

1/30/69

## Memorandum 69-25

Subject: Study 60 - Representations as to Credit (CCP § 197<sup>4</sup>)

At its January meeting, the Commission discussed repeal or revision of Code of Civil Procedure Section 197<sup>4</sup> which provides, in essence, that no person is liable upon a representation as to the credit of a third person unless the representation is in writing.

The Commission directed the staff to prepare a tentative recommendation that would treat Section 197<sup>4</sup> the same as other provisions of the Statute of Frauds are treated--to provide the same exceptions to Section 197<sup>4</sup> that apply to other provisions of the Statute of Frauds. The Commission was particularly concerned that the provision provide protection where a creditor, disappointed by nonpayment, might attempt to throw out a dragnet to reach third persons (who are contractually unrelated to the debt transaction) because of information they gratuitously gave as to the credit of the debtor.

Attached to this memorandum is a tentative recommendation that the staff believes would accomplish the result stated above. The draft would change the results in the more unfortunate decisions that have arisen under Section 197<sup>4</sup>, would make the exceptions to Section 197<sup>4</sup> consistent with those that apply to other provisions of the Statute of Frauds, and would make the application of Section 197<sup>4</sup> conform to the decisions applying similar provisions in other states.

Before turning to the details of the tentative recommendation, it may be worthwhile to pursue briefly two or three lines of inquiry that were suggested at the January meeting. The Commission was concerned

that Section 1974 may have a beneficial effect in the market place and trial courts that more than offsets the few "hard" cases that reach the appellate courts. Further inquiry was suggested into (1) the precise basis of liability covered by Section 1974, (2) the California law as to credit representations that are in writing, (3) the law in states (35 of them) where the writing requirement is unknown, and (4) the impressions of persons who might be concerned about Section 1974.

The Liability Covered by Section 1974 and the Revised Tentative Recommendation

The basis of liability envisioned by Section 1974 is that of "third-party" deceit denounced by Sections 1709 and 1710 of the Civil Code--not the "transactional fraud condemned by Sections 1571-1574."<sup>1</sup> In other words, Section 1974

<sup>1</sup> Sections 1709 and 1710, and Sections 1571-1574, provide as follows:

§1709. Deceit. — Damages. — One who willfully deceives another with intent to induce him to alter his position to his injury or risk, is liable for any damages which he thereby suffers. Leg.H. 1872.

§1710. Elements of Actionable Fraud. — A deceit, within the meaning of the last section, is either:

1. The suggestion, as a fact, of that which is not true, by one who does not believe it to be true;

2. The assertion, as a fact, of that which is not true, by one who has no reasonable ground for believing it to be true;

3. The suppression of a fact, by one who is bound to disclose it, or who gives information of other facts which are likely to mislead for want of communication of that fact; or,

4. A promise, made without any intention of performing it. Leg.H. 1872.

§1571. Fraud—Kinds.—Fraud is either actual or constructive. Leg.H. 1872.

§1572. Actual.—Actual fraud, within the meaning of this chapter, consists in any of the following acts, committed by a party to the contract, or with his connivance, with intent to deceive another party thereto, or to induce him to enter into the contract:

1. The suggestion, as a fact, of that which is not true, by one who does not believe it to be true;

2. The positive assertion, in a manner not warranted by the information of the person making it, of that which is not true, though he believes it to be true;

3. The suppression of that which is true, by one having knowledge or belief of the fact;

4. A promise made without any intention of performing it; or,

5. Any other act fitted to deceive.

§1573. Constructive. — Constructive fraud consists:

1. In any breach of duty which, without an actually fraudulent intent, gains an advantage to the person in fault, or any one claiming under him, by ~~misleading~~ another to his prejudice, or to the prejudice of any one claiming under him; or,

2. In any such act or omission as the law specially declares to be fraudulent, without respect to actual fraud. Leg.H. 1872.

§1574. Question of Fact.—Actual fraud is always a question of fact. Leg.H. 1872.

ought not to apply if the "representer" is a party to the transaction induced or has his legal relationships changed by that transaction. Therefore, the most logical place in the codes to put the substance of Section 1974 would be in connection with Sections 1709 and 1710. The difficulty with placing the substance of Section 1974 in the general statute of frauds part of the Civil Code (in connection with the suretyship provision) is that the Statute of Frauds (Civil Code Section 1624) applies only to contracts. It must be noted that if the "representation" as to credit is promisory or contractual--that is, if the "representer" assumes any contractual responsibility as to the debt induced--the matter is covered directly by the suretyship provisions of the Statute of Frauds, rather than by Section 1974.<sup>2</sup>

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<sup>2</sup> See subdivision (2) of Section 1624 and Section 2787. Section 2787 provides as follows:

§2787. Sureties, Guarantors, Distinction Abolished--Definition.--[1] The distinction between sureties and guarantors is hereby abolished. The terms and their derivatives, wherever used in this code or in any other statute or law of this State now in force or hereafter enacted, shall have the same meaning, as hereafter in this section defined. A surety or guarantor is one who promises to answer for the debt, default, or miscarriage of another, or hypothecates property as security therefor. Guaranties of collection and continuing guaranties are forms of suretyship obligations, and except in so far as necessary in order to give effect to provisions specially relating thereto, shall be subject to all provisions of law relating to suretyships in general. Leg.H. 1872: 1939 ch. 453.

