losses they suffer from reliance on it."²⁸ The draft proceeds to qualify this rule in what seems like a nod to the rule applied in *Hyma v. Lee*. It explains: "Justifiable reliance has a personalized character. It is measured by reference to the plaintiff's capabilities and knowledge; a plaintiff's sophistication may affect a court's judgments about what dangers were fairly considered obvious."²⁹ But this qualification would not absolve the professor, an intelligent man who dealt with the spiritualist "with his eyes open."³⁰ This qualification omits the guts of the rule in *Hyma v. Lee*, which excuses even a plaintiff's conscious disregard of a risk that a representation is untrue when the defendant knew of and purposefully exploited the plaintiff's unreasonable disposition and beliefs. The law has come around to the view of the trial judge in the case.

Most courts equate justifiable reliance with reasonable reliance without specifying whether this means subjectively reasonable reliance or objectively reasonable reliance.³¹ Some courts define justifiable reliance to be nonreckless

28. RESTATEMENT (THIRD) OF TORTS: LIAB. FOR ECON. HARM § 11 cmt. d (AM. LAW INST., Tentative Draft No. 2, 2014).

29. *Id.*

30. Professor Hyma even wrote a scholarly book on the subject of spiritualism years before the lawsuit. ALBERT HYMA, *ETERNAL LIFE: A HISTORICAL ANALYSIS OF THE RELATION BETWEEN CHRISTIANITY AND SPIRITUALISM* (1939).

31. *See, e.g.,* McAnally v. Gildersleeve, 16 F.3d 1493, 1497 (8th Cir. 1994) ("Justifiable reliance requires that the plaintiff actually relied on the misrepresentations, and that this reliance was reasonable."); Ralston Dry-Wall Co., v. U.S. Gypsum Co., 926 F.2d 99, 101–02 (1st Cir. 1991) (equating negligent reliance with nonjustifiable reliance); Foremost Ins. Co. v. Parham, 693 So. 2d 409, 421 (Ala. 1997) (rejecting justifiable reliance standard, "which eliminated the general duty on the part of a person to read . . . documents," and adopting reasonable reliance standard, explaining it would enable a trial court to dismiss a claim "where the undisputed evidence indicates that the . . . parties claiming fraud . . . were fully capable of reading and understanding their documents, but nonetheless made a deliberate decision to ignore written contract terms"); Raysoni v. Payless Auto Deals, LLC, 766 S.E.2d 24, 25 (Ga. 2014) ("To make out a claim at common law for fraud, a plaintiff must show not only that he relied upon some misrepresentation, but he must show as well that his reliance was reasonable."); Flegles, Inc. v. TruServ Corp., 289 S.W.3d 544, 549 (Ky. 2009) ("The plaintiff's reliance, of course, must be reasonable, . . . the law imposes upon recipients of business representations a duty to exercise common sense."); Forbis v. Neal, 649 S.E.2d 382, 387 (N.C. 2007) (for fraud "any reliance on the allegedly false representations must be reasonable"); Porreco v. Porreco, 811 A.2d 566, 571–72 (Pa. 2002) (holding 17-year-old plaintiff's reliance on 45-year-old defendant's representation that an engagement ring was a diamond worth \$21,000 when it was fake cubic zirconium was unreasonable as a matter of law because she could have had the ring appraised); Davis v. McGuigan, 325 S.W.3d 149, 158–60 (Tenn. 2010). *In re Kirsh*, 973 F.2d 1454, 1457–60 (9th Cir. 1992), identifies a circuit split on whether reliance under the fraud provision of the Bankruptcy Code, 11 U.S.C. § 523(a)(2) (2012), means "'actual reliance' or 'reasonable reliance' or 'justifiable reliance,'" ultimately settling on the latter phrase, explaining that this precluded liability "if a person's claimed reliance was manifestly unreasonable, preposterous, or the result of an intentional closing of his own eyes to the facts."

reliance.³² The Third Restatement draft refers both to nonreckless reliance and to subjectively reasonable reliance.³³ When I refer to the reasonable reliance rule, I mean a requirement of objectively reasonable reliance. I explain later why the softer forms of the rule are bad compromises, but suffice it to say for now that the results in most cases are explained by a strong form of the rule. That rule allows a court to dismiss a claim on the pleadings if the court finds the plaintiff's reliance to be objectively unreasonable, taking the issue from the jury even if reasonable people might disagree on the finding.³⁴

Some states continue to follow the old rule and hold that a plaintiff may recover in a deceit action though his reliance on a misrepresentation is unreasonable. *See, e.g., Moses.com Sec., Inc. v. Comprehensive Software Sys., Inc.*, 406 F.3d 1052, 1064 (8th Cir. 2005) (holding that under Missouri law, deceit requires establishing a "specific intent" on the part of the defendant to target the plaintiff). Florida also has retained the intended reliance requirement. *See Butler v. Yusem*, 44 So. 3d 102, 105 (Fla. 2010) ("[T]he policy behind our [rule on unreasonable reliance] is to prohibit one who purposely uses false information to induce another into a transaction from profiting from such wrongdoing." (quoting *Gilchrist Timber Co. v. ITT Rayonier, Inc.*, 696 So. 2d 334, 336–37 (Fla. 1997))).

Courts have imported the element of justifiable reliance from the law of deceit into the 10b–5 action for securities fraud, equating justifiable reliance with reasonable reliance. *See, e.g., Ledford v. Peeples*, 657 F.3d 1222, 1248 n.80 (11th Cir. 2011) ("In an action for damages under Rule 10b–5(b) . . . the plaintiff must show that he reasonably relied on and was injured by the misstatement. In the Rule 10b–5(b) context, we have used the words 'justifiably relied' as the equivalent of 'reasonably relied.'" (internal quotations omitted)); *Harsco Corp. v. Segui*, 91 F.3d 337, 342 (2d Cir. 1996) ("The general rule is that reasonable reliance must be proved as an element of a securities fraud claim."); *Harrison v. Dean Witter Reynolds, Inc.*, 79 F.3d 609, 618 (7th Cir. 1996) ("The fact of reliance . . . is not enough by itself; that reliance must be justifiable, or reasonable."). Thus, reliance by sophisticated investors on an oral misrepresentation by a broker has been held not to be justified as a matter of law where the investors could have determined the representation was false using reasonable diligence and reading available offering materials. *See Kennedy v. Josephthal & Co.*, 814 F.2d 798, 804–05 (1st Cir. 1987); *see also Zobrist v. Coal-X, Inc.*, 708 F.2d 1511, 1517–18 (10th Cir. 1983) (charging sophisticated investor with constructive knowledge of disclosures in offering memorandum). Some cases go so far as to hold that reliance on misrepresentations is not reasonable where the plaintiffs fail to insist that the subject matter of the representations be covered by express warranties in the stock purchase agreement. *See, e.g., Emergent Capital Inv. Mgmt., LLC v. Stonepath Grp., Inc.*, 343 F.3d 189, 195–96 (2d Cir. 2003). Some cases apply a recklessness standard, though they often equate nonrecklessness with reasonableness. *See, e.g., Brown v. Earthboard Sports USA, Inc.*, 481 F.3d 901, 921 (6th Cir. 2007).

The requirement of justifiable reliance also has been imported from the law of deceit into the law of negligent misrepresentation, where courts equate justifiable reliance with reasonable reliance. *See, e.g., Quinn v. McGraw–Hill Cos.*, 168 F.3d 331, 335–36 (7th Cir. 1999); *Redmond v. State Farm Ins. Co.*, 728 A.2d 1202, 1207 (D.C. 1999); *Marram v. Kobrick Offshore Fund, Ltd.*, 809 N.E.2d 1017, 1031 (Mass. 2004) ("[J]ustifiable reliance is integral to a claim for negligent misrepresentation.").

32. *AMPAT/Midwest, Inc. v. Ill. Tool Works Inc.*, 896 F.2d 1035, 1041–42 (7th Cir. 1990) ("[T]he victim of a deliberate fraud is barred only if he has notice of the fraud, and so he need only avoid *deliberate* or *reckless* risk-taking").

33. *See* RESTATEMENT (THIRD) OF TORTS: LIAB. FOR ECON. HARM § 9 cmt. f (AM. LAW INST., Preliminary Draft No. 2, 2013) ("Justifiable reliance amounts to freedom from recklessness: plaintiffs who close their eyes to a known or obvious danger that a statement is fraudulent cannot recover losses they suffer from reliance on it. The rules also differ because reasonable reliance [under negligence law] . . . is measured against community standards of behavior. Justifiable reliance has a subjective character. It is measured by reference to the plaintiff's capabilities and knowledge. A plaintiff's sophistication may affect a court's judgments about what dangers were fairly considered obvious.").

34. *See infra* Section VI.B.

The Third Restatement draft also rejects the intended reliance rule.³⁵ This completes a transition that began with the Second Restatement.³⁶ I will say more about this development in section II.C, but the point I want to make here is that the two changes are connected. The rule that it is no defense to a claim of deceit that the plaintiff was unreasonable or even reckless in relying upon a misrepresentation is connected to the rule that liability for deceit requires that the defendant have made the misrepresentation intending to influence the plaintiff to do the action that resulted in the loss to the plaintiff. The intended reliance rule requires a connection between the defendant and the plaintiff that makes even reckless reliance by the plaintiff irrelevant to the defendant's moral culpability. This connection is clearest when the parties are in an intimate or confidential relationship, as were the professor and the spiritualist. The spiritual-

35. See RESTATEMENT (THIRD) OF TORTS: LIAB. FOR ECON. HARM § 10 cmt. a (“To prevail on a claim of fraud, a plaintiff must prove that the defendant made a misrepresentation knowingly; in other words the plaintiff must prove scienter. . . . The motive for making the statement is not relevant. . . .”). For a recent case on point, see *Exxon Corp. v. Emerald Oil & Gas Co.*, 348 S.W.3d 194, 199–201 (Tex. 2011), which involved a claim by subsequent oil and gas lessees that Exxon improperly plugged wells and then committed fraud by filing false plugging reports upon which the plaintiffs relied in acquiring the leases. A deceit claim in Texas includes the element “the defendant made the representation with the intent that the other party would act on that representation or intended to induce the party’s reliance on the representation.” *Id.* at 217. The trial court granted a directed verdict for Exxon on the deceit claim, finding there was no evidence to satisfy the intent-to-induce element. See *id.* at 201. The Texas Supreme Court reversed, holding the intent-to-induce element can be satisfied by a showing that “[t]he maker of the misrepresentation [has] information that would lead a reasonable man to conclude that there is an especial likelihood that it will reach those persons and will influence their conduct.” *Id.* at 218–21 (alterations in original) (quoting RESTATEMENT (SECOND) OF TORTS § 531 cmt. d (AM. LAW INST. 1977)). Intended reliance remains an element of the prima facie claim in many states. See, e.g., *Lazar v. Superior Court*, 909 P.2d 981, 984 (Cal. 1996) (including in elements “intent to defraud, i.e., to induce reliance”).

36. The general definition of fraud in the Third Restatement might be read to make purpose an element of scienter. See RESTATEMENT (THIRD) OF TORTS: LIAB. FOR ECON. HARM § 9 (“One who fraudulently makes a material misrepresentation of fact, opinion, or law, for the purpose of inducing another to act or refrain from acting, is subject to liability for economic loss caused by the other’s justifiable reliance on the misrepresentation.”).

The reference to purpose in the Third Restatement tracks the general rule in the Second Restatement. See RESTATEMENT (SECOND) OF TORTS § 525 (AM. LAW INST. 1977) (defining fraud as making a misrepresentation “for the purpose of inducing another to act . . . in reliance upon it”). The Reporter Ward Farnsworth proposed to drop this language from the general definition of fraud in the draft of the materials on fraud he prepared for the Advisory Committee. See RESTATEMENT (THIRD) OF TORTS: LIAB. FOR ECON. HARM § 9 (AM. LAW INST., Preliminary Draft No. 2, 2013). He proposed to substitute a general definition of fraud that covered any knowing misrepresentation, which is the rule in the law of securities fraud. See *id.* (“An actor who knowingly makes a misrepresentation of material fact is subject to liability for economic loss caused by another’s justifiable reliance on it.”).

The confusion dates back to the Second Restatement. Notwithstanding the language of purpose in section 525, section 531 provides: “One who makes a fraudulent misrepresentation is subject to liability to [persons] whom he intends or has reason to expect to act . . . in reliance upon the misrepresentation.” RESTATEMENT (SECOND) OF TORTS § 531. No attempt is made to explain the obvious contradiction between this rule and the rule in section 525, which requires that the defendant have made the misrepresentation for the purpose of inducing another to act upon it. The liability rule in section 531 is disjunctive: liability can be established either by showing that the defendant intended the plaintiff’s reliance or that the defendant had reason to expect the plaintiff’s reliance.

ist knew the professor believed she could speak with the spirits of the dead. If she really was a charlatan, then the fact the professor's belief was unreasonable or even reckless does not excuse her conduct morally. It makes her conduct worse.

It may seem simple to rewrite the Restatement to preserve the result in *Hyma v. Lee*. One might rewrite the comment in the materials on justifiable reliance to explain that the "personalized character" of the culpability determination involves an inquiry into the defendant's knowledge of the plaintiff's belief and disposition regarding the misrepresentation. Under this rule, the plaintiff's reliance on a misrepresentation is justified if the defendant knew the plaintiff believed the misrepresentation to be true and was disposed to act upon it, no matter how unreasonable the plaintiff's beliefs and disposition may be. That the parties were in a confidential relationship, a point emphasized by the Michigan Supreme Court in *Hyma v. Lee*,³⁷ bears on this issue for the same reason that it bears on the issue of intended reliance. When a defendant is in a close relationship with the plaintiff, the defendant is likely to be aware of the plaintiff's unreasonable beliefs and disposition.

The Second Restatement takes this tack. *Hyma v. Lee* appears in illustration 2 in section 545A, though the authors changed the gender and occupation of the plaintiff, perhaps to make the plaintiff seem more sympathetic or believable.³⁸ In the example, a spiritualist induces a widow to purchase worthless mining stock by evoking the spirit of the widow's dead husband, who advises the widow to buy the stock.³⁹ The Restatement explains that the requirement of justifiable reliance does not preclude liability "when the defendant knows of the plaintiff's . . . credulity, gullibility or other [incapacity] . . . and deliberately practices upon the deficiencies of the plaintiff in order to deceive him."⁴⁰

I argued for adding a statement along these lines to the comments in the Advisor's meeting on the Third Restatement. Farnsworth did not take my advice. He was right. The simple fix I proposed obfuscates a deep problem in the law of deceit that stems from the relationship between the intended reliance rule and the requirement of justifiable reliance and its attendant rules. Fixing the problem requires a more drastic change: if liability in deceit is not going to require reasonable reliance, then the intended reliance rule must be reinstated unless we are willing to jettison the requirement of justifiable reliance and its attendant rules, which would significantly expand the ambit of liability in deceit.

37. 60 N.W.2d 920, 924 (Mich. 1953).

38. See RESTATEMENT (SECOND) OF TORTS § 545A illus. 2. The authors of the Second Restatement were all well-educated professional men. Perhaps they had difficulty believing that someone like them could fall for such a con.

39. See *id.*

40. *Id.* § 545A cmt. b. *Hyma v. Lee* is likely the basis for illustration 1 in section 538, in which an astrologist induces a believer to purchase stock of a corporation by predicting remarkable success for the corporation based on horoscopes of the officers. See *id.* § 538 illus. 1. The illustration is for the proposition that "[o]ne who practices upon another's known idiosyncrasies cannot complain if he is held liable when he is successful in what he is endeavoring to accomplish." *Id.* § 538 cmt. f.

II. HOW THE CHANGES HAPPENED

This Part explains the intended reliance rule, why the U.S. rejected the rule, and how the rejection of the rule led people to equate justifiable reliance with reasonable reliance. To make these points I use a hypothetical deceit claim based on a recent incident involving mass religious delusion. I chose the hypothetical because no sensible court would entertain a deceit claim involving the incident. The only issue raised by the hypothetical claim is the legal basis for rejecting the claim. The intended reliance rule and the reasonable reliance rule are the two alternatives.

A. CAMPING'S PROPHECY

Harold Camping prophesized that on May 21, 2011, the saved would be taken up to heaven in the rapture and end times would begin, culminating in the destruction of the world on October 21, 2011.⁴¹ His prophecy was widely broadcast on Family Radio, Camping's broadcast network, and through other media, including a billboard a few blocks from my home in North Berkeley. This was not Camping's first prophecy of the end of the world, and his prophecy was widely ridiculed. Nevertheless, some people believed Camping's prophecy and acted on that belief. According to news reports, one believer spent over a half-million dollars advertising the message. Some believers quit their jobs and moved. Some people continued to believe in Camping after the prophecy was proven wrong by events, but other believers came to see him as a fraud. Apparently no one filed a deceit claim against Camping to try to recover the financial losses they incurred in reliance on the prophecy. Had such a lawsuit been brought, I am sure a court would have dismissed it out of hand. A court of law is not a suitable forum for resolving questions of truth and fault in a case of mass religious delusion.⁴²

On what legal basis could the hypothetical deceit claim be dismissed? What distinguishes Camping's case from the case of the spiritualist and the professor? The distinction cannot be that Camping honestly believed his prophecy whereas

41. The following facts are taken from reporting on the mass delusion. See, e.g., Tom Bartlett, *A Year After the Non-Apocalypse: Where Are They Now?*, RELIGION DISPATCHES (May 21, 2012), <http://religiondispatches.org/a-year-after-the-non-apocalypse-where-are-they-now/> [<https://perma.cc/R5WJ-JE GQ>]; Ashley Parker, *Make My Bed? But You Say the World's Ending*, N.Y. TIMES (May 19, 2011), <http://www.nytimes.com/2011/05/20/us/20rapture.html> [<https://nyti.ms/2ySeOXi>].

42. *United States v. Ballard*, 322 U.S. 78, 85–88 (1944), held that the truth or veracity of the defendant's religious doctrines or beliefs could not be submitted to the jury as a basis for establishing criminal mail fraud but held open the possibility that the charge could be submitted to the jury on the theory that the defendant did not honestly and in good faith believe these things. On remand the Court of Appeals sustained the conviction, finding "ample evidence that respondents were without belief in the statements which they had made to their victims." *Ballard v. United States*, 152 F.2d 941, 943 (9th Cir. 1945). The case went back to the Supreme Court, which reversed, finding a fatal error in "the purposeful and systematic exclusion of women from the panel." *Ballard v. United States*, 329 U.S. 187, 193 (1946). The defendants, a mother and her son, had solicited funds and members in the "I Am" movement claiming they had supernatural healing powers. See *Ballard*, 322 U.S. at 79–80.

the spiritualist was a charlatan. These are open questions. Camping may have been a charlatan. The spiritualist claimed she could speak with the spirits; perhaps she really believed she did. Ultimately, such questions are for a jury to resolve under U.S. law.⁴³

B. THE INTENDED RELIANCE RULE

If the hypothetical claim were brought in England, the intended reliance rule would preclude a deceit claim against Camping even if he were a charlatan, and it would also provide a legal basis for distinguishing Camping's case from the case of the spiritualist and the professor. For liability in deceit under English law, "[i]t must be shown that the representor intended the representee to act on the representation in the manner which resulted in damage to him. . . . [I]t must have been the representor's intention that his statement would cause an act of reliance of the kind which the representee has established."⁴⁴ This is the intended reliance rule.

To be clear, reliance can be intended without there being direct communication between the plaintiff and the defendant. The intended reliance rule is not a privity rule. Indeed, the defendant can intend the plaintiff's reliance without knowing the plaintiff's identity. The law of deceit covers fraudsters who cast their nets widely, trolling for the gullible. An English treatise puts it this way: "The representor need not know the representee individually: it is sufficient if he intended that a person in the position of the representee should act on the representation."⁴⁵ An e-mail scammer who casts a wide net to catch a few gullible victims is liable for deceit under English law.

This possibility may seem to open the door to a deceit claim in an English court against Camping by a disillusioned believer who quit his job in reliance on the prophecy. But a court would dismiss the claim, finding reliance was unintended, because of the absence of any evidence that one of Camping's purposes in making the prophecy was to induce people to quit their jobs or to spend their life savings in preparation for judgment day. Camping told people there was nothing they could do or should do to prepare. There is no evidence

43. A jury could render a verdict against Camping without finding that he was a charlatan—that is, Camping could be found liable even if the jury found he believed his own prophecy. To find Camping liable, the jury would only need to find that he was conscious of a sufficient risk that the rapture might occur at a later date—that it was reckless for him to tell believers it was certain to occur on May 21, 2011. Camping is reported to have said in a private conversation a few days before October 21 "that nobody could know exactly when the time of the apocalypse would come." See Luiza Oleszczuk, *Harold Camping Exclusive: Family Radio Founder Retires*, CHRISTIAN POST (Oct. 24, 2011, 8:02 PM), <https://www.christianpost.com/news/harold-camping-exclusive-family-radio-founder-retires-doomsday-prophet-no-longer-able-to-work-59222> [<https://perma.cc/2XND-HMKY>]. If a jury found Camping was conscious of this possibility when he made the prediction, then the jury might well find that he acted recklessly.

44. JOHN CARTWRIGHT, MISREPRESENTATION 112 (2002) (citing *Bradford Third Equitable Benefit Bldg. Soc'y v. Borders* [1941] 2 All ER 205 (HL) at 211 (Eng.)).

45. *Id.*

that he was being disingenuous about his motives.⁴⁶ The intended reliance rule requires that the defendant have made the misrepresentation with a purpose of inducing the plaintiff to do the action that resulted in the harm for which the plaintiff seeks redress.

