

9/26/69

Memorandum 69-110

Subject: Study 60 - Representations as to Credit

Attached is the tentative recommendation relating to representations as to credit. This was sent to the State Bar in May 1969. Also it was sent to the California Bankers Association. Neither group has any comments.

The State Bar Committee on debtor and creditor has discussed the recommendation, but they changed chairmen in July and, as a result, cannot send us a report until the Committee meets and it has not scheduled a meeting. From what I can gather, lawyers generally are not aware of the existence of Section 1974 and are not excited enough about the prospects of its repeal to be willing to meet. However, the Committee will give this matter a priority when it meets.

I also checked with the law firm that represents the California Bankers Association. They have distributed the recommendation to various bankers, but the bankers, too, appear to be unconcerned about the prospects of the section's being repealed.

The staff suggests that the recommendation be approved for printing. The cases under the section illustrate that it results in injustice to clients of real estate brokers and bankers and has protected outright defrauders. The study (attached) indicates that the prospects of recovering on a misrepresentation as to the credit of another are extremely dim, and that the only effect of the section is to protect the defrauder. The repeal will have no effect on the person who makes a negligent misrepresentation unless he does so with the intent to defraud.

If and when the State Bar and the Bankers Association submit comments, they can be considered and any needed modifications made in the proposed legislation.

If you have any concern about this recommendation, please read the research study as well as the recommendation.

Respectfully submitted,

John H. DeMouilly
Executive Secretary

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Revised March 5, 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.

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 unwritten "representations" as to the credit of third persons. The section--first enacted as a part of the 1872 code and not significantly changed since¹--provides that:

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 1828.² That act was adopted

¹ Section 197⁴ was amended in 1965 in the bill that enacted the Evidence Code. Cal. Stats. 1965, 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).

² 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.

to prevent circumvention of the suretyship provision of the original Statute of Frauds. That provision, of course, requires that a purely gratuitous promise to answer for the debt, default, or miscarriage of a third person 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 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 of that era 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 was enacted to overcome the problem by preventing 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 generally are given a very narrow construction consistent with the original purpose of Lord Tenterden's Act. In several jurisdictions, they are interpreted to apply only in situations where, had the misrepresentation been a promise, the promise would have been unenforceable under the suretyship provision of the Statute of Frauds. Thus, the statutes do not apply, for example, 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 inapplicable 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,³ defendant-lessee induced plaintiff-lessor to release him and substitute another lessee by making allegedly false representations as to the credit 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 he allegedly used fraudulent misrepresentations to obtain a release from his continuing obligation to pay rent.⁴

³ 22 Cal. App.2d 559, 71 P.2d 820 (1937).

⁴ 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 1974 has also been applied to protect a fiduciary who misleads 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.⁵ 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.

⁵ 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 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--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 circumvention of the Statute of Frauds and can distinguish between an unenforceable suretyship promise and an actionable misrepresentation as to credit.⁶ 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, any fraudulent representation as to the credit of that third person

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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).

must also be in writing. A promise is a promise, a fraud is a fraud, and the difference is significant.

3. The appellate decisions under Section 197⁴ are unsatisfactory. Either the results are harsh (as when invoked to shelter flagrant fraud)⁷ or leave a great uncertainty. For example, it is impossible to determine whether the section applies to actionable negligent misrepresentations, as well as to those made with "scienter." 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 than it has prevented and has sheltered more fraud than it has suppressed.

⁷ The rule established under the general Statute of Frauds (Civil Code Section 162⁴) is 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 (1960). No similar exception is recognized under 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). As to other jurisdictions that have provisions based on Lord Tenterden's Act, however, see Annot., 32 A.L.R.2d 743 (1953).

4. Section 1974 is the only provision of the Statute of Frauds that applies to tort actions, and the tort to which it presumably is addressed ("third-party" deceit) is a rare and limited one. The section does not appear to routinize, regularize, or authenticate any range of acceptable business or commercial practice.⁸ 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.⁹ The requirements for a successful action for negligent misrepresentation are even more difficult to satisfy. For example, liability for negligent

⁸ In fact, the defendant has sometimes failed to raise the defense provided by Section 1974. For example, 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. See also *Bank of America v. Hutchinson*, 212 Cal. App.2d 142, 27 Cal. Rptr. 787 (1963).

⁹ See 2 Witkin, *Summary of California Law, Torts*, §§ 186-207 at 1371-1392 (1960). See also *Lord v. Goddard*, 13 U.S. 54 (1851); *Russell v. Clark's Exers.*, 11 U.S. 69 (1812); *Williams v. Spazier*, 134 Cal. App. 340, 25 P.2d 851 (1933).

misrepresentation is imposed only on one who supplies information for business purposes in the course of a business or profession.¹⁰ Moreover, it is unlikely that the section was ever intended to apply to negligent, as distinguished from fraudulent, misrepresentations.¹¹ 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 1901,¹² but the 1901 act was held void for unconstitutional defects in form.¹³

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

¹⁰ See 2 Witkin, Summary of California Law, Torts, §§ 207-209 at 1392-1398 (1960).

¹¹ See Taylor, The Statute of Frauds and Misrepresentations as to the Credit of Third Persons--Should California Repeal Its Lord Tenterden's Act? [citation].

¹² Cal. Stats. 1901, Ch. 102, p. 117.

¹³ 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 requires 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 where 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).