The only other possible grounds of liability under Section 197<sup>4</sup> are (a) breach of a fiduciary relationship, (b) breach of a preexisting contract to provide accurate or reliable credit information, and (c) purely negligent speech (if there ever could be any liability under this heading). The revised tentative recommendation exempts the fiduciary and contract situations. With respect to the contract situation, it is interesting to note that the law of credit reporting (on which there appears to be no reported legal experience in California) founds the liability of the reporter on his contract, rather than upon deceit or noncontractual negligence. And, contractual disclaimers and waivers apart, the "implication" is that the reporter does not undertake to verify or vouch for the information he supplies. The deceiver, if there is one, in the credit reporting fact pattern is the person, typically the debtor, who supplies the information to the reporter. (The infrequent judicial decisions are collected in Annot., 32 A.L.R.2d 184.)

With respect to "pure" negligence, the liability in California for "non-privacy" negligent speech is fragmentary at best, but is traceable to subdivision (2) of Civil Code Section 1710 which defines "deceit" to include, "The assertion, as a fact, of that which is not true, by one who has no reasonable ground for believing it to be true." The revised tentative recommendation leaves this situation subject to the requirement of a writing since it requires an "intention to deceive."

### California Law as to Written Representations

Pursuing California law as to credit representations with a writing (notice that Section 1974 requires only the "handwriting" of the "representer") proves fruitless except insofar as the sparsity of law on the subject may be notable. It appears that the disinterested deceiver is a rare bird much better known to law writers than to businessmen or courts. This is not to deny that "fraud and deceit" is not commonly pleaded, but the "privity" of the deceiver usually is apparent. Indeed, the few California decisions still take pains to explain that there can be such a tort as third-party deceit. These few decisions deal with such situations as the termite inspector's being hired by the seller, being bribed by the seller to give an erroneously favorable report, and being held liable in deceit to the buyer.

There appear to be only three reported decisions involving representations (written or unwritten) as to the credit or solvency of a third person. In Beeman v. Richardson, 185 Cal. 280, 196 Pac. 774 (1921), corporate officers were held liable for inducing the plaintiff to purchase stock in a nearly bankrupt corporation. Section 1974 was not mentioned, but that section would have been unavailing inasmuch as that section applies only where the plaintiff becomes a creditor (e.g., rather than a stockholder) as a result of the misrepresentation.

In Burckhardt v. Woods, 124 Cal. App. 345, 12 P.2d 482 (1932), the appellate court reversed the sustaining of a demurrer to a complaint that the plaintiff had been induced by the defendant

corporate officers to purchase stock in an insolvent corporation and to make a loan to that corporation. The defense of Section 1974 would have been applicable to the loan, but the defense was not raised. The appellate courts did not discover Section 1974 until 1933. In Williams v. Spazier, 134 Cal. App. 340, 25 P.2d 851 (1933), a judgment for the plaintiffs (stock purchasers) was reversed where the defendant (a major stockholder) had induced the purchase and had misled the plaintiffs as to the financial condition of the corporation. The decision goes off on the ground that it is extremely difficult to prove the element required by subdivision (2) of Civil Code Section 1710, at least as to a person who has some fragmentary basis for believing the asserted fact to be true or, perhaps, has only his own hopes that it is true.

The other California credit representation cases are those involving unusual "loan" situations which are mentioned in the research study and which debate the application of Section 1974.

#### The Law in States Without Tenterden's Act

The situation without a Tenterden's Act is somewhat clearer than the California law as to written misrepresentations. The question of liability turns, of course, on the "substantive" law of deceit. All jurisdictions accept Pasley v. Freeman, (that there can be actionable deceit as to the credit of a third person), but (according to the reported decisions) the tort is a rare one indeed. (The cases, mostly antiques, are collected in Annot., 32 A.L.R.2d 184.) The "substantive" law of third-party deceit seems almost calculated to thwart the anxious relier upon casual credit information. The misconduct of the defendant entirely apart, the plaintiff

must watch his own step. Specifically, his reliance must be "justifiable" (Restatement, Torts § 537); his reliance must be upon a misrepresentation that is "material" (§ 538); he must not rely upon information obviously false (§ 541); he must specifically rely upon the truth of the representation, rather than his own investigation (§ 547); and he must not be "one who does not rely upon its [the misrepresentation's] truth but upon the expectation that the maker will be held liable in damages for its falsity." (§ 548).

All this, of course, does not solve the problems of the pleading of deceit and the foibles of factfinders. Here, however, the courts seem to override expansive pleading and debatable factfinding with a free hand. For example, in the era when there was a federal common law, the U.S. Supreme Court took occasion to expunge liability in connection with two credit information devices. With respect to the "credit letter of introduction," the court felt that the maker "can be presumed" to speak only to the reputation of the would-be debtor and to speak only from his knowledge of that reputation (Russell v. Clark's Exers., 11 U.S. 69 (1812)). With respect to one merchant's credit inquiry of another merchant, the court surmised that the second merchant is merely passing along information furnished to him or his impressions gained from that information and is not to be charged, absent "fraudulent design" (Lord v. Goddard, 13 U.S. 54 (1851)).

Apparently all that can be said under this heading is that, if there is a problem of permissiveness towards pleading credit

deceit, it is difficult to discover. At least no state in the last 75 years has adopted a Tenterden's provision to deal with the matter. With respect to the particular problem of circumventing the suretyship clause of the Statute of Frauds, it is difficult to discover any difference between Tenterden and non-Tenterden jurisdictions.

#### Popular Impressions of Section 1974

With respect to what Californians do or do not do because of Section 1974, or would do if that section were revised, it appears (from casual inquiries) that the cognoscenti of credit and commercial law are aware of the section. But the impression seems to be that the writing requirement is one provided by statute, not that such requirement is desirable or undesirable, useful or unneeded, etc. It may be that the section is thought to provide an asylum in which credit talk can flow freely and to underscore the generally assumed importance of "putting it in writing." In any event, it seems clear that we are not going to be able to obtain the thoughtful views of anyone (whether credit men or legal aid clinicians) unless we supply some information and have a proposal.