Professor Peter MacDonald Eggers has explained the function of the intended reliance rule in English law as follows: “[A]n intention that the representation be relied upon, is an essential feature of the tort of deceit. . . . Without it, all writers of fiction, speakers of sarcasm and stage magicians would be exposed to claims for deceit.”⁴⁷ The intended reliance rule precludes liability in these cases. Indeed, a less stringent scienter rule would suffice for this purpose. “[W]riters of fiction, speakers of sarcasm and stage magicians”⁴⁸ are not lying because they do not intend the addressee to believe the untruthful statement to be true. For reliance to be intended, a lie must be told with a purpose of inducing the addressee to act. Camping’s case illustrates the difference. Camping intended people to accept his prophecy as the truth. If he did not believe his prophecy, then he would be a liar. Yet he still would not be liable in deceit for his follower’s financial losses under the intended reliance rule if he did not make the prophecy with a purpose of inducing people to quit their jobs or spend their life savings in preparation for judgment day.

C. THE UNITED STATES REJECTS THE RULE

A U.S. court must look elsewhere in the law of deceit for a basis to dismiss the hypothetical deceit claim in Camping’s case because U.S. law does not require that Camping have acted with a purpose of inducing people to quit their jobs or to spend their life savings to hold him liable for deceit. The intended reliance rule was modified in the Second Restatement of Torts to provide that a person “who makes a fraudulent misrepresentation is subject to liability to [a person] whom he intends or has reason to expect to act . . . in reliance upon the misrepresentation.”⁴⁹ The rule in section 531 is disjunctive. Liability can be established either by showing that the defendant intended the plaintiff’s reliance or that the defendant had reason to expect the plaintiff’s reliance. Camping had reason to expect his followers might act as they did in response to his prophecy even though he did not make the prophecy with a purpose of inducing their action.

There is much to be said for the reason-to-expect reliance rule. The rule makes it possible for a predictable collateral victim of a fraud to recover. *Handy v. Beck*

46. See Dan Amira, *A Conversation with Harold Camping, Prophet of Judgment Day*, NEW YORK (May 11, 2011, 4:59 PM), http://nymag.com/daily/intelligencer/2011/05/a_conversation_with_harold_cam.html [https://perma.cc/T3NN-9Z2W]. To the question of what he was going to do with his money, Camping replied: “What’s the point? In other words, Judgment Day is the end of the world. . . . Nothing that goes on is important any longer. . . .” *Id.*

47. EGGERS, *supra* note 3, at 130.

48. *Id.*

49. RESTATEMENT (SECOND) OF TORTS § 531 (AM. LAW INST. 1977).

illustrates this point.⁵⁰ There, the defendant drilled a well on land of the plaintiff's predecessor in interest.⁵¹ State law required that the driller case the well to a depth of eighteen feet and that the driller file a copy of the drilling log with the state engineer to certify compliance. The defendant's sons cased the well to a depth of only eight and one-half feet and then falsified the drilling log. The plaintiffs were subsequent purchasers of the land who discovered these facts when problems developed with the well as a result of the shallow casing. The plaintiffs claimed that they relied upon the certification that the well had been properly drilled. The intended reliance rule precludes liability in deceit in the case for the defendant's sons, who falsified the drilling log to cover their shirking. They were indifferent to the possibility that a subsequent purchaser of land might rely on the facts attested to in the log. The Oregon Supreme Court allowed the claim, applying the reason-to-expect reliance rule.⁵²

The intended reliance rule had few supporters in the United States when the First Restatement of Torts was being drafted. Its chief supporter in the United States at the time was Francis Bohlen, who was the Reporter for the fraud materials in the First Restatement.⁵³ His opponents included such respected scholars and judges as W. Page Keeton, Warren Seavey, and Benjamin Cardozo. Keeton referenced one case as an example of the injustice resulting from the intended reliance rule. That case held an officer of a company who intentionally misled brokers and existing shareholders regarding the company's prospects not to be liable to members of the public who relied upon the misinformation in purchasing the shares in the secondary market.⁵⁴ Keeton called the result in the case and the intended reliance rule a "deformity in the law of deceit."⁵⁵ Warren Seavey thought the rule was the least defensible form of a privity rule. He wrote: "It is here that 'the assault upon the citadel of privity' should be most vigorous. The cheat has no barrier of sympathy behind which he can take refuge when once a breach in the citadel is made."⁵⁶ For his part, Cardozo authored the leading decision rejecting the intended reliance rule.⁵⁷

50. 581 P.2d 68 (Or. 1978).

51. *See id.* at 69.

52. *See id.* at 74.

53. *See* Francis H. Bohlen, *Should Negligent Misrepresentations Be Treated As Negligence or Fraud?*, 18 VA. L. REV. 703, 719 (1932) (criticizing an attempt by Leon Green to dilute the requirement of intended reliance in the law of deceit).

54. W. Page Keeton, *The Ambit of a Fraudulent Representor's Responsibility*, 17 TEX. L. REV. 1, 5–6 (1938) (discussing *Peek v. Gurney* [1873] 6 HL 377 at 411–13 (Eng.)). Francis Bohlen did not reply to Keeton, perhaps because he was stricken by illness in 1937.

55. *Id.* at 26. Keeton proposed a rule that would allow a deceit claim in circumstances in which the misrepresentation "was properly regarded as being addressed to the class of persons in which the plaintiff belonged," or in circumstances in which the defendant was required to supply the information by legislation, and among the purposes of the legislation was that the plaintiff be able to rely on the information. *Id.*

56. Warren A. Seavey, *Mr. Justice Cardozo and the Law of Torts*, 52 HARV. L. REV. 372, 404, 48 YALE L.J. 390, 422, 39 COLUM. L. REV. 20, 52 (1939).

57. *See Ultramares Corp. v. Touche*, 174 N.E. 441 (N.Y. 1931). The case is mostly remembered for holding that a negligent misrepresentation claim is not available against an auditor for an error in

Despite this formidable opposition to the intended reliance rule, Bohlen's views dominate the First Restatement.⁵⁸ The general definition of fraud in section 525 requires that the defendant have made the misrepresentation "for the purpose of inducing another to act . . . in reliance thereon."⁵⁹ The issue of the defendant's "expectation of influencing conduct" is addressed in detail in sections 531 to 536. Section 531 states the general rule that a defendant is subject to liability "only to those persons to whom [the representation] is made with the intent to cause them to act in reliance upon it."⁶⁰ Comment *d* to section 531 explains that corporate directors who make a false statement in a prospectus to induce subscriptions to its bonds are not liable to purchasers of shares who rely on the false statement.⁶¹ Sections 532 to 536 provide limited exceptions to the general rule requiring intended reliance.⁶² Support within the American Law Institute for the intended reliance rule died with Francis Bohlen. The authors of the Second Restatement completely rewrote section 531 to eliminate the requirement of intended reliance for liability in deceit.⁶³

certifying a company's financial accounts absent what later New York cases define as "near privity." *See Credit All. Corp. v. Arthur Andersen & Co.*, 483 N.E.2d 110, 117, 120 (N.Y. 1985). Justice Cardozo prefaced a discussion of the privity issue with respect to a negligence claim by contrasting the law of fraud, which he opined had no such requirement. *Ultramares*, 174 N.E. at 444 ("The defendants owed to their employer a duty imposed by law to make their certificate without fraud. . . . To creditors and investors to whom the employer exhibited the certificate, the defendants owed a like duty to make it without fraud. . . ."). Having dispatched the requirement of intended reliance at the outset, Justice Cardozo focused on the question of whether knowledge that a representation was false could be inferred from a defendant's negligence with respect to falsity in holding that the claim should be submitted to the jury on a theory of fraud. *Id.* at 449.

58. Bohlen gave ground in two places in the First Restatement. He had sought to define intent as follows for purposes of fraud: "The word 'intention' is used in the restricted sense to indicate that the misrepresentation is made for the purpose of inducing the action." RESTATEMENT (FIRST) OF TORTS § 613 (AM. LAW INST., Preliminary Draft No. 76, 1935); *see also* RESTATEMENT (FIRST) OF TORTS § 609 (AM. LAW INST., Preliminary Draft No. 81, 1935) (mirroring similar language); RESTATEMENT (FIRST) OF TORTS § 607 (AM. LAW INST., Tentative Draft No. 13, 1936) (same). This is a clear statement of the intended reliance scienter rule. He was forced to drop this clear statement of the rule from the black letter and to include a statement in the comment that intent includes when a person "acts believing that there is a substantial certainty that such a result will follow from his conduct." RESTATEMENT (FIRST) OF TORTS § 531 cmt. a (AM. LAW INST. 1938). Bohlen did not try to square that definition of intent with the example in comment *d* of the same section where corporate directors make a false statement in a prospectus to induce investors to subscribe to its bonds and are not liable to purchasers of shares who rely on the misrepresentation. *See id.* § 531 cmt. d. The example is inconsistent with the definition of intent in comment *a*, although it makes perfect sense under the rejected definition of intent. Corporate directors who make false statements in a prospectus to prospective purchasers of bonds might predict with substantial certainty that some purchasers of shares will rely on the statements.

59. RESTATEMENT (FIRST) OF TORTS § 525 (AM. LAW INST. 1938).

60. *Id.* § 531.

61. *See id.* § 531 cmt. d. This approves of the result in cases like *Peek v. Gurney*.

62. *See id.* §§ 532–536. The exceptions cover a misrepresentation incorporated in a negotiable instrument or similar document, *see id.* § 532, a misrepresentation made to influence one transaction that has a continuing influence on a later transaction, *see id.* § 535, and a misrepresentation made in complying with a statutory requirement of disclosure of financial or business information, *see id.* § 536.

63. *See supra* note 49 and accompanying text. The reason-to-expect reliance rule demands even less in the way of consciousness on the part of the defendant of the plaintiff's reliance than does the substantial certainty rule, which Bohlen was forced to include in comments in the First Restatement.

D. JUSTIFIABLE RELIANCE BECOMES REASONABLE RELIANCE

The demise of the intended reliance rule does not mean that a U.S. court would entertain a deceit claim in Camping's case. If a disillusioned believer had brought a deceit claim in the United States against Camping, then the court would grant a motion to dismiss holding the claim barred by the requirement of justifiable reliance. A 2011 decision by Judge Richard Posner provides clear authority.⁶⁴ The opinion equates unjustifiable reliance with reckless reliance:

Reliance on a fraudulent representation need only be "justifiable," by which is meant "not reckless," in other words not willfully embracing a substantial risk. So the plaintiff may not "blindly [rely] upon a misrepresentation the falsity of which would be patent to him if he had utilized his opportunity to make a cursory examination or investigation," because "if the plaintiff's own conduct is 'willful,' 'wanton,' or 'reckless,' it will be set up against similar conduct on the part of the defendant, and recognized as a bar to his action."

So why don't courts say "reckless"? Law would be clearer if judges said what they meant. Well, sometimes they do: "The potential victim of a fraud may not ignore a manifest danger. That is recklessness."⁶⁵

Followers of Camping who acted on his prophecy were reckless in the sense Judge Posner uses the term in this passage. Surely they were aware of the risk that his prophecy would not come to pass. How could they not be? The prophecy was widely ridiculed.⁶⁶ And it was widely reported that earlier prophecies by Camping of the end of the world had been proven wrong. That they acted on the prophecy is not evidence that they were unaware of these reasons to doubt it. Belief and doubt are not inconsistent when belief is a matter of faith. To the contrary, "doubt is not the opposite of faith; it is an

Camping's case illustrates the difference. Whether Camping knew with substantial certainty that his followers would quit their jobs or would spend their life savings in response to the prophecy of the rapture is debatable. Either way, he had reason to expect his followers might act as they did.

64. *BPI Energy Holdings, Inc. v. IEC (Montgomery), LLC*, 664 F.3d 131 (7th Cir. 2011); *see also* *Field v. Mans*, 516 U.S. 59, 70–76 (1995) (holding that the standard for excepting a debt from discharge as a fraudulent representation under U.S. bankruptcy law was not reasonable reliance but the less demanding standard of justifiable reliance, which is an individualized standard based on "the plaintiff's own capacity and the knowledge which he has, or which may fairly be charged against him from the facts within his observation in the light of his individual case." (quoting WILLIAM L. PROSSER, *HANDBOOK OF THE LAW OF TORTS* 717 (4th ed. 1971))).

65. *BPI Energy Holdings*, 664 F.3d at 138–39 (citations omitted). The rule does not justify the result in the case because BPI's reliance was neither reckless nor unreasonable. BPI sued Drummond after Drummond terminated a letter of intent. *See id.* at 135. BPI was unable to bring a claim for breach of contract because the letter of intent said that it created no contractual obligations. *See id.* at 135–36. So BPI brought a claim for promissory fraud, basically alleging that Drummond made commitments in the letter of intent knowing at the time it made the commitments that it had no intention to honor them. *See id.* at 136. It was neither reckless nor unreasonable for BPI to rely on the commitments though they were nonbinding. Business people often rely on nonbinding commitments.

66. *See supra* Section II.A.

element of faith.”⁶⁷

Judge Posner’s account of the requirement of justifiable reliance has become the standard account (if one substitutes a standard of reasonableness for a standard of recklessness). Professors John Goldberg and Benjamin Zipursky give a similar account of the requirement in a recent article on fraud on the market. They address “a case in which the plaintiff undertakes the relevant transaction with his eyes wide open to the presence of a distorted price or the risk of such distortion.”⁶⁸ They go on:

[T]he defendant could plausibly assert something akin to consent, assumption of risk, or *volenti non fit injuria*—a familiar set of defenses found throughout tort law. Roughly speaking, the idea common to each is that if one is aware of the harmfulness or riskiness of another’s wrongful conduct but freely chooses to confront it anyway, one may not afterwards complain about resulting injuries.

Notably, the common law of fraud does not recognize any of these affirmative defenses by name. But it does not do so for a very particular reason: a version of these defenses is already built into the *prima facie* case through the requirement that the plaintiff’s reliance on the defendant’s misrepresentation be justified or reasonable.⁶⁹

I will call the Goldberg–Zipursky account of the requirement of justifiable reliance the new account. It is important to be clear about the precise point of disagreement between the new account of the justifiable reliance requirement and the old account. The law of justifiable reliance is composed of a family of rules that cover categories of representations upon which a reasonable person is unlikely to attach material importance in making a decision that involves a material risk of loss. The reasonableness of the plaintiff’s reliance has always been relevant to the issue of whether his reliance was justifiable.

Thus, the Second Restatement refers to the reasonableness of the plaintiff’s reliance in section 538, connecting it to the concept of materiality: “Reliance upon a fraudulent misrepresentation is not justifiable unless the matter misrepresented is material.”⁷⁰ The Restatement continues: “The matter is material if a reasonable man would attach importance to its existence . . . in determining his choice of action in the transaction in question.”⁷¹ The specific rules that define when reliance is unjustifiable follow from this general rule. For example, as a rule, reliance on a statement of opinion is unjustifiable when the circumstances make it unreasonable to rely on the opinion, such as when it is an opinion expressed by a party with an adverse interest in the transaction in question, and

67. 2 PAUL TILlich, *SYSTEMATIC THEOLOGY* 116 (1957).

68. John C.P. Goldberg & Benjamin C. Zipursky, *The Fraud-on-the-Market Tort*, 66 VAND. L. REV. 1755, 1795 (2013).

69. *Id.*

70. RESTATEMENT (SECOND) OF TORTS § 538(1) (AM. LAW INST. 1977).

71. *Id.* § 538(2)(a).

the party expressing the opinion does not purport to have special knowledge or expertise in the matter.⁷² Most people would not rely on an insurance salesman's opinion regarding the need for insurance in choosing whether to buy insurance, unless the salesman is a friend, a relative, or a long-time adviser.

What changed is why it matters that the plaintiff's reliance was unreasonable. Under the old account of the justifiable reliance requirement, the unreasonableness of the plaintiff's reliance on a misrepresentation matters because it bears on whether the defendant had the required scienter of intended reliance. When reliance on a representation is unreasonable, it is unlikely that the defendant intended the plaintiff to rely on the representation. The connection is made clear in the alternative prong of the definition of when a representation is material in the Second Restatement: "The matter is material if . . . the maker of the representation knows or has reason to know that its recipient regards or is likely to regard the matter as important in determining his choice of action, although a reasonable man would not so regard it."⁷³ *Hyma v. Lee* memorably illustrates a specific point that follows from this rule: the requirement of justifiable reliance does not preclude liability "when the defendant knows of the plaintiff's . . . credulity, gullibility, or other [incapacity] . . . and deliberately practices upon the deficiencies of the plaintiff in order to deceive him."⁷⁴

This is the point of disagreement between the new account of the justifiable reliance requirement and the old account. Under the old account, the unreasonableness of the plaintiff's reliance on a misrepresentation matters because it is evidence that the defendant did not have culpable intent. Sometimes the unreasonableness of the plaintiff's reliance is evidence that the defendant did not intend the plaintiff to act on the misrepresentation, and sometimes it is evidence that the defendant did not intend the plaintiff to believe the misrepresentation to be true. When a representation is ambiguous or incomplete, if the false inference drawn by the plaintiff is unreasonable it is evidence that the defendant did not intend the plaintiff to draw the false inference. Critically, under the old

72. See *id.* § 542 cmt. d ("The law assumes that the ordinary man has a reasonable competence to form his own opinion as to the advisability of entering into those transactions that form part of the ordinary routine of life. . . . Thus the purchaser of an ordinary commodity is not justified in relying upon the vendor's opinion of its quality or worth."). The rule in section 542 covering "opinion of adverse party" is bracketed by the rule in section 541A that reliance on a representation of fact by an adverse party is justifiable and the rule in section 543 that reliance on an opinion of an apparently disinterested party is justifiable. *Id.* §§ 541A, 543. Section 541 covers the rule that reliance on an "obviously false" representation is not justifiable. *Id.* § 541; see also 3 DAN B. DOBBS ET AL., *THE LAW OF TORTS* §§ 672–678 (2d ed. 2011) (collecting additional rules covering such matters as predictions, statements of the law, failure to read documents, puffing, and statements of intent).

73. RESTATEMENT (SECOND) OF TORTS § 538(2)(b). The structure of the rule in section 538 is consistent with the disjunctive scienter rule in section 531, which provides that a person "who makes a fraudulent misrepresentation is subject to liability to [a person] whom he intends or has reason to expect to act . . . in reliance upon the misrepresentation." *Id.* § 531.

74. *Id.* § 545A cmt. b; see *Hyma v. Lee*, 60 N.W.2d 920, 922–24 (Mich. 1953); RESTATEMENT (SECOND) OF TORTS § 545A illus. 2.

account the inference that the defendant lacked culpable intent could be overcome by showing the defendant was aware of and purposely exploited the plaintiff's unreasonable disposition and beliefs. Under the new account of the justifiable reliance requirement, the unreasonableness of the plaintiff's reliance precludes a claim based on the plaintiff's conduct without regard to whether the defendant knew of and purposefully exploited the plaintiff's unreasonable disposition and beliefs.

This is an important change in the law. But proponents of the new account of the justifiable reliance requirement do not understand their account to be a change in the law. The elimination of the intended reliance rule renders the old account of the justifiable reliance requirement incoherent for someone who is unfamiliar with the old scienter rule. An example in the Second Restatement illustrates this point. The example illustrates the rule that "the recipient of a fraudulent misrepresentation is not justified in relying upon its truth if he knows that it is false or its falsity is obvious to him."⁷⁵ The example is as follows: "[I]f one induces another to buy a horse by representing it to be sound, the purchaser cannot recover even though the horse has but one eye, if the horse is shown to the purchaser before he buys it and the slightest inspection would have disclosed the defect."⁷⁶

The example makes perfect sense if liability requires intended reliance. It is unlikely the horse seller intended to divert the purchaser from noticing the horse was one-eyed when he represented that the horse was sound. There is a chance the buyer did not notice the horse was one-eyed and was lulled into not looking over the horse by the seller's statement that the horse was sound. However, the seller probably intended to communicate his belief that the horse was sound apart from being one-eyed. A reasonable juror could not find that the horse seller intended to mislead the buyer regarding the horse's condition absent evidence that the seller knew the buyer did not notice the horse was one-eyed. Thus, the court would grant the seller's motion for summary judgment if the buyer did not produce such evidence. Indeed, as will be explained below, in many states to get past a motion for summary judgment the buyer would have to produce clear and convincing evidence that the seller knew the buyer did not notice the horse was one-eyed, and that the seller said the horse was sound to lull the buyer into not making a cursory examination of the horse (which would have revealed the blind eye).⁷⁷

Substituting the reason-to-expect reliance rule for the intended reliance rule complicates the example and calls the result into doubt. To make out a deceit claim, the buyer would have to establish that he failed to notice that the horse

75. RESTATEMENT (SECOND) OF TORTS § 541. Judge Posner invokes this rule in his *BPI Energy Holdings* opinion. See *supra* notes 64–65 and accompanying text.

76. RESTATEMENT (SECOND) OF TORTS § 541 cmt. a.

77. See *infra* Section III.B.

was one-eyed. He would not have to establish that the seller knew he failed to notice the blind eye, or that the seller's purpose in saying the horse was sound was to lull him into not making a cursory examination of the horse. If the buyer can persuade that the jury that he failed to notice the horse was one-eyed, then he has a good shot at persuading the jury that the seller had reason to expect that he did not notice the horse was one-eyed, and that the seller had reason to expect he would be lulled into not inspecting the horse by the seller's false statement that the horse was sound.

