

Pace University

DigitalCommons@Pace

Pace Law Faculty Publications

School of Law

2014

Contesting Disclaimer-of-Reliance Clauses by Efficiency, Free Will, and Conscience: Staving Off Caveat Emptor

Shelby D. Green

Elisabeth Haub School of Law at Pace University

Follow this and additional works at: <https://digitalcommons.pace.edu/lawfaculty>



Part of the [Contracts Commons](#), and the [Property Law and Real Estate Commons](#)

Recommended Citation

Shelby D. Green, Contesting Disclaimer-of-Reliance Clauses by Efficiency, Free Will, and Conscience: Staving Off Caveat Emptor, 2 Tex. A&M L. Rev. 1 (2014), <http://digitalcommons.pace.edu/lawfaculty/986/>.

This Article is brought to you for free and open access by the School of Law at DigitalCommons@Pace. It has been accepted for inclusion in Pace Law Faculty Publications by an authorized administrator of DigitalCommons@Pace. For more information, please contact dheller2@law.pace.edu.

ARTICLES

CONTESTING DISCLAIMER-OF-RELIANCE CLAUSES BY EFFICIENCY, FREE WILL, AND CONSCIENCE: STAVING OFF CAVEAT EMPTOR

*By Shelby D. Green**

TABLE OF CONTENTS

I. INTRODUCTION.....	2
II. SOCIETAL ORDERING THROUGH CONTRACT.....	6
A. <i>Governmental Deference to Market Forces</i>	7
B. <i>The Sweetness of Commerce: Doux Commerce</i>	8
III. TRANSMOGRIFICATION OF CONTRACT LAW: FROM EQUITABLE CONCEPTION TO WILL THEORY	10
A. <i>The Imperatives of Freedom of Contract: Markets and Morals</i>	12
B. <i>Contract Will and Caveat Emptor</i>	13
1. Every Man for Himself and Devil Takes the Hindmost	14
2. Unquestioned Soundness	16
3. Foreclosing Will by Fraud	18
4. Trust and Will	19
IV. FROM WILL TO OUGHT	22
A. <i>Responses: Entrepreneurs and Rascals</i>	25
1. Disclaimers, Free Will, and Fools	26
2. Disclaimers in the Face of Knowing False Statements	28
3. Representations and Reliance in Fact.....	31
V. CONTRACT LIMITS ON WHO CAN RELY	35
A. <i>Judicial and Legislative Abrogation of Privity</i>	36
1. Foreseeability as a Proxy for Privity	40
VI. THE LAW'S CONSCIENCE: INTUITION AND PUBLIC POLICY.....	43
A. <i>Conscience As An Imperative for Moral Markets</i> ...	44
B. <i>Inefficiencies and Externalities</i>	47
C. <i>The Call of Public Policy</i>	48
1. New Framework for Disclaimer-of-Reliance Clauses	48
VII. CONCLUSION	50

* Associate Professor of Law, Pace Law School, J.D. Georgetown University Law Center, B.S. Towson State College.

I. INTRODUCTION

Mark Twain's famous remark, "The report of my death was an exaggeration,"¹ has become most apt in recent years as it pertains to the purported demise of the rule of *caveat emptor* in real estate transactions. An ancient maxim of law, *caveat emptor* puts a buyer on his guard to discover defects in things purchased, with no general duty by a seller to disclose defects of which he has knowledge.² Despite the apparent abrogation of the concept by legislative and judicially-imposed-disclosure obligations, a new phenomenon has emerged that allows a seller of real property, or related real property services, to easily maneuver around the requirement of disclosure through strategic, rent-seeking conduct.

Disclosure obligations intervene in contract relations, as they alter the incentives and burdens of the parties in discovering information material to the bargain.³ The oft-occurring occasion for the law's intervention into private bargains is incompleteness that results from the costs (e.g., negotiating, research, and verification) of contracting for all possible contingencies.⁴ Rational actors will weigh these costs against the benefits of contracting to a theoretical, if not practical, completeness. Where the contract is not complete, default rules—gap fillers—may operate. The most significant gap filler in contract relations is the implied covenant of good faith and fair dealing. This obligation serves as an overarching contract term and cannot be contracted away.⁵ The law seeks to enforce the parties' expectations,

1. Frank Marshall White, *Mark Twain Amused*, N.Y.J., June 2, 1897, at 1.

2. See, e.g., *Swanson v. Baldwin*, 85 N.W.2d 576, 578 (Iowa 1957) ("[P]urchaser must examine, judge, and test" an article for himself, "being bound to discover any obvious defects") (quoting BLACK'S LAW DICTIONARY 294 (3d ed. 1933)); *Dorsey v. Jackman*, 1 Serg. & Rawle 42, 44 n.(a) (Pa. 1814) ("[I]t is the business of the buyer to be upon his guard" and "must abide any loss of any imprudent purchase"). The origins, contours, and abrogation of the maxim are discussed in Part III of this Article.

3. See Jules J. Coleman, Douglas D. Heckathorn & Steven M. Maser, *A Bargaining Theory Approach to Default Provisions and Disclosure Rules in Contract Law*, 12 HARV. J.L. & PUB. POL'Y 637, 650, 693 (1989).

4. See Harold Dubroff, *The Implied Covenant of Good Faith in Contract Interpretation and Gap-Filling: Reviling a Revered Relic*, 80 ST. JOHN'S L. REV. 559, 576 (2006) ("[C]ourts, whether implicitly or explicitly, and regardless of their jurisprudential philosophy . . . acknowledge the impracticality (due to transaction costs) and the impossibility (due to the limits of human imagination . . .) of producing an all-encompassing, express agreement."); Ralph James Mooney, *The New Conceptualism in Contract Law*, 74 OR. L. REV. 1131, 1147 (1995) ("The assumption that most parties in fact reduce their entire agreement to a single, perfectly accurate writing [is] . . . unrealistic.").

5. The implied covenant of good faith and fair dealing aims to ensure the accomplishment of these expectations of the party. See *Nemec v. Shrader*, 991 A.2d 1120, 1126 (Del. 2010) (en banc) (noting that the implied covenant is invoked to "imply contract terms when the party asserting the implied covenant proves that the other party has acted arbitrarily or unreasonably, thereby frustrating the fruits of the bargain that the asserting party reasonably expected."); *Dunlap v. State Farm Fire & Cas. Co.*, 878 A.2d 434, 444 (Del. 2005) (en banc) ("The implied covenant . . . requires that

induced by their mutual promises, but recognizes that there are certain understandings or expectations the parties should not need to negotiate, e.g., the other party will not act to prevent the enjoyment of the fruits of the contract.⁶

However, incompleteness as to the terms of the bargain is not the only occasion for legal intervention. Instead, strategic, rent-seeking conduct, i.e., the withholding of information so as to increase a party's share of the total gains from the transaction, should, but not always, mediate disclosure obligations. The case of *Teer v. Johnston* shows what happens without intervention.⁷ After a county-road project that included the diversion of water, the seller's property was constantly flooded.⁸ Unable to obtain compensation from the government for the diminution in value to her property, the seller opted to recoup those losses through a sale of her property.⁹ The offering price did not reflect the effects of the flooding problem because the seller did not reveal that information.¹⁰ While the sale was "as is," the seller represented orally, as well as in a property condition disclosure statement, that there were "no flooding, drainage[,] or grading problems" with the property and that the property had never flooded.¹¹ The contract did not by its terms incorporate the disclosure statement. It did contain a clause that stated, "No representation, promise, or inducement not included in this contract shall be binding upon any party hereto."¹² The Alabama Supreme Court rejected the buyers' claims of fraud, finding the disclaimer-of-reliance clause negated the required element of reliance.¹³

What the seller practiced in *Teer* was contract by ambush, animated solely by self-interest. One contemplating a real property transaction will enter into a myriad of contracts, e.g., the purchase and sale agreement, inspection, title search, appraisal, and survey, among others. These relationships are, for the most part, self-interested. Indeed, "self-interest" is often identified as the critical component of success-

[each party to a contract] act in a way that honors the [other's] reasonable expectations."); *Moran v. Erk*, 901 N.E.2d 187, 190 (N.Y. 2008) ("The implied covenant of good faith and fair dealing . . . embraces a pledge that 'neither party shall do anything which will have the effect of destroying or injuring the right of the other party to receive the fruits of the contract.'" (quoting *511 W. 232nd Owners Corp. v. Jennifer Realty Co.*, 773 N.E.2d 496, 500 (N.Y. 2002))).