#### Revised Tentative Recommendation (Gold Cover)

Turning to the details of this revision, the idea is simple albeit that the code changes seem complex:

1. Section 1974 is repealed as misplaced and misleading.
2. New Section 1711.5 is added to the Civil Code to join those sections presently dealing with third-party deceit.
3. In subdivision (a), new Section 1711.5 substitutes the classic and still used expression "no action may be brought" for "no person is liable," and then simply repeats the existing language of Section 1974.



4. The scope of subdivision (a) is then limited by subdivisions (b) and (c) which incorporate recognized exceptions to the general Statute of Frauds and exclude the defrauder who would not be protected under the suretyship clause, the fiduciary, the contract-bound credit reporter, the maker of actionable misrepresentations as to matters other than credit, and the willful and intentional defrauder.

5. Subdivision (d) makes clear that the new provision is a statute of frauds defense and is to be asserted and dealt with accordingly.

This may seem to be a complicated disposition of Section 1974, but it is what Tenterden's Act "means," and short of outright repeal, it appears to be the only way to overcome the unnecessarily inequitable results and "hard" cases that seem to arise..

Staff Recommendation (Blue Cover)

The staff again recommends that Section 1974 be repealed. The section is unnecessary to protect a person furnishing credit information unless he is actually seeking to defraud and leads to more litigation than it avoids. At least, we suggest that a tentative recommendation proposing the repeal be distributed for comment so that we can determine whether anyone sees a need to retain the section.

Respectfully submitted,

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Assistant Executive Secretary

January 31, 1969

STATE OF CALIFORNIA  
CALIFORNIA LAW  
REVISION COMMISSION  
TENTATIVE RECOMMENDATION  
relating to  
REPRESENTATIONS AS TO THE CREDIT OF THIRD PERSONS  
AND THE STATUTE OF FRAUDS

CALIFORNIA LAW REVISION COMMISSION  
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WARNING: This tentative recommendation is being distributed so that interested persons will be advised of the Commission's tentative conclusions and can make their views known to the Commission. Any comments sent to the Commission will be considered when the Commission determines what recommendation it will make to the California Legislature.

The Commission often substantially revises tentative recommendations as a result of the comments it receives. Hence, this tentative recommendation is not necessarily the recommendation the Commission will submit to the Legislature.

#### NOTE

This recommendation includes an explanatory Comment to each section of the recommended legislation. The Comments are written as if the legislation were enacted since their primary purpose is to explain the law as it would exist (if enacted) to those who will have occasion to use it after it is in effect.

1/31/69

TENTATIVE  
RECOMMENDATION OF THE CALIFORNIA  
LAW REVISION COMMISSION  
relating to  
REPRESENTATIONS AS TO THE CREDIT OF THIRD PERSONS  
AND THE STATUTE OF FRAUDS

BACKGROUND

Section 1974 of the Code of Civil Procedure is a seemingly simple provision that bars liability upon an unwritten representation as to the credit of a third person. The section--first enacted as a part of the 1872 code and not significantly changed since<sup>1</sup>--states:

No person is liable upon a representation as to the credit of a third person, unless such representation, or some memorandum thereof, be in writing, and either subscribed by or in the hand-writing of the party to be held liable.

Although the particular reason for including Section 1974 in the code can no longer be determined, the section paraphrases a statute known as Lord Tenterden's Act, adopted in England in 1828.<sup>2</sup> That act

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<sup>1</sup> Section 1974 was amended in 1967 in the bill that enacted the Evidence Code. Cal. Stats. 1967, Ch. 299, § 114, p. 1363. The amendment was not intended to make any substantive change in the law. See Law Revision Commission Comment to Section 1974, Recommendation Proposing an Evidence Code, 7 Cal. L. Revision Comm'n Reports 1, 345 (1965).

<sup>2</sup> Section 6 of the Statute of Frauds Amendment Act of 1828, commonly known as Lord Tenterden's Act, provides as follows:

No action shall be brought whereby to charge any person upon or by reason of any representation or assurance made or given concerning or relating to the character, conduct, credit, ability, trade, or dealings of any other person, to the intent or purpose that such person or other person may obtain credit, money or goods upon [sic; thereupon (?) upon it (?)] unless such representation or assurance be made in writing, signed by the party to be charged therewith.

was adopted to prevent circumvention of the suretyship provision of the original Statute of Frauds which required a purely gratuitous promise to answer for the debt, default, or miscarriage of a third person to be in writing. After enactment of the Statute of Frauds, the common law courts came to recognize the tort of intentional deceit; a practice then arose of circumventing the suretyship provision of the Statute of Frauds by alleging, on behalf of the recipient of an unenforceable suretyship promise, that actionable misrepresentations had also been made as to the credit of the third person. The courts at that time were unable to exercise effective control over juries and liability was sometimes found on evidence consisting of little more than the making of the unenforceable suretyship promise. Lord Tenterden's Act thus was designed to prevent artful practitioners from converting unactionable suretyship promises into actionable misrepresentations.

Statutory provisions based on Lord Tenterden's Act are found in 15 states, although not in such important commercial states as New York, Pennsylvania, Ohio, and Illinois. In jurisdictions other than California, these statutes are generally given a very narrow construction consistent with the original purpose of Lord Tenterden's Act. Thus, in many jurisdictions, these statutes are interpreted to apply only in situations, where had the misrepresentation been a promise, the provision would have been unenforceable under the suretyship provision of the Statute of Frauds. The statutes do not, for example, apply to misrepresentations made by fiduciaries to their principals, nor to misrepresentations made in breach of a contractual or other duty to use care in providing credit information. In about half of the 15 states, the statutes have been held not to apply to misrepresentations made with an actual intention to deceive.