This tension runs throughout the law of justifiable reliance. A case or a rule that could be explained by the inability to establish culpable intent under the intended reliance rule cannot be explained by the inability to establish liability under the reason-to-expect reliance rule. A later generation looked for some other explanation for the requirement of justifiable reliance and its attendant rules. They found an explanation in aspects of the plaintiff's conduct that justified dismissing a fraud claim independent of the defendant's mental state regarding the influence of a misrepresentation upon the plaintiff. This is the requirement of reasonable reliance.

I believe that Bohlen was right and Keeton, Seavey, and Cardozo were wrong on the merits of the intended reliance rule—but for a reason that no one anticipated at the time. The scholars and judges who strove to abolish the intended reliance rule did not appreciate that the rule was the basis for the justifiable reliance requirement, and they did not anticipate that eliminating the rule would lead to the justifiable reliance requirement being converted into a reasonable reliance requirement, creating what is functionally a defense of contributory negligence in the law of deceit. Curing one injustice led to an even worse injustice. Nor did anyone anticipate the other changes in the law that followed in the wake of eliminating the intended reliance rule. I turn to the most important of these changes in the next Part.

III. CLAIMS INVOLVING UNREASONABLE RELIANCE ARE DISMISSED ON THE PLEADINGS

Equating justifiable reliance with reasonable reliance makes it possible for courts to dismiss claims involving unreasonable reliance on the pleadings, depriving the plaintiff of an opportunity for discovery to find evidence of culpable intent. This Part uses a recent lawsuit against a lower-tier law school for publishing misleading placement statistics to illustrate this development. It goes on to explain that the plaintiffs in the case would have lost on a motion for summary judgment under the old *scienter* rule and the clear and convincing evidence standard if they had been unable to produce clear and convincing evidence that the school's administrators had culpable intent. Although the plaintiffs may well have lost eventually under the old rule, they would have been given an opportunity for discovery to find evidence of culpable intent.

A. MACDONALD V. THOMAS M. COOLEY LAW SCHOOL

In 2011, twelve recent graduates of Thomas M. Cooley Law School filed a class action in federal court against their alma mater.⁷⁸ The plaintiffs alleged that Cooley Law had published misleading employment data to induce them to enroll in the school.⁷⁹ Cooley Law publicized that around 80% of its recent graduates were employed with an average salary of roughly \$50,000.⁸⁰ It did not disclose that the 80% employment rate included graduates in temporary and part-time work and in non-legal employment.⁸¹ Nor did it disclose that the reported average salary was based on the small percentage of graduates who reported salary information.⁸² The plaintiffs alleged they relied on the seemingly bright employment prospects of Cooley Law graduates in choosing to attend Cooley Law.⁸³ The twelve named plaintiffs graduated from Cooley Law and passed the bar, but many were unable to find full-time legal employment.⁸⁴ The actual employment prospects of a graduate of Cooley Law were much bleaker than what the published data suggested and more consistent with the named plaintiffs' experiences; allegedly, fewer than 25% of Cooley Law graduates obtained full-time, permanent legal employment.⁸⁵

The district court granted Cooley Law's motion to dismiss the claim on the pleadings.⁸⁶ The Sixth Circuit affirmed.⁸⁷ In dismissing the claim on the pleadings, the two federal courts relied on what the courts found to be the rule

78. Amended Class Action Complaint, *MacDonald v. Thomas M. Cooley Law Sch.*, 880 F. Supp. 2d 785 (W.D. Mich. 2012), *aff'd*, 724 F.3d 654 (6th Cir. 2013) (No. 11-cv-00831).

79. *See id.* at 2–3.

80. *See id.* at 26–29.

81. *See id.* at 34 & n.11.

82. *See id.* at 41.

83. *See id.* at 58. The plaintiffs sought disgorgement of the tuition paid to Cooley Law. *See id.* at 60.

84. *See id.* at 8–22.

85. *See id.* at 32.

86. *MacDonald v. Thomas M. Cooley Law Sch.*, 880 F. Supp. 2d 785, 788 (W.D. Mich. 2012). Similar lawsuits fell on a motion to dismiss. *See, e.g.*, *Evans v. Ill. Inst. of Tech.*, No. 1-12-3611, 2014 WL 4803004, at *1 (Ill. App. Ct. Sept. 26, 2014); *Phillips v. DePaul Univ.*, No. 12 CH 3523, 2012 WL 4000001, at *11 (Ill. Cir. Ct. Sept. 11, 2012), *aff'd*, 19 N.E.3d 1019 (Ill. App. Ct. 2014); *Gomez-Jiminez v. N.Y. Law Sch.*, 103 A.D.3d 13, 14 (N.Y. App. Div. 2012); *Bevelacqua v. Brooklyn Law Sch.*, No. 500175/2012, 2013 WL 1761504, at *1 (N.Y. Sup. Ct. Apr. 22, 2013); *Austin v. Albany Law Sch. of Union Univ.*, 957 N.Y.S.2d 833 (N.Y. Sup. Ct. 2013); *cf.* *Casey v. Fla. Coastal Sch. of Law, Inc.*, No. 3:14-cv-1229-J-39PDB, 2015 WL 10096084, at *16 (M.D. Fla. Aug. 11, 2015) (recommending dismissal with prejudice in case pleading statutory claim but not common law deceit). *But see, e.g.*, *Alaburda v. Thomas Jefferson Sch. of Law*, No. 37-2011-00091898-CU-FR-CTL, 2012 WL 6039151 (Cal. Super. Ct. Nov. 29, 2012) (denying motion for summary judgment); *Hallock v. Univ. of S.F.*, No. CGC-12-517861, 2012 Cal. Super. LEXIS 3091, at *1 (Cal. Super. Ct. July 19, 2012) (denying motion to dismiss); *but cf.* *Harnish v. Widener Univ. Sch. of Law*, 931 F. Supp. 2d 641 (D.N.J. 2013) (denying motion to dismiss in case pleading statutory claim but not common law deceit). In *Alaburda*, the judge refused to certify the case as a class action, and the jury found for the law school on all claims. *See* Elizabeth Olson, *Law Graduate Who Sued Her School Loses at Trial*, N.Y. TIMES (Mar. 24, 2016), <https://www.nytimes.com/2016/03/25/business/dealbook/law-graduate-who-sued-her-school-loses-at-trial.html> [<https://nyti.ms/2jZonwu>] (reporting a settlement in another suit against Golden Gate University School of Law that paid \$8,000 each to five graduates).

87. *MacDonald v. Thomas M. Cooley Law Sch.*, 724 F.3d 654, 657 (6th Cir. 2013).

in Michigan law, that “a person who *unreasonably* relies on false statements should not be entitled to damages for misrepresentation.”⁸⁸ This is a requirement of objectively reasonable reliance. As for why the plaintiff’s reliance was objectively unreasonable, the district court held: “it would be unreasonable for Plaintiffs to rely on two bare-bone statistics in deciding to attend a bottom-tier law school with the lowest admission standards in the country.”⁸⁹

The motion to dismiss would not have been granted under the old rule that treated a fraudster as liable though his victim’s reliance was unreasonable, or even reckless, if “the maker of the representation knows or has reason to know

88. *Id.* at 663 (quoting *Novak v. Nationwide Mut. Ins. Co.*, 599 N.W.2d 546, 553–54 (Mich. Ct. App. 1999)). Whether Michigan law requires reasonable reliance for liability in deceit, and if so how such came to be the rule, is unclear. The Michigan Supreme Court has never overruled *Hyma v. Lee*, which is clear authority that a deceit claim may be available even if a plaintiff’s reliance is reckless. *See* 60 N.W.2d 920, 923–24 (Mich. 1953). The federal courts relied upon three Michigan cases decided by intermediate appellate courts as authority for the reasonable reliance rule. *Novak*, 599 N.W.2d 546 (Mich. Ct. App. 1999); *Nieves v. Bell Indus., Inc.*, 517 N.W.2d 235 (Mich. Ct. App. 1994); *Webb v. First of Mich. Corp.*, 491 N.W.2d 851 (Mich. Ct. App. 1992) (per curiam). But these cases are not clear authority for the rule. *Novak* notes a conflict in the court of appeals “regarding whether reliance on a false representation must be reasonable to support a fraud claim.” 599 N.W.2d at 553.

The results in all three cases could be explained without a reasonable reliance rule. *Novak* and *Nieves* both involve claims by an employee who signed an employment contract with at-will termination clause where an agent of the employer had orally represented to the plaintiff that he could be terminated only for cause. *See id.* at 550; *Nieves*, 517 N.W.2d at 237. The result in both cases could be justified on the alternative ground that the agent did not have apparent authority to alter the terms of the employment agreement. The result in *Webb* could be explained by the intended reliance rule. There, the plaintiffs alleged a broker misrepresented an investment in an oil and gas income fund as being “risk free.” 491 N.W.2d at 853. When the representation was made, the plaintiffs had in hand a prospectus that made it clear the investment involved numerous risks. *See id.* at 853–54. The facts bring to mind the example in which a horse seller represents that a one-eyed horse is in sound condition to a purchaser who could easily see that the horse is one-eyed. *See supra* Section II.D.

The status of the intended reliance rule in Michigan is unclear. Michigan still takes its elements of deceit from *Candler v. Heigho*, 175 N.W. 141, 143 (Mich. 1919), *overruled in part* by *U.S. Fid. & Guar. Co. v. Black*, 313 N.W.2d 77 (Mich. 1981). *See, e.g., Titan Ins. Co. v. Hyten*, 817 N.W.2d 562, 567–68 (Mich. 2012). The fourth of the six elements is that the defendant “made [the misrepresentation] with the intention that it should be acted upon by the plaintiff.” *Candler*, 175 N.W. at 143. This is the intended reliance rule. *U.S. Fidelity and Guaranty Co. v. Black* suggests that the intended reliance rule remains part of Michigan law in explaining the different scienter rules for fraud and innocent misrepresentation. *See* 313 N.W.2d at 82–86. Innocent misrepresentation is actionable only if the misrepresentation is “in a transaction between the contracting parties.” *Id.* at 84. Fraud is not so limited. The Court explains “it is unnecessary [for innocent misrepresentation] to prove separately that the representer intended that the victim rely on the misrepresentation, because the representation must be made ‘in a transaction between them,’ where the misrepresenter should realize that the misrepresentation would be relied upon.” *Id.* at 85. The inference is that in a claim for fraud the plaintiff must establish intended reliance.

89. *MacDonald*, 880 F. Supp. 2d at 797. The plaintiffs in *MacDonald* did not challenge the reasonable reliance rule in their briefs. Instead, they argued that their reliance was not unreasonable and that the issue was for the jury. *See* Brief of Appellants Cross-Appellees at 53, *MacDonald v. Thomas M. Cooley Law Sch.*, 724 F.3d 654 (6th Cir. 2013) (No. 12-2066); Brief in Opposition to Defendant’s Motion to Dismiss at 33–34, *MacDonald v. Thomas M. Cooley Law Sch.*, 880 F. Supp. 2d 785 (W.D. Mich. 2012) (No. 11-cv-00831). *See infra* Section VI.A for an explanation that the court’s decision to take the issue of the reasonableness of the plaintiffs’ reliance away from the jury was not an unusual one.

that its recipient regards or is likely to regard the matter as important in determining his choice of action, although a reasonable man would not so regard it.”⁹⁰ Under the old rule, Cooley Law would be liable if its agents published the misleading statistics hoping that some people would draw a false impression of the success of its graduates, and thereby would be influenced to invest in a Cooley Law degree. That the success of the fraud depended on the victim’s gullibility would not shield the school from liability. The facts pled by the plaintiffs make out a plausible claim that the defendant’s agents had culpable intent, which would have sufficed to get past a motion to dismiss under the old rule.⁹¹ It is plausible that Cooley Law’s administrators reported the employment data as they did with intent to create a false impression of the employment prospects of its graduates and with a purpose of influencing people like the plaintiffs to enroll at the school.

B. WHY THE CLAIM IS LIKELY TO FAIL AT SUMMARY JUDGMENT UNDER THE OLD RULE

To be fair, there is an innocent explanation for Cooley Law’s actions. The form in which Cooley Law reported its placement statistics was common practice among law schools and consistent with ABA guidelines at the time.⁹² Perhaps Cooley Law followed the common practice and the guidelines without intending to create a false impression or intending to influence people to enroll at the school. It also is possible that the people at Cooley Law who published the placement statistics understood they might create a false impression, but they merely intended to pique the interest of prospective students to get them to look at Cooley Law more closely and did not intend for students to rely on this “bare-boned” information in making the ultimate decision about whether to enroll at Cooley Law. The published statistics would be analogous to a salesman puffing a good to get a purchaser to look at the good more closely.

The existence of an innocent explanation for the defendant’s actions in *MacDonald* means that the claim might well have been dismissed on a motion for summary judgment under the old rule. In most states to get past a motion for summary judgment on a deceit claim the plaintiff must present clear and

90. RESTATEMENT (SECOND) OF TORTS § 538(2)(b) (AM. LAW INST. 1977).

91. The plaintiffs alleged in their complaint: “Thomas Cooley is primarily marketing its product to naïve, relatively unsophisticated consumers—many of whom are barely removed from college—who are often making their first “big-ticket” purchase based on asymmetrical information.” Amended Class Action Complaint, *supra* note 78, at 39. The district court held that the plaintiffs satisfied the requirement that fraud be pleaded with adequate specificity. *MacDonald*, 880 F. Supp. 2d at 792 n.4. Under FED. R. CIV. P. 9(b), a plaintiff alleging fraud must “allege the time, place, and content of the alleged misrepresentation on which he or she relied; the fraudulent scheme; the fraudulent intent of the defendants; and the injury resulting from the fraud.” *Id.* (quoting *Coffey v. Foamex L.P.*, 2 F.3d 157, 161–62 (6th Cir. 1993)).

92. See Amended Class Action Complaint, *supra* note 78, at 30–31.

convincing evidence that the defendant had culpable intent,⁹³ which under the old scienter rules required establishing that the defendant had culpable intent both with respect to the falsity of the information and with respect to intended reliance.⁹⁴ In a case like *MacDonald*, in which the alleged misrepresentation involved ambiguous or incomplete information, the plaintiff also has to establish by clear and convincing evidence that the defendant intended the plaintiff to draw a false inference from the information.⁹⁵

Applying these rules, the trial court could have granted Cooley Law's motion for summary judgment if the plaintiffs did not find clear and convincing evidence that Cooley Law's agents presented the employment data with an intent to create a false impression to influence people to enroll at the school. It would not be enough to survive a motion for summary judgment that the evidence established that Cooley Law's agents had reason to know the employment data might create a false impression, and had reason to know this false impression might influence people to attend Cooley Law. Nor would it suffice to get past a motion for summary judgment if the evidence were inconclusive, establishing neither the presence nor the absence of culpable intent. Under the clear and convincing evidence standard, doubts regarding the presence of culpable intent are resolved in favor of the defendant.

Another Michigan case, *Hord v. Environmental Research Institute of Michigan*,⁹⁶ illustrates how strict scienter rules work hand in hand with the clear and convincing evidence standard. These rules require a court to dismiss a deceit claim on a motion for summary judgment when the unreasonable character of the plaintiff's reliance suggests the defendant may have lacked culpable intent, and the plaintiff is unable to find clear and convincing evidence of culpable intent. The plaintiff, Hord, was given a packet of materials about Environmental Research Institute of Michigan (ERIM) when he interviewed for a position at the company in late 1992.⁹⁷ The packet included an "operating summary" for

93. See, e.g., *In re Marriage of Culter*, 588 N.W.2d 425, 430 (Iowa 1999); *Snyder v. Lovercheck*, 992 P.2d 1079, 1086 (Wyo. 1999); *Richmond Metro. Auth. v. McDevitt St. Bovis, Inc.*, 507 S.E.2d 344, 346 (Va. 1998); 3 DOBBS, HAYDEN & BUBLICK, *supra* note 72, at 643–45.

94. See *supra* Section II.B.

95. Under the rule in the First Restatement, an actor who made an ambiguous representation was subject to liability in deceit if he made the representation "with the intention that it be understood in the sense in which it is false." RESTATEMENT (FIRST) OF TORTS § 527 (AM. LAW INST. 1938). The rule in the Second Restatement weakens this scienter requirement to hold an actor who makes an ambiguous representation subject to liability in deceit if the actor "knows [the representation] to be capable of two interpretations, one of which he knows to be false," and if the representation is made "without any belief or expectation as to how it will be understood" or "with reckless indifference as to how it will be understood." RESTATEMENT (SECOND) OF TORTS § 527. The Third Restatement addresses this issue briefly in a comment, which states that an ambiguous "statement is actionable if the speaker intends that it be understood in its false sense or is indifferent to which way the statement is taken; a speaker who knowingly makes an ambiguous statement is obliged to take reasonable steps to ensure that the statement is understood accurately." RESTATEMENT (THIRD) OF TORTS: LIAB. FOR ECON. HARM § 9 cmt. c (AM. LAW INST., Tentative Draft No. 2, 2014).

96. 617 N.W.2d 543 (Mich. 2000) (per curiam).

97. See *id.* at 545.

the fiscal year 1991, which gave the impression that the company was thriving.⁹⁸ This was a false impression because 1992 was a bad year for the company. Revenues were down substantially and the company had made substantial layoffs while eliminating several unsuccessful projects. No one at ERIM brought the recent bad news to Hord's attention during the interview. Hord took the job at ERIM in early 1993. He quit his position at the aerospace division of General Electric, declined to pursue other job opportunities, and moved from New Jersey to Michigan. EIRM's condition continued to deteriorate, and Hord was laid off in 1994.

Hord brought a deceit claim alleging that the operating summary misled him about the condition of the company. He prevailed in the trial court and was awarded \$175,000 damages. The Michigan Supreme Court reversed, relying on the unusual rule that a representation must be "objectively false" to be actionable.⁹⁹ Under this rule "[a] plaintiff's subjective misunderstanding of information that is not objectively false or misleading cannot mean that a defendant has committed the tort of fraudulent misrepresentation."¹⁰⁰ This rule would preclude a deceit claim when the plaintiff drew a false inference from ambiguous or incomplete information, like the placement statistics in *MacDonald*.¹⁰¹ Ambiguous or incomplete information is not objectively false. It is susceptible to being interpreted in a way that renders it false. It is not clear where the Michigan Supreme Court got this rule. Usually, an ambiguous or incomplete representation is considered to be fraudulent if the maker intends the recipient to draw a false conclusion from the representation.¹⁰² If ERIM's agents intended to create a false impression about the company's strength when they gave Hord the old financial information, then they have made an actionable misrepresentation under the usual rule.¹⁰³

Judge Hoekstra's dissenting opinion in the Michigan Court of Appeals provides a better rationale for the decision: the plaintiff failed to establish culpable intent. He observes: "There is no evidence that defendant intended the 1991 operating summary to demonstrate the company's financial condition at the time

98. *See id.* at 545–46.

99. *See id.* at 549, 551.

100. *Id.* at 549.

101. This was an alternative ground for the district court's decision in *MacDonald*. *See MacDonald v. Thomas M. Cooley Law Sch.*, 880 F. Supp. 2d 785, 794 (W.D. Mich. 2012) ("[Plaintiffs'] subjective misunderstanding of information that is not objectively false or misleading cannot mean that Cooley has committed the tort of fraudulent misrepresentation.").

102. *See* RESTATEMENT (SECOND) OF TORTS § 527 (AM. LAW INST. 1977).

103. Like the scienter inquiry under the intended reliance rule, the scienter inquiry under the rules on ambiguous and incomplete representations involves an inquiry into the defendant's mental state as oriented towards the plaintiff's mental state. The defendant has a culpable state of mind under these rules when he makes an ambiguous or incomplete representation if the defendant intends the plaintiff to interpret the representation in a way that renders it untrue. Similarly, the defendant has a culpable state of mind under the intended reliance requirement when he makes a representation upon which a reasonable person would not rely if the defendant made the representation hoping the plaintiff would.

it hired plaintiff.”¹⁰⁴ He continues: “The most disconcerting aspect of the majority’s opinion is that it expects that defendant will anticipate plaintiff’s inference and then requires defendant to take appropriate remedial action. Because defendant failed to anticipate how plaintiff would interpret its 1991 operating summary, the majority finds that defendant has committed fraud.”¹⁰⁵ In other words, the people at ERIM probably did not include the 1991 operating summary in the packet in order to create a false impression about the company’s financial condition in 1992.

Judge Hoekstra was able to make this factual finding because Hord was given an opportunity to establish that the defendant had culpable intent. It is possible that someone at ERIM included the 1991 operating summary in the packet of information that was given to Hord to create a false impression about the company’s financial condition. But all of the evidence presented at trial indicated otherwise. It appears that the operating summary was included because it was the most recent financial information available at the time.¹⁰⁶ No one at the company called the operating summary to Hord’s attention. Hord testified that he never told anyone at the company that he was relying on the operating summary.¹⁰⁷ Tellingly, Hord’s appellate briefs cite no affirmative evidence that anyone at ERIM intended to create a false impression.¹⁰⁸ Hord had to be given an opportunity for discovery to make his case before the negative inference could be drawn. The rule requiring that culpable intent be proven by clear and convincing evidence requires that a negative inference be drawn if there is a good chance the defendant did not have culpable intent.

IV. THE RULES ON CAUSATION ARE TIGHTENED

This Part describes how the rules on factual and legal causation have been tightened in the law of deceit to make it easier for a fraudster to escape liability for losses that may result from his fraud. I believe there is a connection between the abolition of the intended reliance rule and the tightening of the rules on causation. To explain the connection between the loosening of deceit’s scienter rule and the tightening of the rules on causation, I use an appalling case in which the Pennsylvania Supreme Court held it unreasonable as a matter of law for a woman to rely on her fiancé’s valuation of her engagement ring.¹⁰⁹ The

104. *Hord v. Env'tl. Research Inst. of Mich.*, 601 N.W.2d 892, 894 (Mich. Ct. App. 1999) (Hoekstra, P.J., dissenting).