6. *Katz v. Oak Indus., Inc.*, 508 A.2d 873, 880 (Del. Ch. 1986) (citing COLIN KELLY KAUFMAN, CORBIN ON CONTRACTS § 570 (Kaufman Supp. 1984)).

7. *Teer v. Johnston*, 60 So. 3d 253 (Ala. 2010).

8. *Id.* at 255.

9. *Id.*

10. *Id.*

11. *Id.* Johnson claimed that she was instructed to fill out the disclosure form this way by the real estate agent and that she expected him to ensure the form reflected what the agent knew about the property.

12. *Id.*

13. *Id.* at 261.

ful markets as a morally positive force.¹⁴ Rational choice theory explains human behavior as the product of rational choices, particularly in an economic context, and states that people are essentially self-interested utility maximizers.¹⁵

Although formally bilateral, these contracts may have effects on third parties who contemporaneously or subsequently rely on the promises in them.¹⁶ In this original relation, neither party consciously does what is abstractly right when entering into the contractual relationship.¹⁷ Instead, throughout history the overarching political and economic driving force behind contractual relations has been self-interest facilitated by the philosophy of freedom of contract, and with the requirement of privity serving as the line of demarcation for a wrongdoing party's liability.¹⁸ That meant downstream purchasers had no cause of action against a remote seller who engaged in unscrupulous conduct that caused injury down the line.¹⁹

This Article hopes to make evident two trends seemingly in conflict. The first trend is toward raising the standards of probity and veridicality in contractual relations toward greater accountability and liability on market actors operating outside traditional bounds. The first is expressed by new rules that: require good faith and fair dealing between parties;²⁰ ensure sellers are obligated to disclose material facts about a property otherwise unavailable to buyers;²¹ and make wrongdoing

14. See DANIEL FINN, *MORAL ECOLOGY OF MARKETS: ASSESSING CLAIMS ABOUT MARKETS AND JUSTICE* 46–56 (2006) (challenging the morality of self-interest in markets and identifying the moral limits). See also Robert C. Solomon, *Free Enterprise, Sympathy, and Virtue*, in *THE MORAL MARKETS: THE CRITICAL ROLE OF VALUES IN THE ECONOMY* 16, 17 (Paul J. Zak ed., 2008); or see discussion *infra* Part II.B.

15. See John N. Hooker, *The Moral Implications of Rational Choice Theories*, Carnegie Mellon U., Tepper Sch. Bus. 1–2 (2011), <http://repository.cmu.edu/cgi/viewcontent.cgi?article=2390&context=tepper> (“[Rational choice theories] have been a major part of the Western intellectual landscape since the market system replaced a medieval economy. This historical shift is seen as giving rise to *Homo economicus*—economic man—who is driven by self-interested economic calculation rather than a value system of loyalty and honor.”).

16. See discussion *infra* Part V.

17. FINN, *supra* note 14, at 55; Harry N. Scheiber, *Economic Liberty and the Modern State*, in *THE STATE AND FREEDOM OF CONTRACT* 149–50 (Harry N. Scheiber ed. 1998).

18. Arthur L. Corbin, *Contracts for the Benefit of Third Persons*, 27 YALE L.J. 1008, 1008 (1918) (“To many students and practitioners of the common law *privity of contract* became a fetish. As such, it operated to deprive many a claimant of a remedy in cases where according to the *mores* of the time the claim was just.”).

19. See W. DAVID SLAWSON, *BINDING PROMISES: THE LATE 20TH CENTURY REFORMATION OF CONTRACT LAW* 12–13 (1996).

20. See Duboff, *supra* note 4, at 615.

21. See Johnson v. Davis, 480 So. 2d 625, 629 (Fla. 1985) (“[W]e hold that where the seller of a home knows of facts materially affecting the value of the property which are not readily observable and are not known to the buyer, the seller is under a duty to disclose them to the buyer.”); Van Camp v. Bradford, 623 N.E.2d 731, 736 (Ohio Com. Pl. 1993) (discussing a then-recently enacted Ohio statute requiring “a seller of residential property to provide each prospective buyer . . . with a prescribed

parties liable to non-parties who foreseeably relied on the wrongdoers' contractual undertakings.²² This trend promises to avert injury, achieve efficiency, and seems to accord with society's evolving notions of fairness.

The second trend, exemplified in *Teers*, counters the first. Because humans are innately self-interested, entrepreneurs (and rascals) have devised techniques to avoid these new levels and kinds of exposure to potential liability for non-disclosure and to non-parties. They have employed market and contract strategies that purport to shift to the other party the onus of uncovering the truth—which might be buried under layers of misrepresentations and that limit non-parties' right to rely on contract promises. The effect is to enable a market actor to contract away liability for intentional wrongdoing by the simple expedients of “as is” and “disclaimer-of-reliance” clauses—the result in *Teers*. This is troubling in a number of respects. First, the clauses undercut the fundamental character of enforceable contracts being the product of free will. Indeed, the first requirement of contract formation is a meeting of minds. Fraud, ostensibly camouflaged by disclaimers, negates the unknowing party's free will. Second, such liability-avoidance techniques, although ostensibly consistent with the contracting parties' free will, disturb the markets because of the externalities. Absent the truth about the quality or condition of the property, buyers enter into transactions, or pay too much for property unsuitable, or useless, for its intended purpose. Undisclosed defects present the potential for injury to third parties. A buyer's costs of inspection and discovery are greater than a seller's costs of disclosure.²³

disclosure form regarding various aspects of the property” intending to disclose all material matters).

22. See *Petrillo v. Bachenberg*, 655 A.2d 1354, 1357 (N.J. 1995) (relaxing the privity requirement for third party suits against attorneys, finding an attorney's duty to a non-client third party depends on a balance of several factors); *Credit Alliance Corp. v. Arthur Andersen & Co.*, 483 N.E.2d 110, 118 (N.Y. 1985) (applying a “near-privity” test imposing liability on accountants to non-contractual third parties based on an evaluation of certain factors); *H. Rosenblum, Inc. v. Adler*, 461 A.2d 138, 147–53 (N.J. 1983) (abandoning strict privity and finding accountants may be liable to any person who the accountant could reasonably have foreseen would obtain and rely upon the accountant's opinion), *superseded by statute*, N.J. STAT. ANN. § 2A:53A-25 (West 2014), *as recognized in* *Cast Art Indus. LLC v. KPMG LLP*, 36 A.3d 1049, 1052–53 (N.J. 2012); *Grgic v. Cochran*, 689 S.W.2d 687, 690 (Mo. Ct. App. 1985) (finding a subcontractor owes no duty to the owner of the project on which he works in the absence of privity); *A. E. Inv. Corp. v. Link Builders, Inc.*, 214 N.W.2d 764, 767, 769 (Wis. 1974) (holding that a tenant may not recover against an architect for building design defect due to lack of privity). In the case of new homes, *see, e.g.*, *Richards v. Powercraft Homes, Inc.*, 678 P.2d 427, 429–30 (Ariz. 1984); *Blagg v. Fred Hunt Co.*, 612 S.W.2d 321, 323–24 (Ark. 1981) (rejecting the imposition of a privity requirement and allowing remote purchasers to maintain a cause of action against a builder).

23. In other words, they offend well-settled notions of efficiency in contract relations. Under one meaning of efficiency, Pareto Efficiency, an exchange is efficient, where it is voluntary—entered into in the absence of fraud or duress—and both parties are made better off, in their own estimation, by virtue of the exchange, each party

Lastly, the exploitative use of these clauses disturbs our sensibilities, offends the law's conscience, and debases not just the parties, but society at large.

Courts' responses to these opportunistic maneuvers have been disparate. Some courts enforce the clauses without much hesitation, focusing on the venerable values of freedom and certainty of contract, chastising buyers for their gullibility.²⁴ Others categorically outlaw the clauses, expressing consternation at conduct that seems abjectly fraudulent and exploitative.²⁵ Yet others appear to be inclined to uphold agreements that are freely entered into, although these courts take a case-by-case approach, making fine distinctions based on subtleties in the clause's language, which might allow an injured party relief.²⁶

These trends must be examined in context, historical and contemporary, to determine whether they reveal a rational response to the self-interested choices of contract participants and whether these responses must be bolstered to ensure that responsibility for unrealized expectations or harm is fairly allocated among the parties. In the end, this Article proposes that disclaimer-of-reliance clauses should be presumptively unenforceable, as they offend current market morality and public policy.

Part II will trace the evolution of thought on market transactions and contracting. Part III discusses the shift in thinking about contract. Part IV reviews limits on contracting imposed by law and policy. Part V discusses the imperative of the law's conscience, outlining a framework for evaluating disclaimer-of-reliance clauses. This Article ends with conclusions and comments on how legal relations have, and must, change in the interests of fairness and efficiency in real estate markets.