In California, however, Section 197<sup>4</sup> has received a different and much more expansive application by the Court of Appeal. (The California Supreme Court has never considered the section.) The section has been applied even though the maker of the fraudulent representation receives a benefit or consideration which, had the misrepresentation been a promise, would have taken the case out of the suretyship provision. For example, in Beckjord v. Slusher,<sup>3</sup> defendant-lessee induced plaintiff-lessor to release him and substitute another lessee by making allegedly false representations as to the credit standing of the new lessee. The Court of Appeal held that Section 197<sup>4</sup> barred relief. The result was that Section 197<sup>4</sup> protected the defendant even though, by his fraudulent misrepresentations, he obtained a release from his continuing obligation to pay rent.<sup>4</sup>

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<sup>3</sup> 22 Cal. App.2d 559, 71 P.2d 820 (1937).

<sup>4</sup> See also Bank of America v. Western United Constructors, 110 Cal. App.2d 166, 242 P.2d 365, 32 A.L.R.2d 738 (1952) (A induced B to lend construction funds to C, fraudulently representing that he would control the funds and see that they were used to complete the project but intending instead that the funds be applied to discharge a debt owed by C to A. The funds were used to discharge C's debt to A and A successfully defeated B's action based on the fraud by invoking Section 197<sup>4</sup>). Professor Corbin describes this decision as "a drastic application of the statute so as to protect a defrauder." Corbin, Contracts § 347 (1964 Supp.).

Section 197<sup>4</sup> has also been applied to protect a fiduciary who makes a fraudulent misrepresentation to his principal. Thus, where a real estate broker induces his principal to enter a transaction by making fraudulent representations as to the credit of another party to the transaction, any action against the broker is barred unless the misrepresentations are in writing.<sup>5</sup> Moreover, although there is no decision precisely in point, the section as interpreted by the Court of Appeal may apply to misrepresentations made in breach of a contractual or other duty to use care in providing credit information.

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<sup>5</sup> Carr v. Tatum, 133 Cal. App. 274, 24 P.2d 195 (1933); Cutler v. Bowen, 10 Cal. App.2d 31, 51 P.2d 164 (1935).

## RECOMMENDATIONS

The barring of at least some meritorious causes of action is an unavoidable consequence of any provision of the Statute of Frauds, i.e., any provision requiring a writing. Presumably this unfortunate result is more than offset by the benefits derived from the requirement.

The particular mischief at which Section 197<sup>4</sup> of the Code of Civil Procedure is directed--circumvention of the suretyship provision of the Statute of Frauds by pleading a misrepresentation as to the credit of the debtor--appears not to be a significant contemporary problem. Whatever may have been the case in 18th century England, courts are now adept at dealing with actions for alleged fraud that are calculated to circumvent a requirement of the Statute of Frauds and can distinguish between an unenforceable suretyship promise and an actionable fraudulent misrepresentation as to credit.<sup>6</sup> Moreover, the early English common law contained no procedure for setting aside a jury verdict and the extent to which the jury's exercise of its powers might be limited and the means by which jury verdicts might be controlled and corrected presented a problem that vexed the English courts for many hundreds of years.<sup>7</sup> In contrast, courts now have considerable control over jury

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<sup>6</sup> California courts deal with the general problem of determining when an action for fraud or other tortious activity can be maintained notwithstanding the Statute of Frauds by closely analyzing the facts of the particular case and by applying equitable precepts that are calculated to maintain the policy of the Statute of Frauds without permitting it to be misused as a shelter for actual fraud. See 1 Witkin, Summary of California Law Contracts §§ 111-114 at 119-124 (1960).

<sup>7</sup> Washington, Damages in Contract at Common Law, 47 L. Q. Rev. 345, 346 (1931).



factfinding and can set aside a verdict that is not supported by the evidence.<sup>8</sup>

Although retention of Section 1974 can scarcely be justified by the reason that led to the adoption of Lord Tenterden's Act in England in 1828, nevertheless the Commission does not recommend that the substance of Section 1974 be entirely repealed. The Commission believes that complete elimination of the section might permit disreputable lenders to take advantage of persons who give gratuitous but inaccurate information relating to credit of others. The requirement of a writing in such a case may be a means of avoiding the need to try nuisance suits. Accordingly, the Commission recommends that Section 1974 be repealed and its substance reenacted, with the following modifications, as Civil Code Section 1711.5:<sup>9</sup>

1. The section should make clear that it is a statute of frauds provision and that the defense it affords is to be raised or waived in the same manner as the defense afforded by other provisions of the Statute of Frauds. This is the interpretation that probably would be given Section 1974 even if it were not revised. See Bank of America v. Hutchinson, 212 Cal. App.2d 142, 27 Cal. Rptr. 787 (1963).

2. The defense afforded by Section 1711.5 should be subject to the same exceptions as the defense afforded by the general Statute of Frauds (Section 1624 of the Civil Code). If Section 1711.5 were so

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<sup>8</sup> See Code of Civil Procedure Sections 629 (judgment notwithstanding verdict), 655-661 (new trial).

<sup>9</sup> Section 1711.5 would be added to the Civil Code in proximity to the provisions of that code relating to third-party deceit. This should help to indicate the proper relationship between these sections.

applied, the maker of a casual but inaccurate statement concerning the credit of a third person would be protected against having to go to trial on a nuisance suit but the person who makes misrepresentations as to the credit of another as a part of an intentional scheme to defraud would not be protected by the statute of frauds defense.