105. *Id.* at 895.

106. *See id.* (“[P]laintiff received the most current report of its type available.”).

107. Defendant-Appellant ERIM’s Brief on Appeal at 2–4, *Hord v. Env'tl. Research Inst. of Mich.*, 579 N.W.2d 133 (Mich. Ct. App. 1998) (No. 95-5102-CK).

108. *See* Plaintiff-Appellee’s Brief on Appeal at 1–6, *Hord v. Env'tl. Research Inst. of Mich.*, 579 N.W.2d 133 (Mich. Ct. App. 1998) (No. 95-5102-CK). The only affirmative representation cited in the brief was the dated operating summary when ERIM’s agent had access to more current and less favorable information. The brief argued, “[e]ven if Defendant’s representations were innocently made, it had a duty to make them accurately.” *Id.* at 5.

109. *Porreco v. Porreco*, 811 A.2d 566, 571–72 (Pa. 2002).

case is useful for my purposes because either the intended reliance rule or tighter rules on causation would provide a defensible basis for the result. This makes the case a good vehicle for explaining the possible connection between loosening the scienter rule and tightening the rules on causation.

A. THE FAKE ENGAGEMENT RING

Louis Porreco may not have intended to deceive his future wife Susan about the nature of his feelings for her when he gave her a fake diamond engagement ring.¹¹⁰ Perhaps Louis gave Susan the fake ring because he could not afford a real stone that was magnificent enough to express his love for her. Louis gave Susan other things of genuine value in the two years they dated before their engagement, including other jewelry worth \$32,500, “an apartment, an automobile, insurance, a weekly allowance, access to one of his credit cards as a secondary card holder, and a gas charge account at his car dealership’s fueling station.”¹¹¹ Later, during the ten years they were married, Louis gave Susan genuine jewelry worth \$50,000.¹¹²

Louis was much older and wealthier than Susan. When they met he was 45 and she was 17.¹¹³ He owned a car dealership. She was a student in high school, working part-time in a ski shop and living with her parents. Louis provided Susan an apartment and other support so she could move out of her parents’ home after her parents vigorously opposed the relationship.¹¹⁴ We have detailed information about the couple’s relative financial wealth at the time of their marriage because Louis asked Susan to sign a prenuptial agreement.¹¹⁵ When he presented her with the agreement to sign he gave her a personal financial statement that accurately disclosed his net wealth to be \$3,317,666. He also gave her a financial statement that put her net wealth at \$46,592. Louis prepared both financial statements. Louis valued the ring at \$21,000 on the list of Susan’s assets. This was a lie. The ring was a fake.¹¹⁶ It is not clear why Louis lied about the value of the ring on the financial statement. His purpose probably was not to mislead Susan about her wealth going into the marriage because he did not include on the list of her assets some of the genuine jewelry he had given her.¹¹⁷ Susan signed the prenuptial agreement, which gave her in the event of divorce a lump sum of \$3,500 per year of marriage, an automobile, and insurance.¹¹⁸

110. *See id.* at 567.

111. *Id.* at 567–68, 568 n.1.

112. *Id.* at 568 n.1.

113. *Id.* at 567.

114. *See* Brief for Appellant at 3, *Porreco v. Porreco*, 811 A.2d 566 (Pa. 2002) (No. 9 WAP 2001).

115. *Porreco*, 811 A.2d at 568.

116. *See id.* at 567.

117. *See id.* at 568 n.2.

118. *Id.* at 568.

Susan learned the engagement ring was fake years later when she took it to a jeweler after she and Louis separated.¹¹⁹ In the divorce proceedings she sought to set aside the prenuptial agreement on grounds of fraud and abuse of confidential relationship. The trial court invalidated the prenuptial agreement on the first ground, finding “Louis misrepresented the nature and value of the ring in order to induce Susan to sign the prenuptial agreement,” and finding “credible Susan’s testimony that if she knew Louis that had given her a fake ring and lied about it, she would not have signed the prenuptial agreement and ‘would not have married the man.’”¹²⁰

The Pennsylvania Supreme Court reversed, finding Susan’s reliance on Louis’s “valuation of her holdings” to be unreasonable as a matter of law.¹²¹ This holding is indefensible.¹²² Louis gave Susan most of her holdings. He knew what he had paid for the jewelry and the automobile, so he could easily provide information on their value. Susan had no reason to doubt Louis’s trustworthiness in reporting the value of these gifts. Even if she had entertained doubts, she might reasonably have declined to seek an independent appraisal because to do so would be a signal that she did not trust Louis.¹²³

Although this basis for the result in the case is indefensible—indeed it is insulting to Susan—the result is not. The intended reliance rule would provide a defensible basis for the result. There is little evidence that Louis lied about the value of the ring to mislead Susan about her wealth going into the marriage to induce her to sign the prenuptial agreement. Probably he lied because he did not want to admit the ring was a fake and did not think of omitting the ring from the list of assets. If Louis’s purpose was to mislead Susan about her wealth, then he would have included other jewelry he had given her of roughly equivalent value in the statement of her assets.

But my interest in the case is two other possible grounds for the decision that were suggested or hinted at by the Pennsylvania courts.¹²⁴ The alternate grounds

119. *Id.* at 569.

120. *Id.* Louis told the trial judge an incredible story about the ring. He testified that Susan asked for a fake diamond because she feared she would lose the stone while working in the stables where she kept a horse. See Brief for Appellant, *supra* note 114, at 5. He testified that they agreed to misstate the value of the ring on the financial statement because they did not want to disclose that it was a fake ring to the lawyer retained to advise Susan about the prenuptial agreement, who was a family friend. See *id.* at 8.

121. *Porreco*, 811 A.2d at 571–72. The court remanded the case so the trial court could consider the abuse of confidential relationship claim. *Id.* at 572.

122. Two dissenting justices argued that Susan’s reliance was reasonable because of her youth and lack of sophistication. See *Porreco*, 811 A.2d at 575 (Saylor, J., dissenting); *id.* at 575–76, 575 n.1 (Eakin, J., dissenting). This is still offensive. Susan’s conduct should not require an excuse.

123. For a survey of the behavioral law and economics literature on the value of signaling trust, see Russell Korobkin, *The Borat Problem in Negotiation: Fraud, Assent, and the Behavioral Law and Economics of Standard Form Contracts*, 101 CALIF. L. REV. 51, 80–86 (2013).

124. Treating the issue as a matter of causation—actual or proximate—glosses over a significant doctrinal point. Susan was seeking the remedy of rescission of the prenuptial agreement and not damages. *Porreco*, 811 A.2d at 569. The law of rescission substitutes a materiality requirement for a requirement of causation. A party can rescind a transaction based on a misrepresentation only if the misrepresentation was material to the transaction. See *Clark v. Kirsner*, 74 A.2d 830, 832–33 (Md.

for the decision are that Louis's lie was not the cause in fact of Susan's decision to sign the prenuptial agreement, or it was not the proximate cause of the loss Susan suffered upon divorce as a result of signing the prenuptial.

The first ground is suggested in the Pennsylvania Supreme Court majority opinion: Louis's lie was not an actual cause of Susan's decision to sign the prenuptial agreements. Susan admitted in her testimony that she would have signed the agreement if Louis had simply omitted the engagement ring from the list of her assets.¹²⁵ The lie would not be an actual cause of her decision to sign the agreement if a court were willing to accept as a counterfactual that Louis could have avoided the lie by omitting the engagement ring from the list of assets.¹²⁶

A dissenting judge in the Superior Court hints at a second ground for the decision. The dissenting judge argued that "the remedy of invalidating the entire prenuptial agreement was too harsh" and that Louis should be required "to pay Susan \$21,000.00 to compensate her for the value of the ring as stated in the prenuptial agreement."¹²⁷ A leading Torts treatise connects the stated concern about the harshness of allowing Susan to avoid the prenuptial agreement to the federal securities law concept of loss causation and the tort law concept of

1950) (holding that the difference between \$75 and \$78 ground rent is not so material as to justify rescission when claimant can be compensated by an adjustment to purchase price). In the context of innocent misrepresentation, materiality is treated as going to whether the claimant might have acted differently had she not been misled. *See* John Dwight Ingram, *Misrepresentations in Applications for Insurance*, 14 U. MIAMI BUS. L. REV. 103, 110 (2005). There is disagreement about whether the inquiry is into objective (normal) or subjective (actual) effect, the weight of the fact misstated, and whether it is necessary that the speaker know or have reason to know of the materiality of the information. Joseph K. Powers, *Pulling the Plug on Fidelity, Crime, and All Risk Coverage: The Availability of Rescission as a Remedy or Defense*, 32 TORT & INS. L.J. 905, 914–17 (1997). Often, a statute governs the matter. *See, e.g.,* York Mut. Ins. Co. v. Bowman, 746 A.2d 906, 909 (Me. 2000).

The law of rescission has no concept of proximate cause. *See, e.g.,* Hyler v. Garner, 548 N.W.2d 864, 872 (Iowa 1996) ("[T]he elements of an equitable claim for rescission based on misrepresentation are (1) a representation, (2) falsity, (3) materiality, (4) an intent to induce the other to act or refrain from acting, and (5) justifiable reliance."). Some of the work that would be done by the concept is done instead by the equitable doctrine of undue hardship, which allows a court to withhold a remedy to which a plaintiff would otherwise be entitled when the effect of granting the remedy would be to give the plaintiff a windfall at the defendant's expense. *See* DOUGLAS LAYCOCK, MODERN AMERICAN REMEDIES: CASES AND MATERIALS 411–14 (4th ed. 2010) (explaining "similar concerns underlie rules against disproportionate measures of damage"). On equitable defenses, *see* generally 2 DAN B. DOBBS, LAW OF REMEDIES: DAMAGES, EQUITY, RESTITUTION § 9.6 (2d ed. 1993).

125. *See Porreco*, 811 A.2d at 571 n.5. At trial, Susan answered "yes" when asked whether "[she] had agreed that [she was] going to sign this document no matter what it said." *Id.* Later, Susan testified, "she would not have signed an agreement that 'included lies.'" *Id.* Another possible counterfactual is that Louis would have disclosed the ring's true value to Susan. Perhaps she would have asked for a genuine diamond. We can only speculate about what would have happened as a result. Perhaps they would never have married.

126. Louis could have avoided the lie in two ways: disclosing the true value of the ring or omitting the ring from the list of assets. It is not apparent why the latter counterfactual would be impermissible in the law of deceit. *Cf.* Mark P. Gergen, *Causation in Disgorgement*, 92 B.U. L. REV. 827, 837–42 (2012) (addressing the general question of what is an impermissible counterfactual in the law of deceit).

127. *Porreco*, 811 A.2d at 569.

proximate cause.¹²⁸ The treatise explains: “[The] idea is that the plaintiff relied on the representation only for the price, not for entering into the transaction. . . . [I]t may be bad policy to permit the plaintiff to avoid the whole transaction rather than to get damages based upon misrepresentations about the price.”¹²⁹

B. THE CONNECTION BETWEEN A STRICT SCIENTER RULE AND UNFORGIVING RULES ON CAUSATION

The availability in 2002 of absence of factual causation and proximate cause as grounds for the outcome in *Porreco* is a product of a tightening of the rules on causation in recent years. The rules on causation in the law of deceit used to be unforgiving to fraudsters. What I want to suggest here is that the abolition of the intended reliance rule is connected to the tightening of the rules on causation.

English law provides some evidence that there is a connection between the intended reliance rule and unforgiving rules on causation and proximate cause. England has retained the requirement of intended reliance for liability in deceit.¹³⁰ Additionally, English law has a near irrebuttable presumption that the plaintiff relies on the defendant’s misrepresentation, which typically establishes actual causation in a deceit action. *Mathias v. Yetts* states the presumption and its limited exceptions:

The man who makes the material misstatement to induce the other to enter into the contract cannot be heard to say that he did not enter into it, to some extent, at all events, on the faith of the statement, unless he can prove one of two things: either in fact that the man did not rely upon it, and made inquiries and got information which showed that the misstatement was untrue, and still went on with the contract, that is one thing; or else that he said, expressly or impliedly, “I do not care what your representations are; I shall not inquire about them. I shall enter into the contract taking the risk.”¹³¹

The English rule on proximate cause is even simpler: “[T]he foresight or contemplation of the parties will not limit the scope of the claimant’s recoverable damages. The defendant will be liable for all losses caused by the deceit, whether or not it was foreseeable.”¹³² The rule is justified to “serve as a deterrent against fraud and, based on moral considerations, as between the fraudster and the innocent party, the fraudster should bear the risks of misfortune caused by the fraud.”¹³³

128. See 1 DOBBS, HAYDEN & BUBLICK, *supra* note 72, at 686–87 (“The function of proximate cause rules is to facilitate or express a value judgment about the appropriate scope of liability of a defendant who is negligent and whose negligence in fact causes harm.”).

129. 3 DOBBS, HAYDEN & BUBLICK, *supra* note 72, at 670 n.12.

130. See *supra* Section II.B.

131. [1882] 46 LT 497 (AC) at 502 (Eng.).

132. EGGERS, *supra* note 3, at 195.

133. *Id.*

There is a moral, evidentiary, and practical connection between having a strict scienter rule for tortious liability and having unforgiving rules of actual and proximate causation. Torts of misrepresentation protect the “decisional autonomy” of the victim and “her interest in making certain kinds of choices in certain settings free from certain forms of misinformation.”¹³⁴ The intended reliance rule requires that the defendant’s interference in the plaintiff’s decisional autonomy be purposeful. This brings into play the general principle that causal uncertainty is resolved against a wrongdoer when his conduct “is deemed wrongful precisely because it has a strong propensity to cause the type of injury that ensued.”¹³⁵ Furthermore, as an evidentiary matter, that the defendant made the misrepresentation with a purpose of inducing the plaintiff’s action is pretty good evidence that the misrepresentation did induce the action. A successful fraudster is likely to know his victim fairly well. Finally, as a practical matter, the intended reliance rule broadly preempts the types of claims that pose difficult causal questions, eliminating the need for rules on actual causation and proximate cause to limit the possible consequences of a misrepresentation for which a defendant is liable. In the occasional cases in which there is a need to draw a line, the intended reliance rule often provides the necessary line.

A hypothetical based on a variation of the facts of *Porreco* illustrates how as a moral, evidentiary, and practical matter the intended reliance rule makes it possible for the law of deceit to have unforgiving rules on actual causation and proximate cause.¹³⁶ Imagine that Louis only deceived Susan by giving her a fake diamond as an engagement ring, and that he did not list the ring among Susan’s assets in the prenuptial agreement. Susan brings a deceit claim and argues that the lie was in giving her a fake engagement ring. As a remedy she seeks to set aside the prenuptial agreement. As a practical matter, the intended reliance rule removes from the table a claim by Susan to invalidate the prenuptial agreement because Louis gave her a fake diamond engagement ring. It is improbable that one of Louis’ purposes was to induce Susan to sign the prenuptial agreement by giving her a fake diamond engagement ring. If Susan cannot establish that this was one of Louis’ purposes, then her claim fails under the intended reliance rule. Because Susan cannot establish culpable intent, there is no need to have a rule on actual causation or proximate cause to deal with the claim.

134. Goldberg & Zipursky, *supra* note 68, at 1761 (quoting John C.P. Goldberg, Anthony J. Sebok & Benjamin C. Zipursky, *The Place of Reliance in Fraud*, 48 ARIZ. L. REV. 1001, 1011 (2006)).

135. *Liriano v. Hobart Corp.*, 170 F.3d 264, 271 (2d Cir. 1999).

136. The hypothetical is reminiscent of an old case in that it raises the issue of whether a misrepresentation made at the outset of a long-term relationship taints later transactions. *See* 1 BIGELOW, *supra* note 4, at 547–48. Bigelow asks whether “representations made by a party with a view to procuring credit with another may be held to apply to and affect subsequent credits extended by the vendor to the vendee.” *Id.* at 548. He answers liability for the misrepresentation may extend to subsequent transactions but only “under circumstances from which it may be inferred that they were made with an intent to induce a continued credit.” *Id.* (citing *Morris v. Talcott*, 96 N.Y. 100 (1884)).

The absence of intended reliance in the hypothetical is also relevant to the moral question of whether Susan should be able to invalidate the prenuptial agreement on the ground that Louis gave her a fake diamond as an engagement ring. Susan's claim to invalidate the prenuptial agreement based on Louis's initial deception is weaker if there is no evidence that one of Louis's purposes in deceiving her was to influence her to sign the prenuptial agreement. Louis did not give Susan the fake to impair her judgment regarding whether she should sign the prenuptial agreement. Although the gift of a fake diamond may be wrongful for several reasons (for example, it would be wrongful if Louis's motive was to mislead Susan about the strength of his affection for her), it is not wrongful because it has a strong propensity to induce Susan to sign the prenuptial agreement. And a causal influence on Susan's decision to sign the prenuptial agreement cannot be inferred from Louis's action and purpose because he did not give her the fake with a purpose of inducing her to sign the agreement.

C. THE CHANGE IN THE RULES ON CAUSATION IN THE UNITED STATES

The rules in the United States on actual causation and proximate cause have been tightened and made more forgiving to fraudsters in the decades since the intended reliance requirement was eliminated. In contrast, the old rules on actual causation and proximate cause in the First and Second Restatements of Torts are not forgiving to fraudsters,¹³⁷ though they are not quite as unforgiving as the English rules. The old rule on actual causation did not require that a misrepresentation be a probable but for cause of the plaintiff's action in reliance on the representation. Instead, both Restatements use the "substantial factor" test of causation¹³⁸ and state that a substantial factor need not be "the predomi-

137. Few cases address the issues of actual causation and proximate cause in the law of deceit at any length prior to the 1950s, and the few cases that do address the issues tend to be emphatic that any doubts on these issues should be resolved in favor of the plaintiff. *See, e.g.,* *Neuman v. Corn Exch. Nat'l Bank & Tr. Co.*, 51 A.2d 759, 765 (Pa. 1947). *Boatmen's National Co. v. M. W. Elkins & Co.*, 63 F.2d 214, 217 (8th Cir. 1933), is authority for the rule in the Second Restatement that a misrepresentation is not the proximate cause of a loss that is due to a cause wholly unrelated to the subject matter of the misrepresentation. There, the plaintiff purchased bonds issued by a county that had been purchased by the defendants (the Elkins Company and the Union Trust Company) relying on a false certificate that the defendants had already paid the county in full for the bonds. *Id.* at 215. The defendants subsequently paid the county in full. The Arkansas Supreme Court later held the bonds to have been illegally issued, and the plaintiff recovered less than the price it had paid for the bonds from the county. *Id.* at 215–16. The court held the Union Trust Company was not liable for the plaintiff's loss because "the bonds which [the] plaintiff purchased were rendered valueless because of the decision of the Supreme Court of Arkansas, and not because the purchase price of the bonds had not been paid to the county treasurer" at the time of the issuance of the false certificate. *Id.* at 217. However, the court went on to hold that the plaintiff could recover its loss from the Elkins Company because "the money has been obtained by fraud." *Id.* (quoting 2 S. MARCH PHILLIPS, *A TREATISE ON THE LAW OF EVIDENCE* 119 (4th ed., Gould, Banks & Co. 1839)).

138. *See* RESTATEMENT (SECOND) OF TORTS § 546 (AM. LAW INST. 1977) ("The maker of a fraudulent misrepresentation is subject to liability for pecuniary loss suffered by one who justifiably relies upon

nant or decisive factor.”¹³⁹ Basically, a misrepresentation was treated as an actual cause of the plaintiff’s decision if the misrepresentation was a material factor in the decision. The defendant could not avoid responsibility for the plaintiff’s decision even if he could prove the plaintiff probably would have made the same decision without the misrepresentation.

The First Restatement had no rule on proximate cause. This is unsurprising because the First Restatement had the intended reliance rule, which made a rule on proximate cause superfluous. A rule on proximate cause was added in the Second Restatement.¹⁴⁰ The rule makes a fraudster liable if the plaintiff’s loss “might reasonably be expected,” echoing the “reason to expect” reliance test in the new, watered-down scienter rule in section 531.¹⁴¹ However, it is unlikely that the authors of the Second Restatement intended courts to apply the same test to determine when a person who relied on a misrepresentation had standing to bring a fraud claim (the issue in section 531) and to determine a fraudster’s scope of liability for losses suffered by an intended or expected victim of a fraud (the issue in section 548A). The general thrust of the comments is that if a misrepresentation influences the plaintiff to enter into a transaction, then the defendant is liable for all foreseeable losses incurred by the plaintiff in the transaction, subject to a narrow exception for a loss that is “a result of some subsequent event that has no connection with or relation to” the subject matter of the misrepresentation.¹⁴²

the truth of the matter misrepresented, if his reliance is a substantial factor in determining the course of conduct that results in his loss.”); RESTATEMENT (FIRST) OF TORTS § 546 (AM. LAW INST. 1938).

139. RESTATEMENT (SECOND) OF TORTS § 546 cmt. b (“It is not, however, necessary that his reliance upon the truth of the fraudulent misrepresentation be the sole or even the predominant or decisive factor in influencing his conduct. It is not even necessary that he would not have acted . . . as he did unless he had relied on the misrepresentation.”); *see also* RESTATEMENT (FIRST) OF TORTS § 546 cmt. a (“It is not necessary that the other’s reliance upon the credibility of the fraudulent representation be the sole or even the predominant factor in influencing his conduct. . .”).

140. RESTATEMENT (SECOND) OF TORTS § 548A (“A fraudulent misrepresentation is a legal cause of a pecuniary loss resulting from action or inaction in reliance upon it if, but only if, the loss might reasonably be expected to result from the reliance.”).