II. SOCIETAL ORDERING THROUGH CONTRACT

In this part of the Article, the Author explores the phenomenon of "contract" as a device for social and economic ordering and considers how the prevailing conception of contract explains or justifies the law's intervention to relieve a buyer of contractual obligations in a particular circumstance. That circumstance being: A buyer signs a writing disavowing the existence of and any reliance upon parol representations by seller when in fact neither was the case. It is useful to begin with a discussion of the articulated views on legal thought in the early 18th to early 19th centuries.

having valued that which they acquired in the exchange more than that originally held. See ROBIN PAUL MALLOY, *LAW IN A MARKET CONTEXT: AN INTRODUCTION TO MARKET CONCEPTS IN LEGAL REASONING* 189–90 (2004).

24. See discussion *infra* Part IV.A.

25. See discussion *infra* Part IV.A.

26. See discussion *infra* Part IV.A.

The 18th century was the age of revolutions: intellectual, scientific, political, and industrial.²⁷ The Industrial Revolution, most significant for the discussion here, “broke out” sometime in the 1780s.²⁸ It was the first time in “human history that the shackles were taken off the productive power of human societies, which henceforth became capable of the constant, rapid, and . . . limitless multiplication of men, goods, and services.”²⁹ Why in the 1780s? The historian E.J. Hobsbawm believed the government’s embrace of private profit and economic development made the times propitious.³⁰

This focus on the material world emanated from the emerging embrace of rationalism and secular thought. The use of reason, rather than tradition and religion, was employed to gauge and understand human relations.³¹ Natural phenomena would be understood by scientific observation and interpretation.³² The individual, rather than God or state, seeking to maximize his own well-being, emerged as the center of the world.³³ Society and social relations came to be defined not by religious precepts, but by the voluntary, calculated relations—contracts.³⁴

A. *Governmental Deference to Market Forces*

As national and international commercial markets emerged, the rhetoric of *laissez-faire* required the government to stay out of private, economic decision-making as a general matter.³⁵ The *laissez-faire* theory rested upon the writings of Adam Smith who claimed that it was the unimpeded operation of free-market forces that best promoted economic growth and provided the happiest result, even though tem-

27. See ERIC HOBSBAWM, *THE AGE OF REVOLUTION 1789–1848* at 263–64 (1996).

28. *Id.* at 28. Hobsbawm explains, “This is now technically known to the economists as the ‘take-off into self-sustained growth.’” *Id.*

29. *Id.* at 45.

30. *Id.* at 48–49. The greater part of the century, for most of Europe, was a period of prosperity and comfortable economic expansion. *Id.* During this period, Adam Smith’s *Wealth of Nations* was a guide to the economists of the era. *Id.* at 237.

31. *Id.* at 235, 278. The American and French revolutions embraced these beliefs. *Id.* at 261.

32. *See id.* at 278–79.

33. *See id.*

34. *See id.* at 176.

35. ADAM SMITH, *THE WEALTH OF NATIONS* 391–92, 395–96, 509, 512, 651, 743–74 (2005), www2.hn.psu.edu/faculty/jmanis/adam-smith_wealth-nations.pdf [hereinafter ADAM SMITH]; see also Herbert Hovenkamp, *Law and Morals in Classical Legal Thought*, 82 IOWA L. REV. 1427, 1436 (1997). J. M. KELLY, *A SHORT HISTORY OF WESTERN LEGAL THEORY* 242 (1992). Smith thought the basis of this natural order was the social division of labor, and that it could be proven scientifically that the existence of a class of capitalists, who owned the means of production benefited all, including the labor class who worked under them. *Id.* It was thought that the “increase in the wealth of nations proceeded by the operations of property-owning private enterprise and the accumulation of capital, and it could be shown that any other method of securing it must slow it down or bring it to a stop.” *Id.*

porary hardship might be experienced.³⁶ The idea was that if society removed artificial restraints and restrictions from men, then the approximately equal, natural powers among them would assert themselves, and unregulated-contract formation would mean equality and justice.³⁷ Government regulations should be relaxed, leaving the development of trade to individual action.³⁸ Thus, each individual, in seeking his own advantage, actually promoted the advantage of the country as a whole.³⁹ Smith thought “humanity consisted essentially of sovereign individuals of a certain psychological constitution pursuing their self-interest in competition with one another.”⁴⁰ Economists embraced Smith’s views believing that these activities, if left unchecked, would produce a social order that was organic and naturally evolved, as opposed to one that was prescribed and constrained by religion, and thus operated to improve overall well-being.⁴¹ The legal historian Herbert Hovenkamp assessed the prevailing view as one where markets were “natural” and “self-executing,” needing governmental intervention only rarely.⁴² This view constrained the state from intervening in private economic affairs.⁴³ Modern adherents of freedom of contract stress economic efficiencies⁴⁴ that enable goods and services to move from less to more valuable uses and to those who value them more highly.⁴⁵

B. *The Sweetness of Commerce: Doux Commerce*

An economic philosophy devoid of all moral constraints would debase social relations and cause the deterioration of those foundations necessary for political society. Those lacking the economic or intellectual wherewithal to navigate markets safely were the most vulnerable to harm in a world where moral compunctions were absent.⁴⁶ Because

36. See generally ADAM SMITH, *supra* note 35; see also KELLY, *supra* note 35, at 306.

37. RICHARD T. ELY, 2 PROPERTY AND CONTRACT IN THEIR RELATIONS TO THE DISTRIBUTION OF WEALTH 475, 604 (1922).

38. W. F. OAKESHOTT, COMMERCE AND SOCIETY 242 (1936).

39. ADAM SMITH, *supra* note 35, at 363–64, 512; see also HOBBSBAWM, *supra* note 27, at 235.

40. HOBBSBAWM, *supra* note 27, at 237. As explained below, this self-interest did not mean the absence of regard for the other. The capacity for “sympathy” was a trait that defined humans as much as “self-interest.” See *supra* text accompanying notes 24–31.

41. *Id.* at 237.

42. Hovenkamp, *supra* note 35, at 1435–36.

43. HOBBSBAWM, *supra* note 27, at 239.

44. See Benjamin E. Hermalin, Avery W. Katz & Richard Craswell, *Contract Law*, in 1 HANDBOOK OF LAW & ECONOMICS 3, 66 (A. Mitchell Polinsky & Steven Shavell eds., 2007).

45. RICHARD A. POSNER, ECONOMIC ANALYSIS OF LAW 79 (3d ed. 1986); ROBERT B. EKELUND, JR. & ROBERT D. TOLLISON, ECONOMICS: PRIVATE MARKETS AND PUBLIC CHOICES 4 (6th ed. 1999).

46. KELLY, *supra* note 35, at 265.

commerce was viewed as a positive, civilizing force, the concept of *doux commerce* emerged as mediation.⁴⁷ The belief was that “[c]ommerce . . . polishes and softens (adoucit) barbaric ways . . .”⁴⁸ Thomas Paine expressed the view that “[commerce] is a pacific system, operating to cordialise mankind, by rendering Nations, as well as individuals, useful to each other”⁴⁹ and commerce teaches a man to “deliberate, to be honest . . . [and] prudent.”⁵⁰

Even Adam Smith described commerce as an activity based on virtue and integrity,⁵¹ a conception of human nature quite at odds with the self-interested model that is so often attributed to him.⁵² Instead, it may have been Immanuel Kant who was responsible for banishing kindly sentiments from moral philosophy.⁵³ In Kant’s view, morality was learned by rational deduction.⁵⁴ Smith believed that compassion for others, not pure self-interest, was the essential component of thriving markets.⁵⁵

Although Smith assessed the world and its imperatives in the 18th century when commerce emerged as organized, deliberate activity, his views were yet thought to be well suited for the 19th century, when business had become the great civilizing influence in Europe. A decade of war from 1805 to 1815 had quietly changed into a century of peace and prosperity.⁵⁶ As a new era dawned, the perpetual wars over religious principles, claims to the throne, and land had been replaced by a new world of business that promised civil compromise and unimagined wealth. Entrepreneurs, merchants, and bankers reigned.⁵⁷

47. Albert O. Hirschman, *Rival Interpretations of Market Society: Civilizing, Destructive, or Feeble?*, 20 J. ECON. LIT. 1463, 1464 (1982) [hereinafter Hirschman, *Rival Interpretations*].