Several Court of Appeal decisions have given Section 1974 a broader application than recommended by the Commission. Repeal of Section 1974 and enactment of Section 1711.5 along the lines recommended by the Commission will conform the new section both to the interpretations given to the general California Statute of Frauds (Civil Code Section 1624) and to decisions interpreting similar statutes in other states, will avoid the unnecessarily harsh results obtained in several California cases, and, at the same time, will preclude a disreputable lender from taking advantage of a person who gives gratuitous but inaccurate information relating to the credit of another.

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The Commission's recommendation would be effectuated by the enactment of the following measure:

An act to add Section 1711.5 to the Civil Code and to repeal  
Section 1974 of the Code of Civil Procedure, relating to  
representations as to credit.

The people of the State of California do enact as follows:

Section 1. Section 1711.5 is added to the Civil Code, to read:

1711.5. (a) No action may be brought upon a representation as to the credit of a third person, unless such representation, or some memorandum thereof, be in writing, and either subscribed by or in the handwriting of the party to be held liable.

(b) This section does not preclude an action from being brought upon a representation not in writing where, had the representation as to the third person's credit been accompanied by a promise to answer for his debt or default, an action could have been brought on the promise to answer for his debt or default even though such promise was not in writing.

(c) This section does not require a writing as to liability arising from:

(1) The breach of a fiduciary or contractual duty owed by the maker of the representation to the person who acted upon the representation.

(2) Representations as to matters other than the credit of a third person that are a substantial factor in determining the course of conduct which results in loss or damage, notwithstanding that representations as to the credit of a third person are also made.

(3) Deceit on the part of the maker of the representation where such deceit consists of a misrepresentation made with the actual intention to deceive, notwithstanding that the deceit consisted in whole or in part of misrepresentations as to the credit of a third person.

(d) The defense afforded by this section may be asserted or waived in the same manner as the defense afforded by the various subdivisions of Section 1624.

Comment. Section 1711.5 is added to clarify the longstanding requirement that representations as to the credit of third persons be in writing. It supersedes Section 1974 of the Code of Civil Procedure. Former Section 1974 and similar statutes in a few other common law jurisdictions were derived from Lord Tenterden's Act (9 Geo. 4, c. 14). See Taylor, The Statute of Frauds and Misrepresentations as to the Credit of Third Persons--Should California Repeal Its Lord Tenterden's Act? [Citation]. Section 1711.5 takes into account the reasons that led to the enactment of Lord Tenterden's Act in England in 1828 insofar as those reasons justify retention of the substance of that act in light of the improvements that have been made in judicial administration since 1828.

Subdivision (a). Subdivision (a) retains the language of former Section 1974 except that the historic language of the Statute of Frauds and Lord Tenterden's Act ("No action may be brought") is substituted for the seemingly substantive statement that "No person is liable." For further discussion, see the portion of this Comment that discusses subdivision (d).

Subdivision (b). Subdivision (b) eliminates the writing requirement imposed by subdivision (a) in cases where, had the person making the representation as to the credit of the third person also promised to answer for the debt of the third person, the promise to answer for the third person's debt would have been actionable even though not in writing. Thus, subdivision (b) makes Section 1711.5 consistent with the suretyship clause of the Statute of Frauds (subdivision 2 of Civil Code Section 1624). Formerly, Section 1974 was applied where a suretyship promise might have been exempted from the requirement of a writing by the specific provisions of Section 2794 of the Civil Code or by case law doctrines, principally the so-called "main purpose rule." See, e.g., Bank of America v. Western United Constructors, 110 Cal. App.2d 166, 242 P.2d 365, 32 A.L.R.2d 738 (1952). Subdivision (b) changes these results by excluding situations in which a suretyship promise would be exempted from the writing requirement by Section 2794 of the Civil Code or the "main purpose rule" or other case law exceptions. As to the main purpose rule, see Michael Distrib. Co. v. Tobin, 225 Cal. App.2d 655, 37 Cal. Rptr. 518 (1964); 1 Witkin, Summary of California Law, Contracts, § 100 at 108; Restatement of Contracts § 184.

Subdivision (c). Subdivision (c) resolves several questions that arose under former Section 1974. That section was held to apply notwithstanding a fiduciary relationship between the maker of the representation and the person who acted upon the representation. See Carr v. Tatum, 133 Cal. App. 274, 24 P.2d 195 (1933); Cutler v. Bowen, 10 Cal. App.2d 31, 51 P.2d 164 (1935). Paragraph (1) of subdivision (c)

changes this result by making the writing requirement inapplicable where there is a breach of fiduciary duty even though the breach consists of making misrepresentations as to the credit of a third party. This adopts the rule that applies under the general Statute of Frauds (Civil Code Section 1624). E.g., Gerhardt v. Weiss, 247 Cal. App.2d 114, 55 Cal. Rptr. 425 (1966). See also Sunset-Sternau Food Co. v. Bonzi, 60 Cal.2d 834, 36 Cal. Rptr. 741, 389 P.2d 133 (1964). It also adopts the view taken in other jurisdictions that have enacted provisions like Section 1711.5. See, e.g., W. G. Jenkins & Co. v. Standrod, 46 Idaho 614, 269 Pac. 586 (1928).