141. *Id.* § 531.

142. *Id.* § 548A cmt. b. This language is opaque. It was meant to endorse the result in *Boatmen’s National Co.*, which is the basis for Illustration 1. *Id.* § 548A illus. 1; *see supra* text accompanying note 137. Illustration 2 involves facts similar to *Bastian v. Petren Resources Corp.*, 892 F.2d 680 (7th Cir. 1990), but reaches a different result. B sells A the bonds of X Oil Corporation, misrepresenting its financial condition. “[C]onditions in the oil industry become demoralized and as a result of financial losses the X Oil Corporation becomes insolvent.” RESTATEMENT (SECOND) OF TORTS § 548A illus. 2. The example continues, adding two facts: “A suffers a pecuniary loss greater than that which would have resulted from the deterioration of conditions in the industry alone”; and “if the financial condition of the Corporation had been as represented it probably would have weathered the storm and not become insolvent.” *Id.* The Illustration concludes: “B is subject to liability to A for the additional pecuniary loss resulting from the insolvency.” *Id.* This suggests that if a cause to which a misrepresentation relates is a factor in some of the plaintiff’s loss on an investment made in reliance on the misrepresentation, then the defendant is liable for the plaintiff’s entire loss on the investment, even if part of the loss is attributable to other factors. *Bastian* held that a defendant is not liable for losses incurred by a plaintiff who invested in an oil company relying on the defendant’s misrepresentation about the quality of the

Since the Second Restatement the rules on actual causation and proximate cause have been tightened, making these grounds available to justify the result in *Porreco v. Porreco*.¹⁴³ Many cases require a plaintiff to establish the misrepresentation was a probable but for cause of his action in reliance, applying the usual preponderance of the evidence standard.¹⁴⁴ The current draft of the Third Restatement adopts this rule, requiring a plaintiff to establish that a misrepresentation is “a factual or ‘but for’ cause of the harm that the plaintiff suffered.”¹⁴⁵

Although the movement in the law of proximate cause is not as strong, some cases apply a rule on proximate cause that is similar to the harm-within-the-risk rule that determines proximate cause in a negligence action involving physical or emotional harm.¹⁴⁶ Under this rule it is not enough for liability that the

company’s management when the losses were largely attributable to a general drop in the oil market. See 892 F.2d at 686.

143. See *supra* Section IV.A.

144. See, e.g., *Kellogg Brown & Root Servs., Inc. v. United States*, 728 F.3d 1348, 1371 (Fed. Cir. 2013) (“[F]raud must be a but-for cause of the outcome to satisfy the requirements of common-law fraud.”); *Moore v. PaineWebber, Inc.*, 189 F.3d 165, 176 (2d Cir. 1999) (“What is true in negligence cases is also true in fraud cases (and hence in RICO fraud cases) insofar as but-for cause is concerned.”); *Price v. Philip Morris, Inc.*, 848 N.E.2d 1, 52 (Ill. 2005) (“In the context of a fraud claim, as in a negligence claim, cause-in-fact is ‘but for’ cause.”); *Robinson v. Perpetual Servs. Corp.*, 412 N.W.2d 562, 567 (Iowa 1987) (applying “the two-part test: (1) But for defendant’s fault, plaintiff’s injuries would not have occurred; and (2) Defendant’s fault must be a substantial factor in bringing about plaintiff’s harm.” (quotation omitted)).

Issues of actual causation and proximate cause are dealt with in the law of securities fraud under the confusing rubrics “transaction causation” and “loss causation.” The fraud-on-the-market theory adopted in *Basic Inc. v. Levinson*, 485 U.S. 224, 247 (1988), relieves the plaintiff of the need to establish reliance or transaction causation but leaves open the possibility that damages may be denied because of the absence of loss causation. See Jill E. Fisch, *Cause for Concern: Causation and Federal Securities Fraud*, 94 IOWA L. REV. 811, 819 (2009) (“If *Basic* had opened the litigation floodgates by relaxing the reliance requirement, perhaps courts could use loss causation to close them.”). Transaction causation, which is sometimes referred to as actual causation, remains an issue in a case not covered by the fraud-on-the-market theory. Transaction causation is determined by applying a but-for test. See *Emergent Capital Inv. Mgmt., LLC v. Stonepath Grp., Inc.*, 343 F.3d 189, 196–97 (2d Cir. 2003) (“[T]ransaction causation refers to the causal link between the defendant’s misconduct and the plaintiff’s decision to buy or sell securities. It is established simply by showing that, but for the claimed misrepresentations or omissions, the plaintiff would not have entered into the detrimental securities transaction.”).

145. RESTATEMENT (THIRD) OF TORTS: LIAB. FOR ECON. HARM § 11 cmt. a (AM. LAW INST., Tentative Draft No. 2, 2014). The Restatement provides a minor qualification to the rule. When a plaintiff is “influenced by several sources . . . [l]iability is nevertheless intact if the defendant’s fraud made a necessary contribution to the plaintiff’s loss.” *Id.* The comment goes on to explain that when a defendant makes multiple representations to a plaintiff, some true and at least one a lie, then the lie is a necessary cause even if the truthful representations would have been sufficient to induce the plaintiff to enter into the transaction, if the fact finder determines the lie would have been sufficient by itself to induce the plaintiff to enter into the transactions in the absence of the truthful representations. See *id.* § 11 illus. 4. *Porreco v. Porreco* illustrates how slight this qualification is if interpreted literally. See *supra* Section IV.A. The lie about the value of the engagement ring would be a cause of Susan’s decision to sign the prenuptial agreement only if the fact finder determined she probably would have signed the agreement if this had been the only representation Louis made to her.

146. See RESTATEMENT (THIRD) OF TORTS: LIAB. FOR PHYSICAL & EMOTIONAL HARM § 29 cmt. d (AM. LAW INST. 2010) (“Central to the limitation on liability of this Section is the idea than an actor should be held liable only for harm that was among the potential harms—the risks—that made the actor’s conduct tortious.”). For example, if the defendant gives a lightweight, loaded gun to a young child and the child

defendant's misrepresentation induced the plaintiff to enter into a transaction in which the plaintiff incurred a loss. The plaintiff must also establish "that the fact misrepresented increased the risk of the specific damages claimed."¹⁴⁷ Often, when the plaintiff incurs a loss on a transaction as a result of a misrepresentation, the loss is a result of the interaction between a risk about which the defendant misled the plaintiff (for example, the quality of a company's management) and other risks (for example, a fall in the market).¹⁴⁸ The harm-within-the-risk rule allows a court to deny or limit damages in such a case by finding that the poor quality of the company's management (the misrepresented fact) did not increase the risk of a fall in the market.¹⁴⁹

D. THE INFLUENCE OF RULES ON CAUSATION FOR SECURITIES FRAUD AND NEGLIGENT MISREPRESENTATION

Although there may be a causal connection between the demise of the intended reliance rule in the United States and the tightening of the rules on causation and proximate cause, the strength of the connection should not be overstated. Another development in the law of misrepresentation in the twentieth century probably had more of an influence. This was the creation of new causes of action for misrepresentation, in particular the statutory private right of action for securities fraud under Rule 10b-5¹⁵⁰ and the common law action for

drops the gun, which breaks the child's toe but does not discharge, then the harm to the child's toe is not within the scope of liability; the risk that made it negligent to give the gun to the child was that the gun would discharge as a result of being mishandled, not that the child would injure his toe by dropping the gun.

147. *Spreitzer v. Hawkeye State Bank*, 779 N.W.2d 726, 742 (Iowa 2009).

148. *See* Fisch, *supra* note 144, at 841.

149. The example is based on the facts of *Bastian v. Petren Resources Corp.*, 892 F.2d 680 (7th Cir. 1990), which is discussed below. The harm-within-the-risk rule invites a court to disaggregate a risk about which the defendant misled the plaintiff and other risks, which interacted to cause a loss on a transaction, by isolating the effect the misrepresentation had on the price the defendant agreed to pay (or accept) in the transaction. This measure of damages is often referred to as "out-of-pocket" damages. *See* *Lawton v. Nyman*, 327 F.3d 30 (1st Cir. 2003). In *Lawton*, the plaintiffs had an 8.8% interest in a closely held family corporation that had fallen on hard times. *See id.* at 33. They redeemed their shares for \$200 per share in May 1996 after the defendants, two brothers who controlled the corporation, told them this was a "once in a lifetime" opportunity while failing to disclose a potential buyer for the company who was willing to pay much more. *See id.* at 34-36. Sixteen months later the company was bought out for more than \$2,000 per share. *Id.* at 36. The plaintiffs sued claiming they had been defrauded. *Id.* at 37. The district court found the plaintiffs were defrauded and awarded \$2,200 per share as compensatory damages. The First Circuit reversed and held that compensatory damages might be limited to the plaintiffs' out-of-pocket loss on the date they redeemed their shares, which was put at \$103 per share, based on the book value of a share (\$303). *Id.* at 43, 51. On remand, the district court found a way to reinstate much of its original damage award by finding that the shares of the company "had a strategic value that was much greater than the 'financial' value of \$303 per share." *Lawton v. Nyman*, 357 F. Supp. 2d 428, 438 (D.R.I. 2005). The court further found that the plaintiffs would have retained ownership of their shares had the defendants not breached their fiduciary duty, *id.* at 438, that is, the loss was caused by the defendants' wrong.

150. 17 C.F.R. § 240.10b-5 (2017). The modern 10b-5 securities fraud class action is the product of a series of decisions by the U.S. Supreme Court and courts of appeals over the span of a quarter-century recognizing a private right of action and then gradually loosening its elements. *See* Amanda M. Rose,

negligent misrepresentation.¹⁵¹ Courts developed rules on actual causation, proximate cause, and damages in these new actions that tend to limit the scope of a defendant's liability and tend to make damages easier to measure. These rules have bled over into the law of deceit. Courts widely assume the same rules on actual causation and proximate cause apply all across all misrepresentation actions. When a plaintiff brings a deceit action alongside one of the newer actions, a court will apply rules on actual causation and proximate cause developed in the newer actions to the plaintiff's deceit claim.

This dynamic is near the surface in *Bastian v. Petren Resources Corp.*¹⁵² There, the plaintiffs sought to recover large losses they incurred on an investment in oil and gas limited partnerships claiming misrepresentations and misleading omissions concerning the competence and integrity of the company's managers in offering documents.¹⁵³ The complaint included a securities fraud class action claim, a civil RICO claim, and a common law fraud claim. The district court dismissed the federal claims with prejudice on the pleadings because the plaintiffs had not alleged "loss causation." Apparently, the plaintiffs made no effort in their pleadings to establish the loss was attributable to bad management rather than to a downturn in the oil market. The Seventh Circuit affirmed the district court.¹⁵⁴ Judge Posner's opinion explains: "what securities

Reforming Securities Litigation Reform: Restructuring the Relationship Between Public and Private Enforcement of Rule 10b-5, 108 COLUM. L. REV. 1301, 1307–18 (2008). This process culminated in the U.S. Supreme Court's 1988 decision that endorsed the fraud-on-the-market theory. See *Basic Inc. v. Levinson*, 485 U.S. 224, 247 (1988). Academics, litigants, and lower courts developed the theory to make 10b–5 class actions certifiable by eliminating individualized factual issues involving reliance and damages. See *id.* at 247 & nn.25–26. The fraud-on-the-market theory creates a presumption of reliance when a plaintiff is able to establish that a misrepresentation affected the price of a security traded on "efficient markets." See *id.* at 241–42. Damages are measured by the amount a misrepresentation distorted the price of a security. See Fisch, *supra* note 144, at 844–45; Donald C. Langevoort, *Basic at Twenty: Rethinking Fraud on the Market*, 2009 WIS. L. REV. 151, 181–82. Langevoort reports: "*Basic* was a boon to plaintiffs, leading to a rapid increase in the number of fraud-on-the-market suits after 1988—the number of filings had already tripled by 1991, and continued to rise dramatically over the next fifteen years." Langevoort, *supra*, at 179 (footnote omitted).

The scienter rule in the 10b–5 action requires that the defendant have known the representation to be false, or have been conscious of a sufficient risk the representation was false to make the representation reckless. See *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 193 & n.12 (1976). There is no requirement of intended reliance, or even a requirement that the defendant had reason to expect the plaintiff would rely on the representation. See *AUSA Life Ins. Co. v. Ernst & Young*, 206 F.3d 202, 220–21 (2d Cir. 2000). A tightening of the pleading rules makes the defendant's purpose in making the misrepresentation an issue in 10b–5 litigation. The Private Securities Litigation Reform Act requires that a plaintiff plead with particularity facts that give rise to a "strong inference" that the defendant knew the representation to be false or was reckless with regards to its falsity. 15 U.S.C. § 78u-4(b)(2)(A) (2012); *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 551 U.S. 308, 314 (2007). Among the facts that help to establish a strong inference of a culpable state of mind is that the defendant "benefitted in a concrete and personal way from the purported fraud." *Novak v. Kasaks*, 216 F.3d 300, 311 (2d Cir. 2000).

151. For the history of the negligent misrepresentation action in the United States, see Mark P. Gergen, *Negligent Misrepresentation as Contract*, 101 CALIF. L. REV. 953, 966–68, 982–89 (2013).

152. 892 F.2d 680.

153. *Id.* at 682.

154. *Id.* at 686.

lawyers call ‘loss causation’ is the standard common law fraud rule . . . merely borrowed for use in federal securities fraud cases.”¹⁵⁵ He continues: “‘Loss causation’ is an exotic name . . . for the standard rule of tort law that the plaintiff must allege and prove that, but for the defendant’s wrongdoing, the plaintiff would not have incurred the harm of which he complains.”¹⁵⁶ The district court dismissed the plaintiffs’ state law deceit claim without prejudice to allow the plaintiffs to refile the claim in state court.¹⁵⁷ The plaintiffs refiled the fraud claim in an Illinois state court, which granted a motion to dismiss on the state claims, largely relying on Judge Posner’s reasoning in the federal case on the federal statutory claims.¹⁵⁸

Returning to *Porreco v. Porreco*,¹⁵⁹ the Pennsylvania Supreme Court could have used the case as a vehicle to establish and to apply tight rules on actual causation and proximate cause, relying on cases like *Bastian*. The court legitimately could have held that no reasonable person could find that Louis’s lie about the value of the engagement ring was a probable but-for cause of Susan’s decision to sign the prenuptial agreement. Alternatively, the court legitimately could have held that the only fact about which Louis misled Susan was the value of the engagement ring, so the only harm she suffered when the prenuptial agreement went into effect that was related to the lie was that she was \$21,000 poorer than she was led to believe she would be at that time. Either or both of these grounds for the outcome is vastly superior to holding Susan’s reliance on

155. *Id.* at 683. Judge Posner may err in equating loss causation with the element of actual causation in tort law. The concept may be closer to the concept of proximate cause. In the typical securities fraud case in which absence of loss causation is a basis for a finding of no liability, the defendant’s misrepresentation arguably induced the plaintiff to purchase a security, but the plaintiff is suing to recover a loss that resulted from the occurrence of a risk unrelated to the subject matter of the misrepresentation. *See, e.g.,* Emergent Capital Inv. Mgmt., LLC v. Stonepath Grp., Inc., 343 F.3d 189, 197 (2d Cir. 2003) (explaining the similarity of loss causation to the tort law concept of proximate cause). *AUSA Life Insurance Co.*, 206 F.3d 202, is a leading case. There, the defendant provided audited financial statements to satisfy financial covenants in bonds held by the plaintiff. The statements failed to note accounting irregularities that materially overstated a company’s net operating income and assets. *Id.* at 205. The errors did not affect the company’s cash balances and actual cash flows or its ability to pay principal and interest on its debt. *See AUSA Life Ins. Co. v. Ernst & Young*, 991 F. Supp. 234, 250 (S.D.N.Y. 1997), *rev’d in part*, 206 F.3d 202 (2d Cir. 2000). The company failed some time later as a result of the acquisition of a computer retailer and a general downturn in the economy. *AUSA Life Ins. Co.*, 206 F.3d at 206. The loss on the bonds was held not to be within the scope of liability. The case split the three judges in the court of appeals. Judge Oakes wrote the opinion for the court, remanding the case with an instruction to the district court to determine whether the defendant could have foreseen that the misstatements might result in the failure of the company. *Id.* at 220 (majority opinion). Judge Jacobs would have affirmed the district court’s decision denying the claim finding the acquisition of the computer retailer was patently unrelated to the misstatements. *Id.* at 228 (Jacobs, J., concurring). Chief Judge Winter would have allowed the claim to proceed reasoning that the statements misled lenders about management’s honesty and willingness to take risks. *Id.* at 228 (Winter, C.J., dissenting). On remand, the district court found the losses to be outside the scope of liability. *AUSA Life Ins. Co. v. Ernst & Young*, 119 F. Supp. 2d 386, 394 (S.D.N.Y. 2000).

156. *Bastian*, 892 F.2d at 685.

157. *See Bastian v. Petren Res. Corp.*, 699 F. Supp. 161, 166 (N.D. Ill. 1988).

158. *See Bastian v. Petren Res. Corp.*, 648 N.E.2d 165, 168 (Ill. App. Ct. 1995).

159. *See supra* Section IV.A.

the honesty of her fiancé to be unreasonable as a matter of law, which is an illegitimate and insulting ground. Even better, the court could have held for Louis by applying the intended reliance rule, and then the court could have explained that the rule eliminates the need for tight rules on actual causation and proximate cause.

V. THE FUNCTIONS OF THE RULES OF JUSTIFIABLE RELIANCE

The changes in the law of deceit that followed in the wake of the elimination of the intended reliance rule occurred unnoticed. Thus, no one has addressed the normative question of whether the elimination of the intended reliance rule made it necessary to establish the requirement of reasonable reliance. To answer this question, we must identify the functions served by the rules of justifiable reliance. The rules of justifiable reliance flow from one or the other general requirements for liability in deceit.¹⁶⁰ This Part argues that the rules of justifiable reliance are justified because they reduce information costs and claim-processing costs in a class of cases in which claim-processing costs are likely to be high and the social cost of undeterred fraud is likely to be low. Part VI argues that the intended reliance rule performs these functions as well as the reasonable reliance rule while allowing fewer frauds to escape punishment.

Designing rules to deter fraud presents a problem similar to designing rules to deter tax evasion.¹⁶¹ In both cases the law tries to deter conduct that shifts wealth between people without destroying wealth. Because deterrence is costly, the socially optimal level of a wrong that involves the redistribution of wealth (and not the destruction of wealth) may be significantly greater than zero. The transfer of wealth from the victim to the fraudster is a private loss to the victim but it is not a social cost. From a social perspective, it may be the case that a significant amount of fraud is not worth deterring. The literature on fraud acknowledges its redistributive nature while focusing on the social cost of undeterred fraud that is represented by resources expended by fraudsters to extract wealth from people and resources expended by people to protect wealth from fraudsters.¹⁶²

160. See *supra* Section II.D. As explained there, the rules of justifiable reliance shield a defendant from liability in deceit when a plaintiff's reliance is unreasonable. This is explicit under the modern account of the rule. Under the old account of the rule, the unreasonableness of the plaintiff's reliance was relevant because it negated the element of intended reliance. Basically, there was a presumption that unreasonable reliance was unintended by the defendant. A plaintiff could overcome the presumption by presenting clear and convincing evidence that the defendant knew of and purposefully exploited his unreasonable disposition and beliefs.

161. See Agnar Sandmo, *The Theory of Tax Evasion: A Retrospective View*, 58 NAT'L TAX J. 643, 656–59 (2005); Joel Slemrod, *Cheating Ourselves: The Economics of Tax Evasion*, 21 J. ECON. PERSP. 25, 43 (2007).

162. See MICHAEL J. TREBILCOCK, *THE LIMITS OF FREEDOM OF CONTRACT* 104 (1993) (“[I]nvestments in fraudulent activity have no positive social value and . . . may induce socially wasteful investments by potential victims in avoidance precaution.”). But see generally Richard Craswell, *Taking Information Seriously: Misrepresentation and Nondisclosure in Contract Law and Elsewhere*, 92 VA. L. REV. 565

If these were the only social costs of concern, then the socially optimal level of fraud might be fairly low. But this analysis disregards what have been called “steering clear costs” in the area of criminal law.¹⁶³ This refers to the costs law-abiding people incur to avoid being mistakenly accused and (even worse) being mistakenly found to have committed a crime. In the law of misrepresentation, the most important steering-clear costs are costs an information provider incurs to avoid providing information that could be believed and found to be misleading. These include costs an information provider incurs to verify information, costs he incurs to communicate information to users, and costs he incurs to collect information regarding users and uses of information in order to better verify and to better communicate information. Although there may seem to be no harm in encouraging information providers to take precautions to avoid providing misleading information to people who will use the information, the cost of these precautions is socially wasteful insofar as the avoided loss is a private loss and not a social loss.

The rules of justifiable reliance reduce information costs by shielding an actor who provides misleading information from liability when a recipient’s reliance on the information is unreasonable.¹⁶⁴ The rules reduce claim-processing costs

(2006) (examining precautionary costs incurred by information suppliers to avoid liability for misrepresentation and nondisclosure).

163. See, e.g., Richard A. Posner, *An Economic Theory of the Criminal Law*, 85 COLUM. L. REV. 1193, 1225–26 (1985); see also Jeffrey S. Parker, *The Economics of Mens Rea*, 79 VA. L. REV. 741, 754 (1993) (observing that highly punitive sanctions are used in criminal law to overcome the low probability of detection, which in turn “creates a second information problem, as the highly punitive sanction induces private actors to overinvest in determining whether they are violating the law”).