48. 2 BARON DE MONTESQUIEU, *THE SPIRIT OF LAWS* 1, 8 (3d ed. 1762).

49. THOMAS PAINE, *THE RIGHTS OF MAN* 92 (1792), http://www.classicly.com/books/17912/download_and_add_to_library/pdf.

50. Hirschman, *Rival Interpretations*, *supra* note 47, at 1465 (citing SAMUEL RICARD, *TRAITÉ GÉNÉRAL DU COMMERCE* 463 (1781)).

51. See ADAM SMITH, *THE THEORY OF MORAL SENTIMENTS* ¶ I.I.1 (1759), <http://www.econlib.org/library/Smith/smMS1.html> [hereinafter *MORAL SENTIMENTS*].

52. Solomon, *supra* note 14, at 17. Adam Smith claimed that *sympathy* or “fellow-feeling” is a “natural” moral sentiment. Like his good friend David Hume, Smith defended a rather broad practical notion of utility. But, Adam Smith can best be understood as a follower of Aristotle, whose philosophy embraced the belief that self-interest at its extreme (*pleonexia* or “grasping” self-interest) was a perversion, that is, as not natural and not itself definitive of human nature. Instead, in Aristotle’s view, what defined human nature, was the capacity for virtue, a desire for excellence. *Id.* at 18; see also *MORAL SENTIMENTS*, *supra* note 51.

53. IMMANUEL KANT, *THE GROUNDWORK OF THE METAPHYSICS OF MORALS* 13 (trans. H. J. Paton 1964) (1785); see also Solomon, *supra* note 14, at 18.

54. Solomon, *supra* note 14, at 18; KANT, *supra* note 53, at 13.

55. KANT, *supra* note 53, at 13.

56. Solomon, *supra* note 14, at 16.

57. *Id.* In fact, Hirschman speaks of the embrace of self-interest during the rise of commercial society as a superior alternative to the passions, such as inherited animos-

III. TRANSMOGRIFICATION OF CONTRACT LAW: FROM EQUITABLE CONCEPTION TO WILL THEORY

Prevailing economic thought carried over and informed the legal sphere—in particular, contract law. At first, contract law was largely conceived as a matter of natural law: promises were enforced because they were morally binding and shaped to some extent by canon law on what promises were binding in conscience.⁵⁸ This was the equitable conception of contract. A contract was enforced if it was reasonable and fair. It was viewed as a fair exchange⁵⁹ and evaluated on the basis of substantive fairness. Underlying this equitable conception of contract was the principle that a “sound price warrant[ed] a sound commodity.”⁶⁰ This meant the parties had impliedly agreed that the quality of the goods sold was impliedly equal the price paid.⁶¹ However, as the Industrial Revolution took hold, transforming a predominantly fixed, land-based economy into a more fluid and enterprising one involving goods developed for market exchange based on money or credit, commerce moved away from the mores of the manor and feudal village to the imperatives of competition in the world. Adam Smith’s central tenet was that an individual’s pursuit of selfish economic gain would benefit society because by serving himself, he also serves society. This is so because the entrepreneur must offer goods and services that the public values and demands and thus the pursuit of self-interest coalesces precisely with the public interest.⁶² Consequently, the individual needed to be free to act and all obligations would arise out of the free will of the individual.⁶³

Under the *laissez-faire* regime, restraint of market activities or parties by the government was positively anathema to prosperity.⁶⁴ Individuals were invested with the capacity to determine what best served

ities and desire for glory that had before dominated public life. See generally ALBERT O. HIRSCHMAN, *THE PASSIONS AND THE INTERESTS: POLITICAL ARGUMENTS FOR CAPITALISM BEFORE ITS TRIUMPH* (1977).

58. ROSCOE POUND, *AN INTRODUCTION TO THE PHILOSOPHY OF LAW* 143 (1982). Natural law can be expressed as embracing the “idea of deduction from the nature of man as a moral creature and of legal rules and legal institutions which expressed this ideal of human nature.” *Id.*

59. MORTON J. HORWITZ, *The Historical Foundations of Modern Contract Law*, 87 HARV. L. REV. 917, 941 (1974).

60. *Id.* at 926.

61. However, 18th century natural law theory was not successful in incorporating the Roman idea of “just price,” that “where a sale had taken place for a price far below the object’s real value, the vendor ought to have a chance to rescind or have the price topped up” KELLY, *supra* note 35, at 266. Instead, the view came to be that the parties should be free to make their own bargains, the principle of freedom of contract being seen as one of natural law. *Id.*; see also MORTON J. HORWITZ, *THE TRANSFORMATION OF AMERICAN LAW 1780–1860* at 180 (Stanley N. Katz ed., 1977).

62. ADAM SMITH, *supra* note 35, at 363–64, 512.

63. *Id.*

64. See generally MORRIS R. COHEN, *The Basis of Contract*, 46 HARV. L. REV. 553 (1933).

their own well-being.⁶⁵ Additionally, a buyer was charged with knowing that he lacked complete information in order to make a wise decision and act accordingly.⁶⁶ This was the “will theory” of contract.⁶⁷

The will theory fit with a philosophy that emphasized ego and individual-human will as the basic facts of human life, and inevitably, the cardinal importance of individual freedom.⁶⁸ This was the case for two reasons: the human will was inherently deserving of respect,⁶⁹ and the free expression of will was essential to societal progress.⁷⁰ Since the manifestation of human wills formed the basis of contract, human will became the source of all the terms of the contract,⁷¹ as well as the source of the implied terms which might be read into a contract.⁷²

Thus, while the equitable conception limited and sometimes denied contractual obligation by reference to the fairness of the underlying exchange,⁷³ in contrast, the will theory held that contract obligation stemmed from the convergence of wills in which equitable considerations had no sway.⁷⁴ During this era, the law rejected the intervention of equity into contractual relations because it would introduce arbitrariness and uncertainty. Moreover, any attempt to interfere with the express terms of the contract was paternalistic, depending upon the will and caprice of the judge in the interests of justice.⁷⁵ Conscience obliged one to perform even the burdensome, improvident bargain.⁷⁶

Contract was part of a system of social order⁷⁷ resting upon the interchange of free choices by members of society, in pursuit of both egotistical and altruistic ends. To accomplish this essential function in

65. *Id.* at 575; see also Duncan Kennedy, *From the Will Theory to the Principle of Private Autonomy: Lon Fuller's "Consideration and Form"*, 100 COLUM. L. REV. 94, 126, 131 (2000).

66. Cohen, *supra* note 64, at 575.

67. *Id.*

68. Samuel Williston, *Freedom of Contract*, 6 CORNELL L.Q. 365, 366 (1921).

69. Cohen, *supra* note 64, at 575.

70. Horwitz, *supra* note 59, at 161.

71. This proposition seems to call for an accommodation of views on account that in the realm of contracts, the element of will is inevitably bound up with law, yet “the law as part of a larger world must be regulated and determined by the nature of the larger order of which it is a part.” Cohen, *supra* note 64, at 568. It is also the case that the law imposed obligation upon parties even when it was most impossible to find any expression of will. Indeed, “[t]here is never a moment of time when the two parties are actually in agreement or of one mind. Yet no one denies that the resulting rights and duties are identical with those called contractual.” *Id.* at 576.

72. *Id.* at 576–77.

73. Horwitz, *supra* note 59, at 164.

74. *Id.*; see also JOSEPH STORY, COMMENTARIES ON EQUITY PLEADINGS AND THE INCIDENTS THEREOF: ACCORDING TO THE PRACTICE OF THE COURTS OF EQUITY OF ENGLAND AND AMERICA 329 (Isaac F. Redfield ed., 8th ed. 1870); Cohen, *supra* note 64, at 562; Kennedy, *supra* note 65, at 97.

75. Horwitz, *supra* note 59, at 161.

76. *Id.* at 160–61.