Also exempted by paragraph (1) of subdivision (c) are situations in which the misrepresentation or misinformation is made or given in breach of a contractual duty between the maker of the representation and the person who acts upon it. This question was not resolved by the decisions under Section 1974. See, however, Bank of America v. Hutchinson, 212 Cal. App.2d 142, 27 Cal. Rptr. 787 (1963). Subdivision (c) adopts the English view that Lord Tenterden's Act and its variations have no application to cases in which the maker of a representation is under a contractual duty to avoid deception or to use care in furnishing information. See W. B. Anderson & Sons v. Rhodes, [1967] 2 All E. R. 850; Banbury v. Bank of Montreal, [1918] A. C. 626.

Difficulties arose in applying Section 1974 where the primary purpose of the defendant was to procure credit for another person, but the alleged misrepresentations were not directly pertinent to the credit of that person or were in addition to misrepresentations as to

the credit of the third person. See, e.g., Bank of America v. Western United Constructors, 110 Cal. App.2d 166, 242 P.2d 365, 32 A.L.R.2d 738 (1952); Baron v. Lange, 92 Cal. App.2d 719, 207 P.2d 611 (1949). Paragraph (2) of subdivision (c) resolves these difficulties by adopting the language and view set forth in Section 546 of the Restatement of Torts. Recovery is not barred if an actionable deceit as to a matter other than the credit of a third person is a "substantial factor," even though the loss results from an extension of credit and misrepresentations are also made as to the credit of the debtor.

An exception for misrepresentations made with an actual intention to deceive was not recognized under former Section 1974. See discussion in Carr v. Tatum, 133 Cal. App. 274, 24 P.2d 195 (1933). See also Baron v. Lange, 92 Cal. App.2d 719, 207 P.2d 611 (1949). However, paragraph (3) of subdivision (c) adopts the rule established under the general Statute of Frauds (Civil Code Section 1624) that the writing requirement does not protect a defrauder. See, e.g., Monarco v. Lo Greco, 35 Cal.2d 621, 220 P.2d 737 (1950). (The California cases, which use the formula of an "estoppel" to assert the Statute of Frauds, are analyzed in Comment, Equitable Estoppel and the Statute of Frauds in California, 53 Cal. L. Rev. 590 (1965). See also Summers, The Doctrine of Estoppel Applied to the Statute of Frauds, 79 U. Pa. L. Rev. 440 (1931); 1 Witkin, Summary of California Law, Contracts, §§ 111-114 at 119-124.) Paragraph (3) is also consistent with the view taken in a number of other American jurisdictions that provisions based on Lord Tenterden's Act do not apply to misrepresentations made with an actual intention to deceive. See Annot., 32 A.L.R.2d 743 (1953).

Subdivision (d). Subdivision (d) makes clear that Section 1711.5 is a statute of frauds provision and that the defense it affords is to be raised or waived in the same manner as the defense afforded by other provisions of the Statute of Frauds. See 1 Witkin, Summary of California Law, Contracts, §§ 87-89 at 94-96. It was never clear whether former Section 1974 stated a rule of evidence, a rule of procedure, or a rule of substantive law. See Bank of America v. Hutchinson, 212 Cal. App.2d 142, 27 Cal. Rptr. 787 (1963).



§ 1974

Sec. 2. Section 1974 of the Code of Civil Procedure is repealed.

~~1974. -- No person is liable upon a representation as to the credit of a third person, unless such representation, or some memorandum thereof, be in writing, and either subscribed by or in the handwriting of the party to be held liable.~~

Comment. See the Comment to Civil Code Section 1711.5.

January 31, 1969

STATE OF CALIFORNIA  
CALIFORNIA LAW  
REVISION COMMISSION  
TENTATIVE RECOMMENDATION  
relating to  
REPRESENTATIONS AS TO THE CREDIT OF THIRD PERSONS  
AND THE STATUTE OF FRAUDS

CALIFORNIA LAW REVISION COMMISSION  
School of Law  
Stanford University  
Stanford, California 94305

WARNING: This tentative recommendation is being distributed so that interested persons will be advised of the Commission's tentative conclusions and can make their views known to the Commission. Any comments sent to the Commission will be considered when the Commission determines what recommendation it will make to the California Legislature.

The Commission often substantially revises tentative recommendations as a result of the comments it receives. Hence, this tentative recommendation is not necessarily the recommendation the Commission will submit to the Legislature.

#### NOTE

This recommendation includes an explanatory Comment to each section of the recommended legislation. The Comments are written as if the legislation were enacted since their primary purpose is to explain the law as it would exist (if enacted) to those who will have occasion to use it after it is in effect.

1/31/69

TENTATIVE  
RECOMMENDATION OF THE CALIFORNIA  
LAW REVISION COMMISSION  
relating to  
REPRESENTATIONS AS TO THE CREDIT OF THIRD PERSONS  
AND THE STATUTE OF FRAUDS

BACKGROUND

Section 1974 of the Code of Civil Procedure is a seemingly simple provision that bars liability upon an unwritten representation as to the credit of a third person. The section--first enacted as a part of the 1872 code and not significantly changed since<sup>1</sup>--states:

No person is liable upon a representation as to the credit of a third person, unless such representation, or some memorandum thereof, be in writing, and either subscribed by or in the handwriting of the party to be held liable.

Although the particular reason for including Section 1974 in the code can no longer be determined, the section paraphrases a statute known as Lord Tenterden's Act, adopted in England in 1828.<sup>2</sup> That act

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<sup>1</sup> Section 1974 was amended in 1967 in the bill that enacted the Evidence Code. Cal. Stats. 1967, Ch. 299, § 114, p. 1363. The amendment was not intended to make any substantive change in the law. See Law Revision Commission Comment to Section 1974, Recommendation Proposing an Evidence Code, 7 Cal. L. Revision Comm'n Reports 1, 345 (1965).