164. Experience with the 10b–5 securities fraud class action provides a real-world example of how the risk of liability in deceit may impose socially undesirable information costs. The presence of the risk of 10b–5 liability has induced firms to take precautions to avoid disseminating information that might lead to a lawsuit, imposing significant information costs. See Rose, *supra* note 150, at 1332–33. For example, when a firm has to correct earlier information, managers will package the corrective information with other information to reduce the risk that a plaintiff will be able to establish that the correction affected the price of a firm’s securities. See, e.g., Barbara A. Bliss et al., *Information Bundling and Securities Litigation* 6–7, 31 (San Diego Legal Studies, Paper No. 16-219, 2016), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2795164 [<https://perma.cc/6M7R-CW35>] (finding evidence that the *Dura* ruling altered how firms bundled information and reporting other studies that firms alter how they present evidence to reduce liability risk).

There is no real social value in a firm managing how it presents information to make it difficult for a plaintiff to get past a motion to dismiss on a securities fraud claim. But there also is not much social value in a firm taking greater precautions to avoid disseminating misleading information, which is another way for a firm to reduce its liability risk. When a misstatement regarding a publicly traded security results in the security being temporarily over-priced, the private loss to purchasers who pay a temporary premium is offset by the private gain to sellers whom are paid the temporary premium. The social cost of securities misstatements does not lie in the trading gains and losses created by a misstatement, the social cost of securities misstatements lies in secondary effects, such as increased precautions investors take to protect against fraud and increased market volatility created by temporary price distortions. See Paul G. Mahoney, *Precaution Costs and the Law of Fraud in Impersonal Markets*, 78 VA. L. REV. 623, 630–31, 631 n.21 (1992).

Several features of the 10b–5 action amplify the risk of liability and the managerial response. A 10b–5 lawsuit has a highly salient triggering event: a correction by a firm of previously issued

in a straightforward way by enabling courts to dismiss deceit claims involving unreasonable reliance without a trial, either on a motion to dismiss or on a motion for summary judgment. Inevitably, the rules will allow some fraudsters to escape liability when a victim's reliance is unreasonable. Although this is troubling as a matter of fairness, it makes sense as a matter of social policy because claim-processing costs are likely to be high and the social cost of undeterred fraud is likely to be low in cases in which a plaintiff's reliance on a misrepresentation is unreasonable. This Part explains these points, beginning with information costs.

A. INFORMATION COSTS

Information costs come in several forms. Assume *A* has access to information about *x*, which is a matter of possible interest to *B*. *A* may incur three different types of information costs to provide information about *x* to *B*. *A* may incur costs to collect¹⁶⁵ better information about *x*. *A* may incur costs to better communicate information about *x* to *B*. *A* may also incur costs to collect information about *B* to better know what information about *x* is useful to *B* and to better know how to communicate information about *x* to *B*.

information that is associated with a significant movement in the price of a security. See Bliss et al., *supra*, at 4–5. A firm's managers can expect a 10b–5 lawsuit if there is a triggering event because plaintiff's firms monitor securities markets for such events. Firm managers are well aware of what triggers a 10b–5 lawsuit, so they manage the information the firm disseminates to avoid a triggering event. See *id.* at 2–3. Managers have a strong incentive to avoid a triggering event because once a 10b–5 lawsuit gets past a motion to dismiss and a class action is certified, a firm has little choice but to settle a claim. See Rose, *supra* note 150, at 1323 n.101. This has the knock-on effect that a firm will incur large litigation expenses to forestall class certification. See John C. Coffee, Jr., *Reforming the Securities Class Action: An Essay on Deterrence and its Implementation*, 106 COLUM. L. REV. 1534, 1540–42, 1546 (2006) (explaining why few claims settle prior to class certification and reporting litigation costs). Managers of large, publicly traded firms are skilled at managing risk. It is a large part of what they do for a living.

These concerns are exacerbated by an agency problem that is endemic to securities-fraud class actions. The costs of securities class actions “fall largely on the defendant corporation, [ultimately] its shareholders” and not the corporate agents who are responsible for a fraud. Coffee, *supra*, at 1536. Indirect deterrence is less effective. See *id.* at 1538. Coffee rejects the criticism that many 10b–5 class actions are “strike suits” that are brought independent of the potential merits of the claim. See *id.* at 1536 n.5 (concluding after reviewing the scholarship on both sides that “[t]he true ‘strike suit’ nuisance action, filed only because it was too expensive to defend, is, in this author’s judgment, a beast like the unicorn, more discussed than directly observed”).

Agency problems are not unique to securities fraud. Often, when an agent of a firm commits fraud, it is in the agent's interest; it is not in the interest of the owners and managers of the firm, who are not complicit in the fraud. For example, a used car salesman who is a short-term employee may lie about the quality of a car to make a sale and pocket a commission. I put agency problems to the side. Often, these problems are best handled within the law of agency and the rules on vicarious liability, and not within the law of deceit. For example, agency problems may be a reason for the law of agency to give conclusive effect to a term in a form that limits the scope of an agent's authority even though the law of deceit does not give conclusive effect to a term in a form disclaiming reliance on a representation. See *infra* note 184.

165. I use the term “collect” broadly to include the costs of collecting, storing, and processing information.

If the law imposes liability on *A* for providing misleading information about *x* to *B*, then *A* may respond to reduce his legal risk by improving or altering the information he provides to *B*, incurring one or more of these types of costs. I will begin by explaining why it often is not in the interest of society, or in the joint interest of *A* and *B*, for *A* to incur costs of the first type by collecting more information about *x* to improve the quality of information he provides to *B*. Next, I will explain why *A* is likely to respond to the presence of a legal risk by incurring communication costs and incurring costs to collect more information about *B*, rather than incurring costs to collect more information about *x*.

1. The Absence of Social Value in Foreknowledge

The literature on information economics as it relates to the law of misrepresentation predominantly focuses on the first type of cost and the problem of nondisclosure.¹⁶⁶ The literature makes the important distinction between “foreknowledge” and “discovery.”¹⁶⁷ Foreknowledge refers to knowledge that “will, in due time, be evident to all.”¹⁶⁸ Discovery involves acquiring information that “[n]ature will not autonomously reveal . . . [and] only human action can extract.”¹⁶⁹ The distinction is important because gains from foreknowledge, like gains from fraud (and gains from tax evasion), tend to be redistributive and not social.

The absence of social value in foreknowledge is clear if one imagines *x* is an asset owned by *A* for which he has no plans to sell. Foreknowledge about facts altering the price of the asset is not even of private value to *A*. Unless *A* is risk adverse or impatient, he will be no better off learning now a fact affecting the value of *x* that will be revealed in time. Indeed, *A* would be made worse off if he had to spend resources to obtain foreknowledge. The disjunction between the social value and the private value of foreknowledge is clear if one imagines *B* proposes to buy *x* from *A*. Both parties have an incentive to obtain foreknowledge about facts altering *x*’s price so long as the knowledge they obtain will not be revealed to the other party. Private foreknowledge is of private value because it enables one party to profit at the other’s expense. But there is no social value in a party acquiring private foreknowledge. Whatever resources *A* and *B* expend to acquire foreknowledge to profit at the other’s expense makes them jointly worse off.

166. See, e.g., ROBERT COOTER & THOMAS ULEN, *LAW AND ECONOMICS* 271–77 (3d ed. 2000); Anthony T. Kronman, *Mistake, Disclosure, Information, and the Law of Contracts*, 7 J. LEGAL STUD. 1 (1978); Steven Shavell, *Acquisition and Disclosure of Information Prior to Sale*, 25 RAND J. ECON. 20 (1994). See generally Melvin A. Eisenberg, *Disclosure in Contract Law*, 91 CALIF. L. REV. 1645 (2003) (explaining the insights of Cooter and Ulen, Kronman, Shavell, and Hirshleifer and how they bear on when a buyer or seller should have a duty to disclose information).

167. Jack Hirshleifer, *The Private and Social Value of Information and the Reward to Inventive Activity*, 61 AM. ECON. REV. 561, 561 (1971).

168. *Id.* at 562.

169. *Id.*

The facts in *Snyder v. Lovercheck*¹⁷⁰ illustrate the concept of foreknowledge and the disjunction between the private value and the social value of foreknowledge. The case involves a sale of 2,000 acres of wheat farmland.¹⁷¹ On his initial tour of the land, the purchaser asked the seller about the extent of the volunteer rye problem on the land.¹⁷² The seller replied that he thought the problem was minor and confined to 100 acres, and that he would check with the prior owner from whom the seller had recently acquired the land. The purchaser made no further effort to investigate the extent of the rye problem other than visiting the land a number of times before agreeing to purchase it. This was during winter, so the true extent of the rye problem could not be determined by casual inspection. When the first crop came in there was rye on 1,800 acres and over 600 acres were 100% infected. The extent of the rye problem may have reduced the value of the land by as much as 25%.¹⁷³ If the seller was being truthful, and he did not know the true extent of the rye problem, then this information was foreknowledge. It would be revealed in time. The loss in the value of the land when the extent of the rye problem was revealed was largely a private loss and not a social loss.¹⁷⁴ Much of the purchaser's loss was the seller's gain. Insofar as the loss was a private loss and not a social loss, it was neither in the parties' joint interest nor in the interest of society for them to collect better information about the extent of the problem.

This disjunction between the private value and the collective value of foreknowledge creates a collective action problem. Returning to my abstract example, *A* and *B* are collectively better off if they can credibly commit not to try to obtain foreknowledge about events altering the price of *x*, or if they can credibly commit to reveal whatever foreknowledge they obtain (which eliminates the incentive to obtain foreknowledge). Private law's solution to this collective action problem is to impose a duty to disclose on a party if he has information relevant to the value of the asset that is unknown to the other party.¹⁷⁵ The rules governing when a seller has a duty to disclose a hidden defect solve this problem on the seller's side. Generally a seller has a duty to disclose known defects.¹⁷⁶ The law does not impose a duty on a seller to

170. 992 P.2d 1079 (Wyo. 1999).

171. *Id.* at 1082–83.

172. *Id.* at 1083. Actually, he asked the seller's broker. I omit this fact for the sake of simplicity. Volunteer rye refers to unwanted and unplanted rye in a wheat crop. It is bad to have rye in a wheat crop because the presence of rye reduces wheat yield and a mix of the two grains reduces the market price of a crop because the mixture makes poor flour. See DREW J. LYON & ROBERT N. KLEIN, RYE CONTROL IN WINTER WHEAT (rev. ed. 2007), <http://extensionpublications.unl.edu/assets/pdf/g1483.pdf> [<https://perma.cc/DCZ4-DGJL>].

173. The purchase price was \$526,500. The purchaser's expert testified the extent of the rye problem diminished the market value of the land to \$392,000.

174. There is a social loss if the owner would have investigated the extent of the rye problem if he had decided to sell the land to the purchaser, and if upon discovering the extent of the rye problem the owner would have planted a smaller crop or taken other measures to reduce the loss on the next crop.

175. Shavell, *supra* note 166, at 28.

176. See RESTATEMENT (SECOND) OF TORTS § 551(2) (AM. LAW INST. 1977).

investigate unknown defects to disclose them. This makes sense as a matter of information economics: if investigation merely involves the acquisition of foreknowledge, the value of which is redistributive and not social, then the investigation is socially counter-productive.

2. The Cost of Communicating Information

In a case like *Snyder v. Lovercheck*—in which *A* provides information about *x* to *B* in the course of selling *x* to *B*—the second type of information cost is of principal concern. These are costs *A* incurs to communicate information to *B*. Under private law, *A*'s liability if the information turns out to be misleading is likely to be determined by contract law (if *A* warrants or promises the information he supplies is accurate) and by the law of deceit (if *A* disclaims responsibility for the accuracy of the information he supplies).¹⁷⁷

Richard Craswell provides a general explanation of how the law of misrepresentation could increase the cost to *A* of providing information about *x* to *B*.¹⁷⁸ He observes that information rarely is “quantized” in the sense that information can be broken down into particles “in order to eliminate the particle containing the false information while leaving the truthful information untouched.”¹⁷⁹ Craswell discusses: “some particles of information may convey more than a single proposition, and thus can be both true *and* false, in the sense of conveying accurate information about some matters while conveying inaccurate inferences about others.”¹⁸⁰ Thus, “preventing misrepresentation often requires decisions about what bits of accurate information are worth giving up in order to get rid of the inaccurate bits.”¹⁸¹ Preventing misrepresentation may require both adding and subtracting bits of information. Deciding what bits of information to add or subtract to prevent misrepresentation imposes a cost on *A*. Adding bits of information imposes a cost on both *A* and *B* because there is additional information for them to process. Adding information may actually increase the

177. This oversimplifies. In most states there is no possible claim for negligent misrepresentation when a representation concerns a prospective contract between the defendant and the plaintiff. See *infra* note 185. However, in many states there is a claim under the doctrine of innocent misrepresentation. See RESTATEMENT (SECOND) OF TORTS § 552C; see also 3 DOBBS, HAYDEN & BUBLICK, *supra* note 72, §§ 668–671 (explaining liability for innocent misrepresentation generally and under a warranty theory or as a basis for rescission). In some states this is not a tort claim. Instead, it is a claim for rescission and restitution, often described as an equitable claim. See, e.g., *Hyler v. Garner*, 548 N.W.2d 864, 870, 872 (Iowa 1996) (“[T]he elements of an equitable claim for rescission based on misrepresentation are (1) a representation, (2) falsity, (3) materiality, (4) an intent to induce the other to act or refrain from acting, and (5) justifiable reliance.”). The Second Restatement covers innocent misrepresentation, treating it as a tort claim. See RESTATEMENT (SECOND) OF TORTS § 552C cmt. b (AM. LAW INST. 1977). The decision to treat the claim as a tort claim was controversial. See Alfred Hill, *Breach of Contract as a Tort*, 74 COLUM. L. REV. 40, 47 (1974) (arguing that a claim for damages for innocent misrepresentation is best handled in contract law where the parol evidence rule can be used to filter out weak claims); Alfred Hill, *Damages for Innocent Misrepresentation*, 73 COLUM. L. REV. 679, 681–82 (1973) (same).

178. See Craswell, *supra* note 162, at 594.

179. *Id.* at 570.

180. *Id.*

181. *Id.*

risk of conveying inaccurate or misleading information if there is a risk the added information is inaccurate or that *B* will misinterpret the additional information. Subtracting information may also deny *B* valuable, truthful information.

Typically, a person in *A*'s position will reduce the threat of a breach of contract claim or a deceit claim by altering the information about *x* he provides to *B*, incurring communication costs, rather than by collecting more information about *x*. This is for several reasons. Usually, altering the information provided to *B* will require less effort and expense than collecting additional information about *x*. Logically, if collecting additional information about *x* is not in the joint interest of *A* and *B*, then it will not be in *A*'s private interest, unless *A* is able to capture a larger share of the gains from trade whatever the new information reveals. The opposite is likely to be true. If investigation reveals negative information about *x*, then *A* will have to disclose this information to *B* (or face an even greater risk of liability in deceit), which will result in a price reduction. Thus, *A* will bear the risk of loss if information he discovers is negative. On the other hand, if investigation reveals positive information, then *A* is unlikely to be able to capture the full value of the positive information through a price increase unless *A* is willing to guarantee the quality of *x* the positive information reveals that warrants a price increase. The guarantee increases *A*'s liability risk if the updated information turns out to be inaccurate. Furthermore, if *A* is inclined to be loss averse, like most people, he will be disinclined to collect further information about *x* because he will assign a greater weight to the loss if the information that is revealed is negative than the gain if the information revealed is positive, even if he is able to capture the gain from positive information. Finally, communicating whatever additional information *A* discovers often will increase communication costs.

Snyder v. Lovercheck illustrates this point.¹⁸² The seller in *Snyder* is unlikely to respond to the liability risk by collecting more information about the extent of the rye problem. If he collects more information, which reveals the extent of the rye problem is worse than he believes, then he must communicate this information to the purchaser (or face an increased threat of a deceit claim), which will result in the purchaser demanding a price reduction. On the other hand, if the new information confirms his belief that the extent of the rye problem is minor, then the seller is unlikely to be able to demand a commensurate price increase unless he is willing to guarantee the extent of the rye problem is minor. Making a guarantee increases his liability risk if the extent of the rye problem is greater than expected.

Instead, the seller will act to reduce the threat of a breach of contract claim and a deceit claim by altering the information he communicates to the purchaser. The simple answer the seller gave to the purchaser's question about the extent of the rye problem conveys information that can be both true and false. It

182. See *supra* Section V.A.1.

is a true statement of the seller's opinion, but it may convey a false sense of the seller's confidence in the opinion. The seller could avoid conveying a false impression by subtracting information, for example by refusing to answer the purchaser's question about the extent of the rye problem. Yet this has costs. The purchaser may infer from the seller's refusal to answer his question that the problem is worse than the seller believes it to be. The seller could add information, for example, by explaining that his opinion is based on limited information. This requires the seller to decide how much background information to provide, and it requires the seller to confirm any background information he does provide, to avoid the risk of providing false information.

The seller in *Snyder v. Lovercheck* did what many honest (and dishonest) sellers do. He gave a brisk answer to the purchaser's question and covered his legal risk by including an "as is" clause in the contract as well as a term in which the purchaser disclaimed relying on any representations made by the seller.¹⁸³ The legal issue in the case was the effect to be given to these exculpatory terms on the purchaser's negligent misrepresentation and deceit claims.

3. The Cost of Collecting Information About the Recipient

The threat of a breach of contract claim or a deceit claim may also induce *A* to collect information about *B*, imposing the third type of information costs. The concern for this type of information cost typically is associated with the tort of negligent misrepresentation and cases in which an actor disseminates information upon which many people may rely, such as when an auditor certifies the accounts of a large, publicly traded company.¹⁸⁴ There are obvious information

183. *Snyder v. Lovercheck*, 992 P.2d 1079, 1083 (Wyo. 1999).

184. Often this is expressed as a concern for indeterminate liability. See, e.g., *Ultramares Corp. v. Touche*, 174 N.E. 441, 444 (N.Y. 1931) (stating concern for indeterminate liability). There is a special rule that shields an actor from liability that would be indeterminate. See RESTATEMENT (SECOND) OF TORTS § 552(2) (AM. LAW INST. 1977). The concern for these types of costs also justifies the intended reliance requirement in the law of negligent misrepresentation. An actor owes a duty of care in supplying information only if the actor intends the recipient to rely on the information. See, e.g., *Bily v. Arthur Young & Co.*, 834 P.2d 745, 749 (Cal. 1992). Under New York law, the defendant must have been aware that the information would be used for a particular purpose or purposes, the defendant must have intended the plaintiff (or a class of persons in which the plaintiff belongs) to be able to rely on the information, and there must be a sufficiently close relationship between the plaintiff and defendant to "evinced [the defendant's] understanding of [the plaintiff's] reliance." *Credit All. Corp. v. Arthur Andersen & Co.*, 483 N.E.2d 110, 118 (N.Y. 1985).

The intended reliance rule limits the users and uses an information provider must investigate to ascertain his legal risk, reducing information costs. See Mark P. Gergen, *Privity's Shadow: Exculpatory Terms in Extended Forms of Private Ordering*, 43 FLA. ST. U. L. REV. 1, 39–43, 84–89 (2015) [hereinafter Gergen, *Privity's Shadow*]. The savings in information costs are stark if one compares the intended reliance rule with a rule that conditions the existence of liability on the risk a court will find the recipient's reliance to be reasonable. Such a rule creates a liability risk for a vastly larger set of information for the simple reason that it is much more common for reliance on information to be reasonable when it is unintended than it is for reliance on information to be unreasonable when it is intended. The information an actor needs to determine his liability risk may be more costly to acquire;

costs in making an auditor who certifies the accounts of a large, publicly traded company liable in negligence for far-flung losses if the auditor fails to detect a material error in the books. An auditor would have to acquire information about the extent of possible losses if he failed to detect a material error in the books to be able to determine the appropriate level of care or to otherwise manage his liability risk.

4. Some Ways the Common Law Reduces Information Costs

Snyder v. Lovercheck illustrates some of the ways that the common law reduces information costs. In that case, the Wyoming Supreme Court held that the exculpatory terms precluded a claim for negligent misrepresentation.¹⁸⁵ The

an actor may have to investigate the personal characteristics and situation of a recipient of the information to determine the recipient's proclivity to rely on the information.

There is a subtle difference between the intended reliance duty rule in the law of negligent misrepresentation and the intended reliance scienter rule in the law of deceit. The latter rule requires that the defendant have subjectively intended to influence the plaintiff to rely. *See supra* Section II.B. The intended reliance duty rule in the law of negligent misrepresentation does not require the defendant to have subjectively intended to influence the plaintiff to rely. *See Gergen, supra* note 151, at 959–66. Instead, the rule requires the defendant to have reasonably appeared to have subjectively intended to invite the plaintiff's reliance. *See id.* To be more precise, an actor has a duty of care in supplying information to another if the recipient subjectively believes the actor subjectively intends to invite his reliance on the information, and the actor objectively appears to intend to invite the recipient's reliance. *See id.* This duty rule is similar to rules in contract law that make an actor's contractual obligation turn on his manifest or apparent intent, not his actual intent. *See, e.g.,* RESTATEMENT (SECOND) OF CONTRACTS §§ 20, 201 (AM. LAW INST. 1981). Properly speaking, the duty rule is not a scienter rule. It is a conduct rule under which an actor's conduct matters because it expresses his intent. *See* Kenneth W. Simons, *Rethinking Mental States*, 72 B.U. L. REV. 463, 476–77 (1992) (explaining the difference between a scienter rule and a conduct rule).