77. MORRIS R. COHEN & FELIX S. COHEN, READINGS IN JURISPRUDENCE AND LEGAL PHILOSOPHY 141 (1951) [hereinafter COHEN & COHEN].

social ordering, subject to narrow limits, the principle was that law would delegate power to the contracting parties to devise their own rules as they related to rights and responsibilities over the matter contracted for.⁷⁸ As far as the parties are concerned, the law of contracts was of their own making—society merely lent its machinery of enforcement to the party injured by a breach.⁷⁹ The impact of the adoption of the will theory was substantial. Judge Joseph Story explained:

[E]very person who is not from his peculiar condition under disability is entitled to dispose of his property as he chooses, and whether his bargains are wise and discreet or profitable or unprofitable or otherwise are considerations not for the courts of justice but for the party himself to deliberate upon.⁸⁰

Judge Story's stern views were not accepted without criticism. Roscoe Pound and Richard Ely, in protesting against the will theory, pointed out that if contract left the parties to protect their own interests the contract must mirror the disparities in the ability to protect them.⁸¹ The idea that the standards of fairness belong to the very institution of contract—an idea that jurists had defended for centuries—seemed to have vanished from the face of the earth.⁸² For Ely and Pound, the result was "that contract, taken in itself, was inherently impossible to reform. The terms of a contract must necessarily reflect, not justice, but power. Therefore, the state must intervene to protect people from contract."⁸³

A. *The Imperatives of Freedom of Contract: Markets and Morals*

The views of Ely and Pound were not universally embraced. Instead, the predominant beliefs were that contract was the product of will, and free choice operated as a means of social integration and social ordering.⁸⁴ Freedom to contract on whatever terms served individual self-interest and would promote the progress of society—making available wanted commodities and keeping prices down through competition.⁸⁵ The general belief was that persons of full age and competence should have the greatest freedom in contracting and that, while force and fraud would justify interference by the law, it was not the function of the law to strike down or relieve a party from a bad or

78. Cohen, *supra* note 64, at 562.

79. Although it could not be said that a contract between two individuals was always devoid of all public interest, if there was none, why enforce it? *Id.* at 562.

80. James Gordley, *Contract, Property, and the Will—The Civil Law and Common Law Tradition, in THE STATE AND FREEDOM OF CONTRACT* 66, 85 (Harry N. Scheiber Ed. 1998) (quoting J. Story, *Commentaries* 1:337).

81. *Id.*

82. *Id.* at 83.

83. *Id.* at 85.

84. COHEN & COHEN, *supra* note 77, at 142.

85. Cohen, *supra* note 64, at 562–63.

improvident bargain.⁸⁶ However, this proposition was questionable in that it rested upon the fallacy that parties to a contract stood on equal footing and were thus capable of taking measures for the protection of their own interests.⁸⁷ While the 18th-century belief was that economic man was not without sympathy,⁸⁸ that sympathy did not seem to appreciate the capacity of man to do evil. Inequality concerns in economic society that flowed naturally from the varying capacities of humans were dismissed.⁸⁹ The thinking was that markets would improve conditions for all, since they operated on the basis of the exchange of equivalents—so many hours of labor for so many dollars.⁹⁰

While *laissez-faire* theory sought to characterize government regulation as evil, it ignored a huge point—it forgot that “not only industry but also the whole of life of civilization depend[ed] on the feeling of security that the protection of government or organized community afford[ed].”⁹¹ Orthodox-American thought was preoccupied with the “liberty of contract in economic matters, but could readily approve serious intervention with the liberty of contract when morals were at stake.”⁹² Yet, the thinkers during this classical period employed a narrow definition of the “moral sphere.”⁹³ It did not extend to paying an honest and decent wage or limiting the required hours of work.⁹⁴ So too, it did not extend to requiring honesty and full disclosure between parties in a seemingly “arm’s length” transaction.⁹⁵

B. *Contract Will and Caveat Emptor*

The “will theory” as it operated in the *laissez-faire* market regime provided the foundation for the rapid adoption of *caveat emptor*,⁹⁶ the apotheosis of the 19th-century individualism.⁹⁷ As human relations

86. *Id.* at 563.

87. *Id.*; see also Kennedy, *supra* note 65, at 118, 124.

88. See text accompanying notes 48–52.

89. ADAM SMITH, *supra* note 35, at 309–10, 330–31.

90. *Id.*; see also HOBBSAWM, *supra* note 27, at 281–82.

91. Cohen, *supra* note 64, at 559. Cohen points out that the philosophy of freedom or liberty illustrated one of the most pervasive and persistent vices of reasoning on practical affairs, i.e., “the setting-up of premises that are too wide for our purpose and indefensible on their own account.” *Id.* It was fallacious reasoning to conclude that because some oppressive restraints were bad, that the absence of all restraints was a good thing. Instead, while agreements and promises should be enforced to encourage reliance upon them, and thus provide market security, nonetheless, sometimes, the law must intervene and go beyond the original intention of the parties in recognition of the general effects of classes of transactions. *Id.* at 592.

92. Hovenkamp, *supra* note 35, at 1444.

93. *Id.* at 1446.

94. *Id.* at 1436.

95. See discussion *infra* text accompanying notes 92–96.

96. COHEN & COHEN, *supra* note 77, at 180.

97. PATRICK S. ATIYAH, *THE RISE AND FALL OF FREEDOM OF CONTRACT* 464 (1979) (“[D]octrine of caveat emptor can be said to represent the apotheosis of the nineteenth century individualism . . .”).

played out in the world, notions of justice and virtue played little or no role in human affairs. The powerful and cunning took advantage of the weaker and gullible and then described as law and justice whatever they had laid down in their own self-interest.⁹⁸ To be sure, the law at that time did not tolerate misrepresentations or fraud in commercial dealings, but it also did not require a seller of goods or real property to disclose all that the seller knew, which would enable the other party to get a better or even honest bargain.⁹⁹ A buyer was imprudent when the buyer did not learn the worth or value of the thing negotiated for through an independent investigation, inquiries to the seller, or by obtaining warranties.¹⁰⁰

1. Every Man for Himself and Devil Takes the Hindmost

Even as *caveat emptor* was embraced, the law's intolerance of fraud, having very definite moral undertones, persisted.¹⁰¹ Yet, the task of discerning the point when a seller's silence rises to the level of fraud has never been an easy one. In an 1834 work entitled *A Series of Letters to a Man of Property*, Edward Burtenshaw Sugden illustrates the moral ambiguities in the vendor/vendee relationship in the form of a witty letter to a client.¹⁰² He writes:

I will not argue with you, whether in selling an estate you are bound in conscience to disclose all its defects to the purchaser. Moralists, as you know, agree that a seller is bound to do so, although the principle has been controverted. I shall content myself with stating how the law on this subject stands.

If the person to whom you sell was aware of all the defects in the estate, of course he cannot impute bad faith to you in not repeating to him what he already knew; neither will you be liable, if you were yourself ignorant of the defects. And even if the purchaser was, at the time of the contract, ignorant of the defects, and you were acquainted with them, and did not disclose them to him, yet he will be without a remedy, if the defects were such as might have been discovered by a vigilant man . . .

If, however, you should, during the treaty, industriously prevent the purchaser from seeing a defect which might otherwise have eas-

98. Brian Leiter, *Holmes, Economics, and Classical Realism*, in *THE PATH OF THE LAW AND ITS INFLUENCE: THE LEGACY OF OLIVER WENDELL HOLMES, JR.* 292 (Stephen J. Burton ed. 2000).

99. See generally *Dorsey v. Jackman*, 1 Serg. & Rawle 42 (Pa. 1814).

100. Until the 18th century, the tendency of courts was to apply the maxim *caveat emptor* to all types of contracts, but during that century, the idea grew that warranties could be implied to a broader category than those discussed *infra*, first in relation to title and later, and less completely, in respect of quality. 13 SIR WILLIAM SEARLE HOLDSWORTH, *A HISTORY OF ENGLISH LAW* 69-70 (2d ed. 1937).

101. *Bell v. Harrison*, 102 S.E. 200, 204 (N.C. 1920).

102. EDWARD BURTENSHAW SUGDEN, *Letter IV*, in *A SERIES OF LETTERS TO A MAN OF PROPERTY ON THE SALE, PURCHASE, LEASE, SETTLEMENT, AND DEVISE OF ESTATES* (Philadelphia, Farrand and Nicholas 1834).

ily been discovered—for example, if you carefully conceal from him the necessary repairs of a wall to preserve the estate from the sea . . . the contract would not bind the purchaser either at law or in equity.