<sup>2</sup> Section 6 of the Statute of Frauds Amendment Act of 1828, commonly known as Lord Tenterden's Act, provides as follows:

No action shall be brought whereby to charge any person upon or by reason of any representation or assurance made or given concerning or relating to the character, conduct, credit, ability, trade, or dealings of any other person, to the intent or purpose that such person or other person may obtain credit, money or goods upon [sic; thereupon (?) upon it (?)] unless such representation or assurance be made in writing, signed by the party to be charged therewith.

was adopted to prevent circumvention of the suretyship provision of the original Statute of Frauds which required a purely gratuitous promise to answer for the debt, default, or miscarriage of a third person to be in writing. After enactment of the Statute of Frauds, the common law courts came to recognize the tort of intentional deceit; a practice then arose of circumventing the suretyship provision of the Statute of Frauds by alleging, on behalf of the recipient of an unenforceable suretyship promise, that actionable misrepresentations had also been made as to the credit of the third person. The courts at that time were unable to exercise effective control over juries and liability was sometimes found on evidence consisting of little more than the making of the unenforceable suretyship promise. Lord Tenterden's Act thus was designed to prevent artful practitioners from converting unactionable suretyship promises into actionable misrepresentations.

Statutory provisions based on Lord Tenterden's Act are found in 15 states, although not in such important commercial states as New York, Pennsylvania, Ohio, and Illinois. In jurisdictions other than California, these statutes are generally given a very narrow construction consistent with the original purpose of Lord Tenterden's Act. Thus, in many jurisdictions, these statutes are interpreted to apply only in situations, where had the misrepresentation been a promise, the provision would have been unenforceable under the suretyship provision of the Statute of Frauds. The statutes do not, for example, apply to misrepresentations made by fiduciaries to their principals, nor to misrepresentations made in breach of a contractual or other duty to use care in providing credit information. In about half of the 15 states, the statutes have been held not to apply to misrepresentations made with an actual intention to deceive.

In California, however, Section 1974 has received a different and much more expansive application by the Court of Appeal. (The California Supreme Court has never considered the section.) The section has been applied even though the maker of the fraudulent representation receives a benefit or consideration which, had the misrepresentation been a promise, would have taken the case out of the suretyship provision. For example, in Beckjord v. Slusher,<sup>3</sup> defendant-lessee induced plaintiff-lessor to release him and substitute another lessee by making allegedly false representations as to the credit standing of the new lessee. The Court of Appeal held that Section 1974 barred relief. The result was that Section 1974 protected the defendant even though, by his fraudulent misrepresentations, he obtained a release from his continuing obligation to pay rent.<sup>4</sup>

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<sup>3</sup> 22 Cal. App.2d 559, 71 P.2d 820 (1937).

<sup>4</sup> See also Bank of America v. Western United Constructors, 110 Cal. App.2d 166, 242 P.2d 365, 32 A.L.R.2d 738 (1952)(A induced B to lend construction funds to C, fraudulently representing that he would control the funds and see that they were used to complete the project but intending instead that the funds be applied to discharge a debt owed by C to A. The funds were used to discharge C's debt to A and A successfully defeated B's action based on the fraud by invoking Section 1974). Professor Corbin describes this decision as "a drastic application of the statute so as to protect a defrauder." Corbin, Contracts § 347 (1964 Supp.).

Section 197<sup>4</sup> has also been applied to protect a fiduciary who makes a fraudulent misrepresentation to his principal. Thus, where a real estate broker induces his principal to enter a transaction by making fraudulent representations as to the credit of another party to the transaction, any action against the broker is barred unless the misrepresentations are in writing.<sup>5</sup> Moreover, although there is no decision precisely in point, the section as interpreted by the Court of Appeal may apply to misrepresentations made in breach of a contractual or other duty to use care in providing credit information.

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<sup>5</sup> Carr v. Tatum, 133 Cal. App. 274, 24 P.2d 195 (1933); Cutler v. Bowen, 10 Cal. App.2d 31, 51 P.2d 164 (1935).

## RECOMMENDATION

The barring of at least some meritorious causes of action is an unavoidable consequence of any provision of the Statute of Frauds, i.e., any provision requiring a writing. Presumably, this unfortunate result is more than offset by the benefits derived from the requirement. However, Section 1974 has caused not only generally unsatisfactory results but has produced no identifiable social benefits.

The case against Section 1974 can be summarized thus:

1. Statutes similar to Section 1974 exist in only 15 states, England, and three or four commonwealth countries; the other states and jurisdictions--including the most important commercial states--appear to get along very well without the provision.
2. The particular mischief at which the section is directed--circumvention of the suretyship provision of the Statute of Frauds by pleading a misrepresentation as to the credit of the debtor--appears not to be a significant contemporary problem. Whatever may have been the case in 18th century England, courts are now adept at dealing with actions for alleged fraud that are calculated to circumvent a requirement of the Statute of Frauds and can distinguish between an unenforceable suretyship promise and an actionable fraudulent misrepresentation as to credit. In any event, it is not logically necessary or desirable to provide that, whenever a promise as to the undertaking of a third person must be in writing,

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California courts deal with the general problem of determining when an action for fraud or other tortious activity can be maintained notwithstanding the Statute of Frauds by closely analyzing the facts of the particular case and by applying equitable precepts that are calculated to maintain the policy of the Statute of Frauds without permitting it to be misused as a shelter for actual fraud. See 1 Witkin, Summary of California Law, Contracts, §§ 111-114 at 119-124 (1960).



any fraudulent representation as to the credit of that third person must also be in writing. A promise is a promise, a fraud is a fraud, and the difference is significant.