185. *Snyder*, 992 P.2d at 1089. The Third Restatement adopts a broader rule that categorically excludes a negligent misrepresentation claim based on a representation concerning a prospective or existing contract between the plaintiff and defendant. *See* RESTATEMENT (THIRD) OF TORTS: LIAB. FOR ECON. HARM § 5(5) (AM. LAW INST., Tentative Draft No. 1, 2012); *see also* Gergen, *Privacy's Shadow*, *supra* note 184, at 69–82 (considering the differences between the two rules).

Sometimes the absence of negligence liability in a case like *Snyder* is explained by the absence of justifiable reliance. This is curious because justifiable reliance is usually defined as reasonable reliance, which is said to be a jury issue when the issue is in doubt. *See, e.g.,* All. Mortg. Co. v. Rothwell, 900 P.2d 601, 608–09 (Cal. 1995) (in bank). Nevertheless, courts often find reliance to be unjustifiable as a matter of law, applying rules on materiality, “opinion, statements of law, future predictions, or puffing.” 3 DOBBS, HAYDEN & BUBLICK, *supra* note 72, § 672 n.1. I have argued elsewhere that liability for negligent misrepresentation is best understood in contractual terms. *See* Gergen, *supra* note 151. Thus, liability usually requires that a plaintiff's reliance be objectively reasonable, with courts giving conclusive effect to forms that people use to signify that reliance is not intended.

Courts have struggled with defining the relationship between justifiable reliance as an element of the plaintiff's prima facie claim and the defense of contributory negligence. Some courts treat justifiable reliance as an element of the claim and contributory negligence as a separate defense, which a defendant may raise to reduce his liability if reliance is found to be justifiable. *See, e.g.,* Hicks v. Eller, 280 P.3d 304, 311 (N.M. Ct. App. 2012) (describing this as the majority approach). Other courts treat justifiable reliance as an element of the claim and do not permit a defendant to assert contributory negligence as a defense to reduce his liability if reliance is found to be justifiable. *See, e.g.,* Estate of Braswell *ex rel.* Braswell v. People's Credit Union, 602 A.2d 510, 515 (R.I. 1992). Another possible approach is to eliminate justifiable reliance as an element of the prima facie claim and treat the plaintiff's negligence as a defense and a basis for reducing damages under principles of comparative

concerns for all three types of information costs explain why the common law does not impose negligence liability in this situation. Although the buyer is likely to be incensed by the seller's neglect to verify his information regarding the extent of the rye problem, it is not in society's interest or in the parties' joint interest for the seller to verify his information because the loss is a private loss and not a social loss. The concern for the second and third types of information costs explains why a person in the seller's position can shield himself from liability in negligence and in contract by including an exculpatory term in a contract. This rule enables a party in the seller's position to cheaply communicate to a sophisticated purchaser (and to a court) that he is not legally responsible for the accuracy of information he supplies.¹⁸⁶ This in turn enables the seller to communicate the information he has without alteration and without having to investigate to ascertain whether the purchaser actually understands the terms under which the seller is communicating the information. More generally, the common law encourages parties to a contract to determine by contract any liability for the accuracy of information supplied concerning a contract. Private ordering is preferred because contract law and the law of negligent misrepresentation do not directly address the problem of liability being a function of the private cost of information being misleading rather than the social cost, which often is lower than the private cost. The common law addresses this general problem indirectly by encouraging parties to a contract to address the allocation between them of loss if information turns out to be false in their contract.

The purchaser's deceit claim in *Snyder* presented a more difficult question of law and of policy. These difficulties are reflected in a disagreement over whether an exculpatory term can preclude a claim for fraud. The seller argued that the Wyoming Supreme Court should adopt the New York rule that prevents a sophisticated party from claiming fraud in the inducement when he signs a contract with an exculpatory term.¹⁸⁷ The Court declined to adopt the New York rule. Instead, it affirmed the trial court's decision granting summary judgment for the seller by applying the rule that requires fraud to be proven by clear and convincing evidence.¹⁸⁸ This is the majority rule.¹⁸⁹

responsibility. See RESTATEMENT (THIRD) OF TORTS: LIAB. FOR ECON. HARM § 5 cmt. j (AM. LAW INST., Tentative Draft No. 1, 2012).

186. Unsophisticated purchasers raise difficult legal and normative issues.

187. See *Snyder*, 992 P.2d at 1084–85 (discussing *Danann Realty Corp. v. Harris*, 157 N.E.2d 597, 598 (N.Y. 1959)).

188. *Id.* at 1086.

189. For a survey of the cases, see Allen Blair, *A Matter of Trust: Should No-Reliance Clauses Bar Claims for Fraudulent Inducement of Contract?*, 92 MARQ. L. REV. 423, 445–50 (2009). See generally Mark P. Gergen, *Contracting Out of Liability for Deceit, Inadvertent Misrepresentation and Negligent Misstatement*, in EXPLORING CONTRACT LAW 237, 239–54 (Neyers et al. eds., 2009) (explaining the range of approaches taken by states on the effect of a contractual disclaimer of responsibility for the accuracy of a representation on possible claims of deceit, innocent misrepresentation, or negligent misrepresentation).

The choice between the New York rule and the majority rule involves trade-offs that are somewhat similar to the choice between the intended reliance rule and the reasonable reliance rule. The New York rule enables a court to dismiss deceit claims on a motion to dismiss in a case within the rule. The majority rule gives the plaintiff an opportunity for discovery while enabling a court to dismiss a claim on summary judgment if the plaintiff does not have clear and convincing evidence of culpable intent. I will return to the relative merits of the two rules in Part VI. My immediate interest is something the two rules have in common. Both rules resolve doubts about the existence of fraud in favor of the person accused of fraud.¹⁹⁰ Although this policy may be worrisome

190. That A honestly believes the information about x he supplies to B is true does not shield A from the risk of liability for deceit. Psychologically, an individual may engage in deception while being unaware that he is doing so because he deceives himself as well as his victim. People have a great capacity for self-deception. See Robert Trivers, *Deceit and Self-Deception*, in *MIND THE GAP: TRACKING THE ORIGINS OF HUMAN UNIVERSALS* 373, 374 (Peter M. Kappeler & Joan B. Silk eds., 2010) (arguing that a major function of self-deception is that it “evolves in the service of deception (1) the better to avoid its detection and (2) to reduce the immediate cognitive costs”).

In addition, a court cannot observe A’s state of mind regarding the truth of the information he supplies. A court may incorrectly infer that A knew the information was false from the availability to A of the means to determine the information was false. See, e.g., *Ultramares Corp. v. Touche*, 174 N.E. 441, 449 (N.Y. 1931). The defendant Touche, a public accountant, certified the balance sheet of Fred Stern & Co., which showed the company had a net worth in excess of \$1 million. *Id.* at 442. The plaintiff Ultramares sold rubber to Fred Stern & Co. on credit, relying on the certified balance sheets. *Id.* at 443. In fact, the company was insolvent and its books had been falsified to hide this fact. *Id.* at 442. This could have easily been discovered if the auditors had examined the paperwork behind some suspicious accounts receivable. *Id.* at 443. The plaintiff sued the defendant claiming both negligence and deceit. The trial court dismissed the deceit claim on the ground that there was insufficient evidence of fraudulent intent. It submitted the negligence claim to the jury, which found liability, but ultimately dismissed the claim finding no duty to the plaintiff. The appellate division affirmed the dismissal of the deceit claim but reinstated the verdict on the negligence claim.

The New York Court of Appeals reversed the verdict on the negligence claim but remanded the case so the deceit claim could be submitted to the jury. *Id.* at 550. The case is mostly remembered for the holding on the negligence claim, which established the rule in New York that liability in negligent misrepresentation requires that the defendant and the plaintiff be in a relationship of near privity. See *id.* at 444–48.

My interest in the case is in the handling of the deceit claim. Justice Cardozo found that the jury could infer fraudulent intent from evidence of gross negligence, invoking a “principle . . . that [gross] negligence or blindness, even when not equivalent to fraud, is none the less evidence to sustain an inference of fraud.” *Id.* at 449. He also found that the jury could infer fraudulent intent from the availability to the auditors of facts calling the accuracy of a representation into question (the suspicious accounts receivable) when the auditors did not investigate the facts; in other words, the jury could infer that the auditors chose to close their eyes to the truth. *Id.* (“The defendants were put on their guard by the circumstances touching the December accounts receivable to scrutinize with special care. A jury might find that, with suspicions thus awakened, they closed their eyes to the obvious, and blindly gave assent.”).

There is an additional risk that if A appears to have been careless regarding the accuracy of information, then a court will be offended by A’s negligence and find culpable knowledge as a roundabout way to redress negligence. Leon Green thought this to be a feature and not a bug of the law of deceit because it meant courts could use the tort to redress negligence, eliminating the need for an explicit rule of negligence liability. See Leon Green, *Deceit*, 16 VA. L. REV. 749, 755–58 (1930). This may explain Justice Cardozo’s behavior in his *Ultramares Corp.* opinion, which excoriates Touche for

on moral grounds, I have explained that it is partly justified by the concern for information costs. I now turn to two other justifications.

B. CLAIM-PROCESSING COSTS

The rules of justifiable reliance reduce claim-processing costs in a straightforward way by enabling courts to dismiss a claim involving unreasonable reliance prior to trial, either on a motion to dismiss or a motion for summary judgment.¹⁹¹ The reduction in claim-processing costs is likely to be large because liability for deceit turns on information concerning a party's mental state, which is not observable to the other party or to a court. When information about the true value of a legal claim is observable to only one party and is hidden to the other party, it reduces the probability of settlement and delays settlements that occur, thereby increasing claim-processing costs.¹⁹² This effect is exacerbated not only when information about the true value of a legal claim is hidden from the other party at the start of the lawsuit, but also when the information is hidden from the court at the end of the lawsuit if the claim is litigated.

The unobservable nature of mental states also creates problems in contract law because contractual liability will often depend on the parties' mental states regarding the making and terms of an agreement.¹⁹³ Contract law functions reasonably well because language and legal forms enable people to communicate with each other and with courts to manifest their intent regarding the existence and terms of a contract. One way contract law responds to this problem is by having rules of form, like the parol evidence rule and the plain-meaning rule, both of which give parties dependable means to express

the negligence of its auditors. He may have stretched to find the possibility of fraudulent knowledge to give the plaintiff a shot at a remedy for the auditors' gross negligence.

191. Presumably the rules also deter plaintiffs from filing some claims involving unreasonable reliance, further reducing claim-processing costs.

192. See Andrew F. Daughety & Jennifer F. Reinganum, *Settlement*, in *PROCEDURAL LAW AND ECONOMICS* 386, 443–44 (Chris William Sanchirico ed., 2012). Common psychological biases may also make it difficult for parties to settle a deceit claim. A deceit claim impugns the defendant's honesty. It is not easy to admit you are a liar. Meanwhile the plaintiff will have suffered a loss from a decision he made after receiving false information from the defendant that favored the decision. Often the defendant will have benefited from the plaintiff's decision. People who make decisions they regret often seek to blame others for the decision. The misrepresentation makes the defendant a natural target for the plaintiff's blame. A defendant who argues that his misrepresentation did not actually influence the plaintiff's action is likely to be seen by the plaintiff as evading and shifting blame back to the plaintiff. If the defendant argues that the plaintiff was unreasonable to rely on his representation, he also impugns the plaintiff's judgment.

193. The classical theory of contract took the extreme position: "A contract has, strictly speaking, nothing to do with the personal, or individual, intent of the parties. A contract is an obligation attached by the mere force of law to certain acts of the parties, usually words, which ordinarily accompany and represent a known intent." *Hotchkiss v. Nat'l City Bank of N.Y.*, 200 F. 287, 293 (S.D.N.Y. 1911). Although modern theories of contract reject this extreme view, they accept that contract is a matter of manifested intent. See, e.g., *RESTATEMENT (SECOND) OF CONTRACTS* § 3 (AM. LAW INST. 1981) (defining agreement as "a manifestation of mutual assent").

their intent to each other and to a court.¹⁹⁴ Rules of form reduce information costs and claim-processing costs. Deceit claims present a more difficult problem because deceit often involves intentional misuse by a defendant of language and legal forms and carelessness by a plaintiff in attending to language and legal forms. This makes the usual linguistic and formal indicators of intent unreliable.

To be clear, sometimes the character and context of a misrepresentation make it possible for a fact finder to infer with confidence the presence or absence of a mental state relevant to liability. For example, if Artful Forger sells a clever forgery he created to Collector, a fact finder can infer with confidence that Artful Forger had knowledge of the fraud and intent to mislead, and a court can infer with confidence that the fraud influenced Collector's decision to purchase the forgery. Similarly, the unreasonable character of a plaintiff's reliance on a representation sometimes makes it possible for a fact finder to infer with confidence the absence of a mental state. For example, if Horse Seller tells Discerning Buyer that an obviously one-eyed horse is sound,¹⁹⁵ a fact finder can infer with confidence that Horse Seller meant the horse is sound apart from being one-eyed, and a fact finder can infer with confidence that Discerning Buyer understood this was what the seller meant.

In the example involving the one-eyed horse and the discerning buyer, the parties' intent is obvious. But often when a deceit claim involves unreasonable reliance, the observable facts will neither establish nor negate the presence of mental states relevant to the liability determination. *MacDonald v. Thomas M. Cooley Law School* illustrates this point.¹⁹⁶ In that case, the administrators of Cooley Law published potentially misleading placement statistics and the plaintiffs, who had access to the statistics, chose to enroll at Cooley Law.¹⁹⁷ However, a court cannot observe the defendant's mental state concerning how the published statistics were intended to influence prospective students. Equally, a court cannot observe the influence the statistics had on the plaintiffs' decisions to enroll.

The apparent unreasonableness of the plaintiff's reliance on the statistics means that a court cannot infer with confidence that Cooley Law's administrators intended to create a false impression about the success of the school's graduates, or that they intended this false impression to influence people like the plaintiffs to enroll at the school. It is plausible that the administrators assumed potential applicants would treat the information as unreliable because it was the reasonable thing to do. Turning to the plaintiffs' mental states, a court cannot

194. This is clearest with respect to the hard form of the parol evidence rule, *see, e.g.*, *Mitchill v. Lath*, 160 N.E. 646, 647 (N.Y. 1928), and the plain-meaning rule, *see, e.g.*, *Steuart v. McChesney*, 444 A.2d 659, 661 (Pa. 1982).

195. *See* RESTATEMENT (SECOND) OF TORTS § 541 cmt. a (AM. LAW INST. 1977).

196. 724 F.3d 654 (6th Cir. 2013). Something similar occurs with a strict scienter rule regarding the defendant's knowledge of the falsity of a representation. However, the fact a defendant conveyed the information gives the defendant some reason to ascertain the information's accuracy.

197. *Id.* at 657.

infer with confidence that the plaintiffs drew a false impression of the employment prospects of Cooley Law graduates from the published statistics, or that this false impression influenced the plaintiffs' decisions to attend Cooley Law, because of the unreasonableness of the false impression and the decision. On the other hand, neither can a court infer with confidence that the administrators of Cooley Law did not intend to create a false impression of the success of the school's graduates, because it was in the school's interest to create a false impression that might induce people to enroll at Cooley Law. Nor can a court infer with confidence that the plaintiffs did not rely on a false impression created by the published statistics in choosing to enroll at Cooley Law, because this is a plausible explanation for what may otherwise seem to be an unwise decision on the plaintiffs' parts.

Uncertainty regarding the presence of a relevant mental state has knock-on effects in discovery and litigation if a claim gets past a motion to dismiss or a motion for summary judgment. There may not be conclusive evidence of the presence or absence of a mental state. Nevertheless, the parties will conduct extensive discovery hoping to find conclusive evidence or a prejudicial admission of such. They will also conduct extensive discovery hoping to obtain evidence that is suggestive of the presence or absence of a relevant mental state. Thus, in *MacDonald*, the plaintiffs would want to comb through Cooley Law's records and to depose Cooley Law employees to find a smoking gun, and in the absence of a smoking gun they would want to find other evidence that might persuade a court and a jury that Cooley Law's administrators had a motive to mislead prospective students.¹⁹⁸

Sometimes investigation will reveal facts that establish the presence or absence of a relevant mental state with a fair degree of certainty. But sometimes the court will be left having to choose between two plausible inferences based on inconclusive evidence. Had the motion to dismiss not been granted in *MacDonald*, there is a good chance that the parties would have conducted prolonged and contentious discovery, yielding voluminous evidence that the parties would present at the summary judgment stage and at trial. This evidence, however, would in the end yield no clearer answers on whether the defendant had a culpable mental state or whether the plaintiffs were actually misled by the placement statistics to enroll at the school compared to the information contained in the pleadings.¹⁹⁹

The law of deceit directs a court to dismiss a claim if there is a good chance that the defendant did not have culpable intent or the plaintiff was not influenced by the misrepresentation.²⁰⁰ The reasonable reliance rule enables a court

198. For example, the plaintiffs might try to find evidence that Cooley Law was in a desperate financial position because it could not attract a sufficient number of tuition-paying students to cover its operating expenses.

199. The claim would be dismissed on a motion for summary judgment because the plaintiff could not establish culpable intent by clear and convincing evidence. See *supra* Section III.B.

200. See *supra* Part III.

to dismiss a claim involving unreasonable reliance on the pleadings. The intended reliance rule and clear and convincing evidence standard require a court to dismiss a claim on a motion for summary judgment. This policy of erring on the side of the defendant reduces false positives (incorrect findings of culpable intent and influence) and increases false negatives (incorrect findings of the absence of culpable intent or influence). We have seen that one justification for this policy is that it reduces socially undesirable information costs that are created by the risk of a false positive. A second justification is that it reduces claim-processing costs. I now turn to a third justification.

C. THE LOW SOCIAL COST OF DECEIT WHEN A VICTIM'S RELIANCE IS UNREASONABLE

A policy of erring on the side of the person accused of fraud when the victim's reliance is unreasonable should increase the incidence of fraudulent activity. However, the increase would likely be in types of fraudulent activity that involve a low social cost. Recall that the social cost of deceit lies in the resources expended by fraudsters to extract wealth from their victims and in the resources expended by people to protect their wealth from fraudsters.²⁰¹ The transfer of wealth from the victim to the fraudster is a private loss to the victim but is not a social cost.

The social costs of deceit are likely to be fairly small in cases in which a victim's reliance on a fraud is unreasonable. When reliance is unreasonable, avoiding a fraud rarely requires a great deal of effort on the part of a victim. And frauds that exploit a victim's ignorance or gullibility often do not involve much effort on the part of a fraudster. They are cheap cons. Cheap cons do not involve a significant expenditure of resources by a fraudster. That is why they are called cheap cons.

Of course, a fraud that exploits a victim's ignorance or gullibility can be expensive to pull off. A fraudster may go to considerable effort to mask culpable intent. A fraudster may expend considerable resources trolling widely for ignorant or gullible victims, and a cheap con can impose costs on people who do not fall for the con because they waste time to determine whether an opportunity being offered them is a con and to decline the opportunity.

A policy that allows fraudsters to exploit people's vulnerabilities also has troubling distributional implications. The elderly, the young, the uneducated, and newcomers to a community are likely to be more vulnerable to cheap cons. Thus, it is important that the law deters deceit even in cases in which a victim's reliance is unreasonable. But this interest has to be balanced against the interest in reducing information costs and the interest in reducing claim-processing costs.

201. See TREBILCOCK, *supra* note 162, at 104 ("[I]nvestments in fraudulent activity have no positive social value and . . . may induce socially wasteful investments by potential victims in avoidance precautions.")

VI. WHY THE INTENDED RELIANCE RULE IS SUPERIOR

Part V explains that the function of the intended reliance rule, the reasonable reliance rule, and the rules of justifiable reliance (which flow from either rule) is to reduce information costs and claim-processing costs in a class of cases in which the social cost of undeterred fraud is small. This Part argues that the intended reliance rule may well be superior at performing these functions because it provides greater deterrence at comparable information costs and somewhat greater claim-processing costs. Which rule is ultimately superior as a matter of efficiency turns on the relative magnitude of the social benefits of the intended reliance rule in reducing the incidence of fraud balanced against the social costs of the rule resulting from higher claim-processing costs.

The possibility that the intended reliance rule is superior as a matter of efficiency suffices for my argument. The intended reliance rule is superior to the reasonable reliance rule on moral grounds, so the burden should be on a defender of the reasonable reliance rule to justify the rule on efficiency grounds. As of now the reasonable reliance rule has no defenders. People who are ignorant about the original rationale for the rules of justifiable reliance have assumed that the law of deceit has always had a requirement of reasonable reliance. They do not realize that the requirement is a recent invention responding to a need created by the elimination of the requirement of intended reliance.

A. THE MAIN CONTENDERS: INTENDED RELIANCE VS. OBJECTIVELY REASONABLE RELIANCE

The intended reliance rule provides greater deterrence and lets fewer frauds go unpunished because a deceit claim involving unreasonable reliance cannot be dismissed on a motion to dismiss under the rule if the plaintiff pleads fraud with sufficient specificity. A plaintiff must be given an opportunity for discovery and a chance to prove the defendant had culpable intent. Instead, a claim involving unreasonable reliance will be dismissed on a motion for summary judgment if the plaintiff is unable to present clear and convincing evidence the defendant had culpable intent.²⁰² This lets fewer frauds go unpunished because, in some cases, the plaintiff will be able to establish the defendant had culpable intent by clear and convincing evidence even though the plaintiff's reliance was unreasonable. The increase in the probability that a fraud will be punished increases deterrence. The increase in claim-processing costs stems from the additional cost of discovery and of proceedings at the summary judgment stage for claims that would have been dismissed on the pleadings under the reason-

202. The plaintiff must do more than establish that the defendant had a culpable intent with respect to the falsity of the representation. *See supra* Section III.B. The plaintiff must also establish that the defendant made the representation with a purpose of influencing the plaintiff's conduct, and when a representation involves ambiguous or incomplete information, the plaintiff must establish that the defendant intended him to draw a false conclusion from the information. It is not sufficient to establish merely that the defendant had reason to expect the plaintiff would rely on or draw a false conclusion.

able reliance rule, and the additional cost of litigating claims that make it to trial.