So, if there is a latent defect in your estate, of which you are aware, and which the purchaser could not by any attention whatever possibly discover, you are bound to disclose it to him . . . [But if] you warrant a house to be in perfect repair, and he knew that it was without a roof or windows, he cannot object that the property does not agree with the description of it

Thus I have told you what truths you *must disclose*. I shall now tell you what falsehoods you may utter in regard to your estate. In the first place, you may falsely praise, or, as it is vulgarly termed, puff your property; for our law, following the civil law, holds that a purchaser ought not to rely upon vague expressions uttered by a vendor at random in praise of his property . . . Besides value consists in judgment and estimation, in which many men differ. But if you should affirm that the estate was valued, by persons of judgment, at a greater price than it actually was, and the purchaser act upon such misrepresentation, you could not enforce the contract in equity.¹⁰³

Sugden's description of the law of vendor and purchaser reveals the tension between the rule of the marketplace, which can be brutish and harmful, and the rule of conscience, which requires regard for the well-being of others or at least avoidance of deliberately harmful acts. In his mind, a seller of real property could set aside the moral requirements so far as his conscience would permit, needing only respond to the law's requirements. The parties otherwise had to take care that the deal was as they hoped, with little expectation of interference by the law.¹⁰⁴

103. *Id.* at 23–28. See also *Gustafson v. Rustemeyer*, 39 A. 104, 106 (Conn. 1898) (holding that “a mere false representation as to the value of real property knowingly made by the seller to the buyer, is not actionable, unless the buyer has been fraudulently induced to forbear inquiry as to its truth”); *Williams v. McFadden*, 1 So. 618, 620 (Fla. 1887) (explaining that assertions concerning the value of land, or its condition and adaptation to particular uses—which are only matters of opinion and estimates as to which men may differ—are the usual and ordinary means adopted by sellers to obtain a high price and are understood to not afford buyers any ground for failing to make inquiries for the purpose of ascertaining the real condition of the property); *Parker v. Moulton*, 114 Mass. 99, 100 (1873).

104. Buyers were held to the duty of learning of the precise location and dimensions of the property they were acquiring. See, e.g., *Lytle v. Bird*, 48 N.C. 222, 224 (1858); but see *Elliot v. Boaz*, 9 Ala. 772, 776–77 (1846) (holding vendor induced vendee to purchase land, by showing lands other than those conveyed. The court held that vendee need not have a survey conducted, but was entitled to rely upon vendor and obtain relief in equity against a claim by the vendor for the purchase price); *Post v. Liberty*, 121 P. 475, 480 (Mont. 1912) (holding a seller liable even though he did not know of the falsity of his representations—but should have known). In *Post*, the court also relied upon a statement by Judge Story that:

[w]hether the party, thus misrepresenting a material fact, knew it to be false, or made the assertion without knowing whether it were true or false, is

2. Unquestioned Soundness

Caveat emptor was believed to be a necessary principle for governing market transactions during its heyday. In fact, so firmly had the doctrine become embedded in the law that many courts merely recited the principle without much questioning of its fairness or validity.¹⁰⁵ The theory was that:

The law redresses those only who use diligence to protect themselves. Such diligence as prudent men ordinarily use. The quality of land, on which its value depend[ed], and which [was] too various for a market standard, the purchaser [could] see, if he [would] but look. And the course that prudence has established, requires that he should look.¹⁰⁶

The morality of a seller's failure to make disclosures to the buyer was not reviewed as it would burden commerce to require "the vendor [to] see for the purchaser. It is enough for him, in point of law, that he does not conceal the knowledge of secret defects nor give a warranty, express or implied."¹⁰⁷ Thus, it was up to the buyer to extract representations and warranties from the seller if he was to be protected in the deal.¹⁰⁸ The logic behind this position is clear. Who better to know her requirements, to inspect and assess the risks and value, than the buyer?¹⁰⁹ If equity were to intervene, it would change the bargain; thus obviating the parties' wills.¹¹⁰

Caveat emptor was said to be one of the best-settled maxims of the land.¹¹¹ Some courts even found it was not consistent with moral conduct, yet could not resist its application,¹¹² instead identifying many

wholly immaterial; for the affirmation of what one does not know or believe to be true is equally, in *morals* and law, as unjustifiable as the affirmation of what is known to be positively false. And even if the party innocently misrepresents a material fact by mistake, it is equally conclusive; for it operates as a surprise and imposition upon the other party. (emphasis added).

1 JOSEPH STORY, COMMENTARIES ON EQUITY JURISPRUDENCE § 193 (1835) (emphasis added).

105. See, e.g., *Whitmore v. Orono Pulp & Paper Co.*, 39 A. 1032, 1036 (Me. 1898) (explaining that *caveat emptor* is the rule and any change is for the legislature).

106. *Sherwood v. Salmon*, 2 Day 128, 136 (Conn. 1805) (holding sale of land represented as "good, arable land, of an excellent quality" with "good timber . . . wholly of bottom land, fit for all agricultural purposes, without any waste or broken land" proved false as the land contained no bottom land, but rocks and inaccessible mountains, and never was of any value).

107. *Id.*

108. *Wolbert v. Lucas*, 10 Pa. 73, 74 (1848); *Barnard v. Kellogg*, 77 U.S. 383, 388 (1870).

109. See DAVID A. THOMAS, THOMPSON ON LAW OF REAL PROPERTY § 99.06(a)(3)(D); *Barnard*, 77 U.S. at 397; *Wolbert*, 10 Pa. at 74.

110. *Wolbert*, 10 Pa. at 74.

111. *Lamar's Ex'r v. Hale*, 79 Va. 147, 159 (1884).

112. See, e.g., *Bean v. Herrick*, 12 Me. 262, 266 (1835) (pointing out the difficulty of reconciling cases in which "[s]ome have been more indulgent to fraud and misrepresentation, than is consistent with morals, or the common sense of mankind"); *Bryan v. Primm*, 1 Ill. 33, 34 (1822) (holding silence may be "moral fraud . . . [b]ut this moral

positive values from it—"leading to vigilance and circumspection and serv[ing] to check litigation."¹¹³ Only a few courts even ventured to discuss the wisdom or philosophical foundations of the doctrine. But the views of the judges' of one court, in *Dorsey v. Jackman*, who did engage in that discussion, although feeling bound to follow the maxim by the principle of stare decisis, are worthy of comment here.¹¹⁴ There the purchaser sought the return of monies paid on the purchase of a piece of real property.¹¹⁵ After the purchase, the purchaser discovered defects in title, which seller did not disclose at the time of contracting.¹¹⁶ The court ruled that where no warranty was involved, it must be supposed that the parties took the defects into consideration when agreeing on the purchase price.¹¹⁷ Therefore, in the absence of fraud, the purchaser is without relief.¹¹⁸

A concurring judge pointed out the differences between the civil law and the common law. Under civil law, the seller of either real or personal property was obliged to inform the buyer of all the defects of the subject property and was responsible to him for any defect; even those not known at the time of sale. In contrast, the common law, evolving and adjusting as human affairs demand,¹¹⁹ did not encompass a rigid rule of morals that might be ill-suited to the circumstances.¹²⁰ Rather, it:

happily reconciles the claims of convenience with the duties of good faith, by requiring the purchaser to apply his attention to those particulars, which may be supposed within the reach of his observation and judgment, and the vendor to communicate those particulars and defects which cannot be supposed to be immediately within the reach of such attention: and even against his want of vigilance the purchaser may provide, by requiring the vendor expressly to warrant the property sold.¹²¹

The judge went on to explain the court was "not at liberty to remove the settled landmarks of property, although individually we may be dissatisfied with the policy of particular parts of the system, or their abstract justice, when applied to special cases, which may forcibly

fraud has not yet grown into a *legal* fraud. In cases of this kind there may be circumstances which cause this moral fraud to be a legal fraud, and give the buyer his action on the implied warranty, or on the deceit").

113. See, e.g., *Bean*, 12 Me. at 269; see also *Warden v. Eichbaum*, 14 Pa. 121, 126 (1850).

114. *Dorsey v. Jackman*, 1 Serg. & Rawle 42, 42 (Pa. 1814).

115. *Id.* at 47.

116. *Id.*

117. *Id.* at 48.

118. *Id.*

119. *Id.* at 51.

120. *Id.*

121. *Id.*

strike our minds.”¹²² The judge felt “bound to acquiesce in its provisions.”¹²³

A third judge took a more conciliatory stance and an expansive view of the court’s role and of the concept of fraud, which would vitiate any contract.¹²⁴ He found that the purchaser was “a simple man, dealing with one whom he took to be of superior information in matters of land title, and in whose integrity he had reposed confidence.” Given the inherent risks in taking a conveyance by a tax-sale deed,¹²⁵ it was a manifest fraud and an imposition for a speculator knowingly to convey a defective title as a good one to this honest and unsuspecting buyer.¹²⁶

This court’s indulgence but rejection of a plea to overrule a judge-made rule even where it is revealed to produce unjust results is troubling. It cannot be explained by the need to further reliance by future contracting parties on the existing state of the law because the costs to the injured parties are too great. That the existing law was good because it furthered other interests, such as facilitating commercial transactions, could not outweigh the unfairness to parties who are unsophisticated and unknowledgeable about the law and how the courts would interpret it. Law failed when it sanctioned and provided cover for what was tantamount to fraudulent or arguably immoral conduct. Of equal concern is a court that felt so constrained by rules that went against reason that it did not seek to accommodate fairness. If the common law was essentially what the judges declared, evolving over time and with circumstances, the reluctance to circumscribe *caveat emptor* in egregious cases was inexplicable.