3. The case law results under Section 1974 are unsatisfactory. Either the results are harsh (as when invoked to shelter flagrant fraud) or leave a gnawing uncertainty. For example, we may never know whether the section applies to negligent misrepresentations. Because the application of the section has been so **uncertain**, **it is reasonable** to suppose that counsel and their clients have not been deterred--and will not be deterred--from bringing any action merely because it might fall within the section. Although the proposition cannot be demonstrated, one can reasonably assume that Section 1974 has led to more litigation that it has prevented and has sheltered more fraud than it has suppressed.

4. Section 1974 does not routinize, regularize, or authenticate any range of acceptable business or commercial practice. The decisions under the section have exonerated such miscellaneous persons as bankers, real estate brokers, subcontractors, lessees, and fathers of aspiring young businessmen. Insofar as there is a need to protect the maker of a casual, off-hand representation as to the credit of another person, that is a prime concern of the law of deceit and of negligent misrepresentation. The requirements for a successful action of deceit on a misrepresentation as to the credit of another person are not easily met, with or without a writing. The plaintiff must affirmatively prove the misrepresentation of fact, the defendant's knowledge of the falsity, the defendant's intention to defraud, the plaintiff's justifiable reliance,

and the resulting damage.<sup>7</sup> The requirements for a successful action for negligent misrepresentation are even more difficult to satisfy. For example, liability for negligent misrepresentation is imposed only on one who supplies information for business purposes in the course of a business or profession.<sup>8</sup> Moreover, it is unlikely that the section was ever intended to apply to negligent, as distinguished from fraudulent, misrepresentations.<sup>9</sup> It should be noted that repeal of Section 1974 would make no change in existing law other than eliminating the requirement of a writing. No change would be made with respect to the substantive question of liability, whether that liability allegedly is based upon fraud and deceit, negligence, or the breach of a contractual, fiduciary, or other duty.

5. Section 1974 was repealed as a part of the omnibus revision of the Code of Civil Procedure in 1901<sup>10</sup> but the 1901 act was held void for unconstitutional defects in form.<sup>11</sup>

For the reasons set forth above, the Commission recommends that Section 1974 of the Code of Civil Procedure be repealed.

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<sup>7</sup> See 2 Witkin, Summary of California Law, Torts, §§ 186-207 at 1371-1392 (1960).

<sup>8</sup> See 2 Witkin, Summary of California Law, Torts, §§ 207-209 at 1392-1398 (1960).

<sup>9</sup> See Taylor, The Statute of Frauds and Misrepresentations as to the Credit of Third Persons--Should California Repeal Its Lord Tenterden's Act? [citation].

<sup>10</sup> Cal. Stats. 1901, Ch. 102, p. 117.

<sup>11</sup> Lewis v. Dunne, 134 Cal. 291, 66 Pac. 478 (1901).

RECOMMENDED LEGISLATION

The Commission's recommendation would be effectuated by the enactment of the following measure:

An act to repeal Section 1974 of the Code of Civil Procedure, relating to representations as to the credit of third persons.

The people of the State of California do enact as follows:

Section 1. Section 1974 of the Code of Civil Procedure is repealed.

~~1974.--No person is liable upon a representation as to the credit of a third person, unless such representation, or some memorandum thereof, be in writing, and either subscribed by or in the handwriting of the party to be held liable.~~

Comment. Section 1974 formerly precluded liability "upon a representation as to the credit of a third person" unless the representation was in writing. For the history and applications of the repealed section, see Taylor, The Statute of Frauds and Misrepresentations as to the Credit of Third Persons--Should California Repeal Its Lord Tenterden's Act? [citation].

Section 1974 and similar statutes in a few other common law jurisdictions were derived from Lord Tenterden's Act (9 Geo. 4, c. 14). That act was adopted in England in 1828 to bulwark the provision of the Statute of Frauds (29 Car. 2, c. 3) which required a suretyship promise--a promise "to answer for the debt default or miscarriages of another person"--to be in writing. The act was intended to bar an action in those cases in

which the recipient of an unwritten, and therefore unenforceable, suretyship promise otherwise might avoid the requirement of a writing by pleading an unwritten misrepresentation as to the credit of the debtor. The repeal of Section 1974 permits the maintenance of an action based on an unwritten misrepresentation as to the credit of the debtor but has no effect on the suretyship provision of the Statute of Frauds (Civil Code Sections 1624(2) and 2794).

The repeal of Section 1974 makes significant the distinction between an unwritten misrepresentation as to the credit of a third person (action not barred by the Statute of Frauds) and an unwritten suretyship promise (action barred by subdivision (2) of Civil Code Section 1624 unless otherwise provided in Civil Code Section 2794 or by decisional law). California courts deal with the general problem of determining when an action for fraud or other tortious activity can be maintained notwithstanding the Statute of Frauds by closely analyzing the facts of the particular case and by applying equitable precepts that are calculated to maintain the policy of the Statute of Frauds without permitting it to be misused as a shelter for actual fraud. See 1 Witkin, Summary of California Law, Contracts, §§ 111-114 at 119-124 (1960). The repeal of Section 1974 permits the same process to be used to prevent circumvention of subdivision (2) of Civil Code Section 1624 by the making of unfounded allegations that oral misrepresentations were made as to the credit of the debtor.

The effect of Section 1974 was limited to imposing the requirement of a writing; it had no other bearing upon the rules of law that determine the liability, if any, incurred by the making of a misrepresentation as to the credit of another person. Accordingly, apart from eliminating

the requirement of a writing, repeal of the section does not affect such rules. See 2 Witkin, Summary of California Law, Torts, §§ 186-209 at 1371-1398 (1960).