The off-setting advantages of the reasonable reliance rule over the intended reliance rule with respect to claim processing costs require courts to apply a hard form of the rule. This enables a trial court to dismiss a claim involving unreasonable reliance on the pleadings, if the court finds the plaintiff's reliance unreasonable, without deferring to the jury even when it would be possible for a jury to find otherwise if the facts of the case were developed.²⁰³ Sometimes courts apply the rule in just this way. For example, in seven of nine lawsuits against low-ranked law schools for publishing misleading placement statistics the court held the plaintiffs' reliance to be unreasonable as a matter of law, dismissing the claim on the pleadings.²⁰⁴ These lawsuits involve unsophisticated plaintiffs and arise in a noncommercial context. Not surprisingly, the pattern is even stronger in cases that arise in a commercial context, particularly when the plaintiff is a sophisticated party who might be expected to be vigilant against fraud.²⁰⁵

The hard form of the reasonable reliance rule is a marvel at reducing claim-processing costs. Yet, how the rule compares to the intended reliance rule with respect to information costs is less clear. In theory, even the hard form of the reasonable reliance rule could impose higher information costs than the intended reliance rule. Whether an actor intends an addressee to rely on a representation turns on facts salient to the actor whereas whether the addressee is reasonable to rely on a representation turns on facts salient to the addressee.²⁰⁶ But my hunch is that the two rules involve roughly comparable information costs in practice. The same facts that will lead a court to find the plaintiff's reliance on a representation to be unreasonable typically will also

203. In other words, courts approach the reasonableness determination in the law of deceit differently than they approach the reasonableness determination in the law of negligence. In the law of negligence, the question of whether a party's conduct breached the standard of reasonable care is for the jury to decide in a case in which reasonable people might disagree. See Mark P. Gergen, *The Jury's Role in Deciding Normative Issues in the American Common Law*, 68 *FORDHAM L. REV.* 407, 424–30 (1999). If courts treated the reasonableness determination in the law of deceit this way, then it would be difficult to dismiss a deceit claim involving unreasonable reliance on the pleadings because a plaintiff would be entitled to an opportunity to develop the facts necessary to demonstrate that his reliance was reasonable. A claim could not be dismissed on a motion for summary judgment unless a plaintiff's reliance was indisputably unreasonable, taking account of all of the facts.

204. See *supra* text accompanying note 86.

205. See, e.g., *First Data POS, Inc. v. Willis*, 546 S.E.2d 781, 785 (Ga. 2001) (holding it unreasonable as a matter of law for a sophisticated plaintiff to rely on precontractual representations that were not included in signed agreement containing a merger provision); *Flegles, Inc. v. TruServ Corp.*, 289 S.W.3d 544 (Ky. 2009); see also Debra Pogrud Stark & Jessica M. Choplin, *A License to Deceive: Enforcing Contractual Myths Despite Consumer Psychological Realities*, 5 *N.Y.U. J. L. & BUS.* 617, 636–55 (2009) (reporting on a large number of cases in which courts have invoked the requirement of reasonable reliance to dismiss a fraud claim by a consumer when the consumer signed a contract disclaiming the representation that is the basis for the claim).

206. For a comparison of the intended reliance rule to a rule requiring subjectively reasonable or nonreckless reliance, see *infra* Section VI.B.

lead a court to find the defendant did not intend the plaintiff to rely on a representation (absent clear and convincing evidence to the contrary). For example, in *Snyder v. Lovercheck* these facts included the casual character of the seller's response to the purchaser's inquiry about the extent of the rye problem, the contract terms providing the land was sold "As Is" and disclaiming reliance on any representations, the fact the seller had recently purchased the land and may have therefore had limited knowledge of the extent of the rye problem, and the fact the purchaser was an experienced business person.²⁰⁷

The advantage of the intended reliance rule over the reasonable reliance rule from an economic perspective is that it provides greater deterrence. Thus, the central trade-off between the two rules from an economic perspective is between claim-processing costs and deterrence. The Wyoming Supreme Court was confronted with a somewhat similar trade-off in *Snyder v. Lovercheck* when it was asked to choose between the New York rule,²⁰⁸ which treats an exculpatory term in a contract as a bar to a fraudulent inducement claim when the plaintiff is a sophisticated party, and the Wyoming approach, which gives the plaintiff an opportunity to establish that he was deceived while requiring that deceit be proven by clear and convincing evidence.²⁰⁹ The Court rejected the New York rule.²¹⁰ Its reasons bear quoting at length:

In the realm of fact it is entirely possible for a party knowingly to agree that no representations have been made to him, while at the same time believing and relying upon representations which in fact have been made and in fact are false but for which he would not have made the agreement. To deny this possibility is to ignore the frequent instances in everyday experience where parties accept, often without critical examination, and act upon agreements containing somewhere within their four corners exculpatory clauses in one form or another, but where they do so, nevertheless, in reliance upon the honesty of supposed friends, the plausible and disarming statements of salesmen, or the customary course of business. To refuse relief would result in opening the door to a multitude of frauds and in thwarting the general policy of the law.²¹¹

There are two points here. The first is an observation about the behavior of victims of fraud. Often, victims of fraud fail to take what would seem to be simple precautions to protect themselves from a fraud, such as reading a contract.²¹² The second point is an observation about the behavior of fraudsters:

207. 992 P.2d 1079, 1082–83 (Wyo. 1999).

208. *See id.* at 1084–86 (discussing *Danann Realty Corp. v. Harris*, 157 N.E.2d 597, 599–600 (N.Y. 1959)).

209. *See id.* at 1085–86.

210. *Id.* at 1086.

211. *Id.* at 1086 (quoting *Bates v. Southgate*, 31 N.E.2d 551, 558 (Mass. 1941)).

212. *See Stark & Choplin, supra* note 205, at 655–77; *see also* Robert Prentice, *Contract-Based Defenses in Securities Fraud Litigation: A Behavioral Analysis*, 2003 U. ILL. L. REV. 337, 358–78.

they tend to find and exploit whatever doors the law leaves open to fraud, such as a rule that enables a fraudster to cloak a fraud by putting a disclaimer in a contract. This is old wisdom. As Augustus Hand observed in 1927:

It is worth remembering that the ingenuity of draftsmen is sure to keep pace with the demands of wrongdoers, and if a deliberate fraud may be shielded by a clause in a contract that the writing contains every representation made by way of inducement, or that utterances shown to be untrue were not an inducement to the agreement, sellers of bogus securities may defraud the public with impunity, through the simple expedient of placing such a clause in the prospectus which they put out, or in the contracts which their dupes are asked to sign.²¹³

In warning of “the ingenuity of draftsmen,” Hand directs attention to the role of lawyers in advising fraudsters on how to exploit legal shields.

These points merely suggest that a rule like the New York rule, which allows a fraudster to shield himself from legal liability in a transaction with a sophisticated party by including a disclaimer in a contract, is likely to increase the incidence of fraudulent activity and to result in a fair number of cases in which a fraud goes unpunished. These are the costs of the New York rule. On the other hand, the benefit of the New York rule is that it enables courts to dismiss fraud claims on the pleadings in cases in which the claim is likely to be unfounded, reducing claim-processing costs. That these benefits are quite large is also old wisdom. Augustus Hand cautioned, when warning of the ingenuity of draftsmen, that in the majority of cases in which a sophisticated party signs a contract disclaiming representations, the claim of fraud is “unfounded.”²¹⁴ If most claims of fraud are unfounded, then the New York rule provides considerable benefits in providing “certainty and freedom from attacks” in “contractual relations.”²¹⁵

If one compared the social costs of the New York rule in an increase in the incidence of fraud with the social benefits of the rule in a reduction in claim-processing costs, then the benefits of the rule might well outweigh the costs by a nontrivial amount.²¹⁶ This is because the increase in incidence of fraud usually entails types of fraud that involve low social costs. The frauds involve a low social cost because the victim typically can protect himself from the fraud without much effort, which means that the fraudster, if rational, will not expend much effort in trying to perpetrate the fraud.²¹⁷ The argument against the New

213. *Arnold v. Nat'l Aniline & Chem. Co.*, 20 F.2d 364, 369 (2d Cir. 1927). When Hand wrote, Massachusetts followed what is now the New York rule and New York did not. The positions of the two states have since flipped on the issue.

214. *Id.*

215. *Id.*

216. *See Blair, supra* note 189, at 467–68.

217. To be clear, this assumes that the rule giving preclusive effect to an exculpatory term is limited to contracts in which the party who claims to have been defrauded is sophisticated, because a

York rule is that it leads to morally offensive outcomes in cases in which the plaintiff could have established fraud if given the opportunity. Many courts reject the New York rule on moral grounds.²¹⁸ This is where Augustus Hand came out. He concluded the New York rule shows too little “consideration for the individual who may suffer wrong through deliberate fraud.”²¹⁹

The reasonable reliance rule stands on even weaker footing than the New York rule. For one, it delivers smaller savings in claim-processing costs. The New York rule is a bright-line rule, whereas the reasonable reliance rule is a standard. The reasonable reliance rule enables a trial court to dismiss a claim involving unreasonable reliance on the pleadings, but the rule does not *require* a trial court to do so even though the plaintiff’s reliance seems unreasonable. Indeed, the rule instructs trial courts that the question of whether a plaintiff’s reliance is unreasonable requires close scrutiny of the facts in a case, and that a court should take the question from the jury only when the answer is clear. Although courts often disregard these features of the rule (like seven of nine courts did in the lawsuits against lower-tier law schools for publishing misleading placement statistics),²²⁰ sometimes they will not. And sometimes a court will have doubts on whether a plaintiff’s reliance is unreasonable, or a court will want to learn the facts of a case before making this determination.²²¹ Thus, a significant number of claims involving arguably unreasonable reliance will get past a motion to dismiss under the reasonable reliance rule.

The other advantage of the intended reliance rule over the reasonable reliance rule is deterrence. The intended reliance rule gets more bang-for-the-buck in terms of deterrence at the same level of claim-processing costs. The intended reliance rule directs courts to the appropriate factual question, assuming the goal is to target and deter the socially harmful conduct of fraud. Much of the social harm in fraud lies in a fraudster’s expenditure of resources to communicate misleading information to a victim and influence the victim’s action to extract wealth from the victim or to obtain some other benefit. The social harm entails purposive conduct by a fraudster; he expends resources to provide misleading information to his victim to influence the victim’s action.

MacDonald v. Thomas M. Cooley Law School illustrates how the intended reliance rule directs courts to the appropriate factual question if the goal is to reduce the social cost of fraud.²²² It would be socially wasteful if the school’s administrators expended resources to tailor its published placement statistics to

sophisticated party may be expected not to rely on information provided by the other party concerning a contract when there are not terms in the contract making the other party responsible for the accuracy of the information, such as a warranty or a condition. This expectation reduces the expected value to the other party of providing misleading information.

218. See Blair, *supra* note 189, at 440–45.

219. Arnold, 20 F.2d at 369.

220. See *supra* text accompanying note 86.

221. See, e.g., Marcus Bros. Textiles, Inc. v. Price Waterhouse, LLP, 513 S.E.2d 320, 327–28 (N.C. 1999).

222. See *supra* Section III.A.

create a misleading impression of the value of a Cooley Law degree to influence students to enroll at the school. However, making the effort implies purposive conduct by the administrators in publishing the statistics. Matters are different if the purpose of misleading prospective students never enters anyone's mind at the school because there is no concern that resources are being wasted to tailor the information to mislead prospective students. Instead, the concern is that the threat of liability may encourage the school's administrators to tailor the information to reduce the liability risk. When this expenditure of resources is of no social value, the loss to prospective students that is avoided by the effort is a private loss, not a social loss.

The reasonable reliance rule directs the court to the wrong factual question, assuming the goal is to deter fraudsters from expending resources to perpetrate frauds. Indeed, the reasonable reliance rule creates terrible incentives for fraudsters. It encourages fraudsters to expend resources to devise frauds that exploit the vulnerabilities of the victim in the hope that a court will find the victim's reliance on the fraud to be unreasonable. The rule also encourages fraudsters to expend resources to identify and target people who are vulnerable to a fraud.

B. BAD COMPROMISES: SUBJECTIVELY REASONABLE OR NONRECKLESS RELIANCE

The moral implications of the reasonable reliance rule are sufficiently troubling that some have proposed loosening the rule so that it requires only that a plaintiff's reliance be subjectively reasonable²²³ or nonreckless.²²⁴ I will briefly explain why these compromises should be rejected, focusing on a comparison of the two rules with the intended reliance rule. The intended reliance rule is superior to the two rules in every respect. The meaningful choice is between the intended reliance rule and the reasonable reliance rule.

A requirement of subjectively reasonable reliance "has a personalized character. It is measured by the reference to the plaintiff's capabilities and knowledge. . . ." ²²⁵ A requirement of nonreckless reliance precludes liability if the plaintiff was conscious of a sufficient risk that a representation was false. A requirement of nonreckless reliance would preclude liability in *Hyma v. Lee* but not in *MacDonald v. Thomas M. Cooley Law School*.²²⁶ A requirement of subjectively reasonable reliance might permit some of the plaintiffs to recover in *MacDonald*. For example, a plaintiff who was unfamiliar with the high degree of stratification among law schools in the United States and unaware of the role law school rankings place in establishing the hierarchy might reason-

223. See RESTATEMENT (THIRD) OF TORTS: LIAB. FOR ECON. HARM § 11 cmt. d (AM. LAW INST., Tentative Draft No. 2, 2014).

224. *AMPAT/Midwest, Inc. v. Ill. Tool Works, Inc.*, 896 F.2d 1035, 1041–42 (7th Cir.1990) ("[T]he victim of a deliberate fraud is barred only if he has notice of the fraud, and so he need only avoid *deliberate* or *reckless* risk-taking." (emphasis in original) (citing *Smith v. Ethell*, 494 N.E.2d 864 (Ill. App. Ct. 1986))).

225. RESTATEMENT (THIRD) OF TORTS: LIAB. FOR ECON. HARM § 11 cmt. d.

226. See *supra* Sections I.A, III.A.

ably have relied on the misleading impression created by the published placement statistics.

A nonreckless or subjectively reasonable reliance rule performs no better and probably performs worse than the intended reliance rule with respect to claim-processing costs. The rules do not enable a court to dismiss a deceit claim involving unreasonable reliance on a motion to dismiss because of the individualized character of the determination. Evidence must be taken on the plaintiff's capabilities, knowledge, and disposition, and on whether the plaintiff was conscious of the risk a representation was untrue. The rules may also result in fewer claims being dismissed at the summary judgment stage than the intended reliance rule because it will be harder for a plaintiff to present sufficient evidence to allow a jury to find intended reliance than it will be for a plaintiff to present sufficient evidence to allow a jury to find his reliance was nonreckless or subjectively reasonable. If the rules result in fewer claims being dismissed at the summary judgment stage, as seems likely, then the rules will perform worse than the intended reliance rule with respect to claim-processing costs.

A subjectively reasonable and nonreckless reliance rule performs significantly worse than the intended reliance rule with respect to information costs. To assess his risk of liability under the nonreckless or subjectively reasonable reliance rules, an actor must collect information concerning the capabilities, beliefs, and dispositions of a person to whom he plans to communicate information. Once an actor has this information about a recipient, he must assess the information he plans to communicate in light of information about the recipient to determine which information is likely to be treated as salient by a recipient and the risk the communicated information may be misleading. If an actor alters the information he communicates to reduce the risk that it will be misleading, he must tailor the information to the individual characteristics of the recipient. The intended reliance rule requires less effort because it makes liability a matter of an actor's apparent intent concerning the influence of information upon a recipient. To determine an actor's apparent intent, a fact finder will focus on information that is salient to the actor, and a fact finder will take an actor's knowledge about a recipient's capabilities, beliefs, and dispositions as a given.

An example may help to illustrate the different information demands the nonreckless or subjectively reasonable reliance rules and the intended reliance rule place on an actor who tries to manage his risk of liability. I will use *Hord v. Environmental Research Institute of Michigan*.²²⁷ When ERIM recruited Hord, its managers gave him an information packet that included the firm's most recent financial statements, which gave a misleading impression of the firm's financial condition because the statements omitted recent bad news.²²⁸ Hord sued when he was fired a year after joining the company, claiming he had been deceived about its financial condition.

227. 617 N.W.2d 543 (Mich. 2000) (per curiam).

228. *Id.* at 545–46.

In recruiting a prospective employee, a firm's managers often give the prospect a large amount of information of mixed quality, like the managers gave to Hord. The firm faces a risk that if the relationship with the employee sours, the employee will sue and claim the firm gave him misleading information upon which he relied. Managers who are sensitive to this risk of liability will manage the information they provide to a prospective employee to reduce that risk. Under the nonreckless or subjectively reasonable reliance rules, the risk of liability turns on the weight a prospect places on information that turns out to be misleading and whether a court considers the prospect's reliance on misleading information to be reckless or subjectively unreasonable, which turns on the prospect's capabilities, knowledge, and disposition. Thus, if managers want to be able to manage the firm's liability risk effectively, they must collect information about a prospect, assess the information they plan to communicate in light of the information they collect about a prospect to determine what information may be misleading to the prospect, and tailor the information they communicate to alter portions that may mislead the prospect. The intended reliance rule requires much less effort on the part of managers. Under the intended reliance rule, managers can manage the firm's liability risk by verifying the accuracy and clarity of information that is sufficiently salient to the managers, such that a court is likely to infer that the managers intended the prospect to rely on the information.

C. CAN THE DEFECT IN THE INTENDED RELIANCE RULE BE FIXED?

One issue remains: the problem of the unintended victim of a fraud. This is the problem that led Page Keeton to call the intended reliance rule a "deformity in the law of deceit."²²⁹ For example, imagine a firm's managers misrepresent the firm's condition with a purpose to sell newly issued bonds in the bond market. Purchasers of the firm's stock in the secondary market will predictably rely on the misrepresentation. Under the intended reliance rule, the managers and the firm are not liable to the stock purchasers because their reliance on the misrepresentation was not intended. This result was widely condemned as morally offensive, and it is.

Yet critics of the intended reliance requirement did not foresee that eliminating the rule would lead to the establishment of a requirement of reasonable reliance in the law of deceit, which yields a morally offensive result in a case in which a fraudster exploits a victim's unreasonable disposition and beliefs. If we have to live with one or the other morally offensive result, then the intended reliance rule is preferable on moral grounds. A rule that limits the class of victims who may recover when a fraud has unintended consequences is less

229. Keeton, *supra* note 54, at 26. Keeton proposed a rule that would allow a claim for deceit in circumstances in which the misrepresentation "was properly regarded as being addressed to the class of people to which the plaintiff belonged," or in circumstances in which the defendant was required to supply the information by legislation and among the purposes of the legislation is that the plaintiff be able to rely on the information. *Id.*

objectionable than a rule that lets fraudsters who prey on people's vulnerability off the hook entirely. And there may be a solution to the dilemma of having to choose between two morally offensive results. Perhaps we can avoid being put to this choice by adopting a rule of transferred intent to allow an unintended victim of an intended fraud to recover.²³⁰ I leave this possibility for someone else to develop.

There is another possibility. Objectively reasonable reliance could be retained as a requirement for liability in deceit when the plaintiff is unable to establish intended reliance but is able to establish that the defendant had reason to expect his reliance. In other words, contributory negligence would be a defense to a deceit claim unless the plaintiff was able to establish intended reliance. I think this is a nonstarter because it is too complicated, and it is not clear where it would leave the rules on justifiable reliance. That this solution is too complicated to work in practice, or that it would unduly undermine the ability of courts to use the rules of justifiable reliance to screen out weak claims, is suggested by the fact that this is essentially the solution that was tried in the Restatement Second of Torts, which defines reliance as justifiable either if it is reasonable or if it is intended.

CONCLUSION

Courts should restore the intended reliance rule and eliminate the reasonable reliance rule. The rules of justifiable reliance can be kept as they are, but they will return to being presumptions that a plaintiff can overcome by showing that a defendant had culpable intent. The reasonable reliance rule deserves no deference. No other common law system has anything like it, and it used not to be the rule in the United States. The rule came into U.S. law because it made sense of the justifiable reliance requirement, which flowed from the intended reliance rule, and because it enabled courts to dismiss on the pleadings what they perceived to be weak deceit claims. While the rule serves the valuable functions of reducing information costs and claim-processing costs, those functions are as well-served (or almost so) by the intended reliance rule. Meanwhile, the intended reliance rule is superior at deterring fraud and is morally superior because it lets fewer frauds go unpunished. Weak deceit claims that involve unreasonable reliance can still be dismissed at the summary judgment stage when the plaintiff is unable to establish the defendant had culpable intent by clear and convincing evidence. But people who are victimized by frauds that a reasonable person would not fall prey to will still be given an opportunity to establish they were defrauded.

230. The doctrine of transferred intent has been criticized as a "curious survival of the antique law." William L. Prosser, *Transferred Intent*, 45 TEX. L. REV. 650, 650 (1967). Prosser collects cases refusing to extend the doctrine to "cases of pecuniary loss from deceit, where the defendant intends to mislead one person and another relies instead." *Id.* at 656 & n.51.