3. Foreclosing Will by Fraud

Even so, fraud *per se*, that is, involving affirmative false statements,¹²⁷ was still held to vitiate any contract, and *caveat emptor* would not shield a seller where fraud was established.¹²⁸ Indeed, one court spoke for many that “[i]t would be a sorry administration of justice that would sanction . . . palpable fraud by crying *caveat*

122. *Id.*

123. *Id.* at 53.

124. *Id.* at 54–55.

125. *Id.* at 54. The greatest risk is the possibility of the sale being set aside because of irregularities. *Id.* at 55–56.

126. *Id.* at 56.

127. Fraud is said to involve an affirmative statement of material fact, made with knowledge of its falsity or disregard for its truth, with the intent that the person to whom made rely on it, reliance that is reasonable and injury. *Schnuck v. Kriegshauser*, 371 S.W.2d 242, 246–47 (Mo. 1963); *Lowther v. Hays*, 225 S.W.2d 708, 713 (Mo. 1950). See also 77 AM. JUR. 2d *Vendor and Purchaser* § 57.

128. See, e.g., *Griel v. Lomax*, 5 So. 325, 326 (Ala. 1889); *Tobin v. Bell*, 61 Ala. 125, 128 (1878).

emptor.”¹²⁹ The transactions of business, trade, and commerce could not be conducted with that facility and confidence, which are essential to successful enterprise, and the advancement of individual and national wealth and prosperity without reasonable reliance on the integrity of representations made in bargaining.¹³⁰ Thus, a party commits manifest fraud and violates rules of equity, when he or she misrepresents a material fact or creates a false impression by words or acts in order to mislead or obtain an undue advantage where the parties do not have equal access to the means of information—such conduct serving to vitiate and void the contract.¹³¹

The other equally important reason for checking fraud lies in the sense of moral approbation. Under long-recognized principles of natural justice, fraud or deceit was not countenanced because it was “an evil act with an evil intent.”¹³²

4. Trust and Will

While affirmative misrepresentations were actionable, silence was not.¹³³ However, where the conditions were not reasonably discoverable by the buyer, and the seller had knowledge of them, the seller had a duty to speak.¹³⁴ The courts took varying views on whether a

129. *Cox v. Montgomery*, 36 Ill. 396, 398 (1865) (explaining that the seller knew that the buyer “was dealing with him in full reliance upon his statements, which he professed to make from his personal knowledge of the land, and this fact imposed upon an additional obligation to be truthful, which a man of ordinary uprightness would have jealously respected”).

130. *Pridgen v. Long*, 98 S.E. 451, 454 (N.C. 1919); *Gray v. James*, 65 S.E. 644, 645 (N.C. 1909); *Walsh v. Hall*, 66 N.C. 233, 238 (1872).

131. *Mitchell v. Zimmerman*, 4 Tex. 75, 79 (1849) (internal citations omitted).

132. *Bell v. Harrison*, 102 S.E. 200, 204 (N.C. 1920).

133. *Phillips v. Homestake Consol. Placer Mines Co.*, 273 P. 657, 658 (Nev. 1929) (holding purchaser discovered that all the ore and gravel of commercial had been extracted from the property before the time of purchase—the seller failed to disclose this fact). The general rule, like all seeming absolutes, was filled with exceptions. First, nondisclosure of defects likely to cause bodily harm or property damage was often held to be actionable. *See, e.g., Ultramares Corp. v. Touche*, 174 N.E. 441, 447 (N.Y. 1931); *Glanzer v. Shepard*, 135 N.E. 275, 276 (N.Y. 1922).

134. *See Pac. Portland Cement Co. v. Placer Cnty. Land Co.*, 201 P. 126, 128 (Cal. 1921) (holding that the buyer had a duty to inquire as to seller’s title). “Mere expressions of opinion as to the sufficiency of title, when the means of information are equally accessible to both parties, or the same facts are within the knowledge of both parties, and when no confidential relation exists between them, do not constitute fraud or deceit upon the part of the vendor.” *Id.*; *see also Fausett & Co. v. Bullard*, 229 S.W.2d 490, 491 (Ark. 1950) (explaining the general rule is that “[i]f the means of information are alike accessible to both, so that, with ordinary prudence or vigilance, the parties might respectively rely upon their own judgment, they must be presumed to have done so; or if they have not so informed themselves, must abide the consequences of their own inattention and carelessness.”) (citing *Yeates v. Pryor*, 11 Ark. 58, 66 (1850)); *Mincy v. Crisler*, 96 So. 162, 163 (Miss. 1923) (holding for the purchaser where seller constructed a house on foundation pillars resting on decaying lumber that was covering a 6-foot ditch, thus knowingly creating a foundational defect that could not be detected from an examination of the exterior of the premises); *Adkins v. Stewart*, 166 S.W. 984, 985 (Ky. 1914) (discussing two views on hidden defects); *Ripley*

seller could escape liability for fraud and misrepresentations on the ground that the buyer should have investigated for himself.¹³⁵ If defects were patent, *caveat emptor* applied and the seller, even knowing of their existence, could not be held liable for failure to disclose them, unless he did something to prevent investigation.¹³⁶ However, if the defect was latent and known to the seller, his mere silence with knowledge that the buyer is acting upon the assumption that no defect exists amounted to actionable fraud.¹³⁷ Of course, active concealment could be just as deceitful as a positive false statement.¹³⁸ Even the employment of artifices, deceits, and frauds to discourage a purchaser from inquiring or investigating would be actionable.¹³⁹ Indeed, it may be

v. Cronon, 115 S.W. 791, 794 (Ky. 1909) (holding where facts are not within vendor's knowledge, but are equally available, vendee must use his means of knowledge—and in failing to do so, he cannot recover on the ground of being misled by vendor); Wardell v. Fosdick, 13 Johns. 325, 327 (N.Y. Sup. Ct. 1816) (allowing the plaintiffs to nullify a purchase of land in Pennsylvania based on the sellers apparent fraudulent act of engaging in the sale of land he knew did not exist).

135. See, e.g., *Sipola v. Winship*, 66 A. 962 (N.H. 1907). A case where defendant represented that wood and timber on the farm were worth over \$1,000 when in fact they were not worth over \$600 and also represented that there were 45 acres of tillage land when in fact there were only 18. Though buyer examined the tillage fully, he had no definite idea of the extent of an acre of land and therefore relied on plaintiff's oral assurances. The court, quoting *Pringle v. Samuel*, 11 Ky. 43, 46 (1822), stated "we do not remember any case, where the maxim quoted [caveat emptor] has been used by the chancellor, in such manner as to compel him to shut his ears against false representations, or to give latitude to a vender of real estate to state facts untruly, without any responsibility." *Id.* "It does not lie in the mouth of the vendor to complain that the vendee took him at his word." *Sipola*, 66 A. at 966. See also *Coon v. Atwell*, 46 N.H. 510, 512-513 (1866).

136. *Adkins*, 166 S.W. at 985; EDWARD SUGDEN, *THE LAW OF VENDORS AND PURCHASERS OF ESTATES* 276 (13th ed. 1857); STORY, *supra* note 104, at § 216 (citing 2 Kent 482).

137. *Adkins*, 166 S.W. at 985 (finding seller lacked knowledge of the defect and no facts would permit an inference thereof). See also *Cohen v. Vivian*, 349 P.2d 366 (Colo. 1960); *Greenberg v. Glickman*, 50 N.Y.S.2d 489 (1944), *modified*, 268 A.D. 882 (N.Y. App. Div. 1944) (finding an action exists against seller concerning concealment of subsurface water condition resulting in flooding of the basement of residence constructed by seller, while seller's contract to erect building with finished basement further "invited the impression that there were no conditions below the surface of the land that would affect the utilization of the basement"); *Groves v. Chase*, 151 P. 913, 914-915 (Colo. 1915) (holding that lack of equal access of information precludes application of *caveat emptor*). Practical difficulties, such as distance and difficult terrain, might excuse a buyer from conducting an investigation of the land offered for sale, entitling buyer to rely upon seller's representations and if they prove to be false, seek rescission or damages. See *Miner v. Medbury*, 6 Wis. 295, 317-318 (1858); see also *Cohen*, 349 P.2d 366, 367-368 (Colo. 1960) (holding that failure to disclose a known defect, otherwise undiscoverable—e.g., latent soil defect—amounts to concealment); *Boyce v. Grundy*, 28 U.S. 210 (1830).

138. *Adkins*, 166 S.W. at 985 (citing *Hughes v. Robertson*, 17 Ky. 215 (1824)).

139. See, e.g., *Southern v. Floyd*, 80 S.E.2d 490, 491 (Ga. 1954) (finding vendor failed to disclose defects in furnace, and also covered a break in the boiler of the furnace with a temporary filling, thereby concealing the defect from the buyer who inspected the property); *Herzog v. Capital Co.*, 164 P.2d 8, 10 (Cal. 1945) (holding vendor's failure to disclose his agents' refinishing and painting concealed structural

even worse where the buyer is unable to learn of and order repairs. While the maxim entitled the seller to remain silent, if he did venture to speak, he was required to speak truthfully.¹⁴⁰

When a buyer did rely on a seller's statements, many courts would not permit a seller to excuse his false statements on the basis that the purchaser should not have believed him for the law would not hear the guilty party say: "You were yourself guilty of negligence," or "you ought not to have trusted me."¹⁴¹ It would have been a true perversion of law and justice to allow *caveat emptor* to enable positive fraud

defects and amounted to fraud); *Rice v. Silverston*, 48 N.E. 969, 970–71 (Ill. 1897) (holding while seller pretended that he wanted buyer to examine land for himself, he succeeded—by indirection—in making buyer believe that an investigation would not be necessary).

140. If the purchaser had not examined the property before purchase, but relied on seller's representations that were false, seller's conduct would be actionable. *Boyce*, 28 U.S. at 218, 220 (finding misrepresentations by seller that vitiated the contract). The court rejected the seller's argument that the purchaser bought with knowledge of the problem with inundation, where the seller mentioned the land's overflowing, but stated that overflowing could be prevented by a levee at small expense. *Id.* The communication was not of such full and decided character as to amount to a communication of knowledge to the purchaser. *Id.* Nor was it sufficient to put the purchaser to inquiry, because he had the seller's positive assurances to the contrary. *Id.* He had a right to rely upon such assurances without inquiry. *Id.* at 218; *see also Groves*, 151 P. at 913–14 (holding that where purchaser visited the land at a time when it was snow covered, and thus inspection would not be informative, purchaser was entitled to rely upon representations made by seller that, *inter alia*, the land was good corn producing land, and could hold seller liable as the facts showed these to be misrepresentations); *Bianconi v. Smith*, 28 P. 880, 881 (Ariz. 1892) (holding that buyer neglected to inquire as to seller's title and/or to obtain a deed containing warranties of title where another person was in possession of the deed at the time of the contract); *Erickson v. Fisher*, 53 N.W. 638, 638 (1892) (involving a land exchange where seller pointed in the direction of the subject lots, but no lot specifically, and buyer relied upon seller's representation); *Schumaker v. Mather*, 133 N.Y. 590, 590 (1892) (holding failure of buyer to inspect the farm does not preclude a claim against seller where the seller made misrepresentations on which the purchaser relied); *Clarke v. Baird*, 7 Barb. 64 (N.Y. Sup. Ct. 1849) (holding that fraudulent misrepresentations or false assertions, respecting a fact material to show the value of land, by which the purchaser is injured, will subject the seller to an action in deceit, even though it was in the power of the purchaser to ascertain whether the assertion was true or false, but in fact relies upon seller's representations); *Sherwood v. Salmon*, 5 Day 439, 445 (Conn. 1813) (affirming the principle "that it is not the duty of the vendee to make enquiry [sic], whether the representation of the vendor be true or not, though it is in his power to do it; but he may rely on such representation, and if it be false, he is entitled to his remedy."); *Fishback v. Miller*, 15 Nev. 428, 440–41 (1880) (holding purchaser could rely on seller's statements of facts as to the location of a shaft and was under no obligation to investigate and verify the statement to which the seller has deliberately pledged his faith); *Sipola*, 66 A. at 96; *Cowger v. Gordon*, 4 Blackf. 110 (Ind. 1835). *But see Parker v. Moulton*, 114 Mass. 99, 99 (1873) (holding buyer was not excused from examination unless he was fraudulently induced to forbear from inquiries that he would have otherwise made).

141. MELVIN M. BIGELOW, A TREATISE ON THE LAW OF FRAUD ON ITS CIVIL SIDE 523–24 (2d ed. 1888); WILLIAM WILLIAMSON KERR, A TREATISE ON THE LAW OF FRAUD AND MISTAKE 40–42 (2d ed., 1883); *Cottril v. Krum*, 13 S.W. 753, 755 (Mo. 1890); *Judd v. Walker*, 114 S.W. 979 (Mo. 1908); *John Schweyer & Co. v. Mellon*, 162 N.W. 1006, 1008–09 (Mich. 1917).

upon the unwary¹⁴² or to require a defrauded party to use diligence to discover the fraud.¹⁴³ Indeed, "the law does not require a prudent man to deal with every one as a rascal, and demand covenants to guard against the falsehood of every representation which may be made as to facts which constitute material inducements to a contract."¹⁴⁴ Even buyer's independent inquiries will not necessarily excuse seller's misrepresentation if the buyer relies on seller's statements.¹⁴⁵

IV. FROM WILL TO OUGHT

As the prospect of liability did not always counsel sellers to be honest and forthcoming about the condition of property held out for sale, and ex-post remedies proved insufficient to make buyers whole or undo injuries that might have fallen upon the buyer or third parties, a new approach to the problem was necessary: one imposing a duty of disclosure. That approach grew out of a general utilitarian movement in the early 19th century. Utilitarianism at first meant the use of law to promote economic growth, which often sacrificed an individualized sense of justice.¹⁴⁶ The claims of individualism and localism, which had emerged in the 18th century, were frequently subordinated by the perceived need for standardization in national markets and a national economy.¹⁴⁷ Law became more goal-oriented.¹⁴⁸ The late-19th-century thinkers were attempting to create an autonomous system of legal doctrine in which law was sharply separate from politics.¹⁴⁹ Political reasoning was subjective, discretionary, and a matter of opinion; but legal reasoning was objective and not subject to the whims of the judge.¹⁵⁰ Law was conceived as a science.¹⁵¹

142. *Burger v. Calek*, 215 P. 981, 981 (Idaho 1923).

143. *Steele v. Banninga*, 196 N.W. 404, 405 (Mich. 1923); *Beetle v. Anderson*, 73 N.W. 560 (Wis. 1897); *Burger*, 215 P. at 238 (holding one has the right to rely upon a statement of a material fact made as a positive assertion under circumstances from which it is fairly inferable that the parties making the statement knew that the former was relying expressly upon this representation).

144. *Bell v. Harrison*, 102 S.E. 200, 203 (N.C. 1920); *Walsh v. Hall*, 66 N.C. 233, 243 (1872). *But see Etheridge v. Vernoy*, 70 N.C. 713 (1874) ("Even fraud in the misrepresentation will not entitle the vendee to relief, unless that fraud is such that the plaintiff could not have reasonably provided against it under the maxim, caveat emptor.").

145. *See, e.g., Wood v. Jones*, 237 S.W. 99, 101 (Ark. 1922) (holding where seller has peculiar knowledge, makes false representations in order to induce, and thereby does induce buyer to rely upon his false statement, seller will not be heard to say buyer should have ascertained the truth).

146. HORWITZ, *supra* note 61, at 36.

147. MORRIS R. COHEN, *LAW AND THE SOCIAL ORDER: ESSAYS IN LEGAL PHILOSOPHY* 106-08 (1982).

148. KELLY, *supra* note 35, at 315.

149. HORWITZ, *supra* note 61, at 198.

150. *Id.* at 199.

151. *Id.* at 200-01.

Protecting freedom of contract would further the interests of society in a large and robust industrial economy. State statutes aiming to protect workers from pitiful wages, children from dangerous industries and interminable hours of labor, and workers generally from oppressive working conditions were struck down in violation of a property right guaranteed by the Fifth and Fourteenth Amendments of the Constitution.¹⁵² The courts were slow in recognizing the dangers and harms that seemed inherent in the inequality of bargaining power that characterized relationships between worker and factory owner in industrial society. It was not really until the first third of the 20th century that courts took the position that freedom of contract had gone too far.¹⁵³ Changes in society—great depressions, railroad amalgamations, unregulated working conditions, child labor, and other problems wrought by the industrial movement—caused a rethinking of the virtues of freedom of contract in its absolute sense. It came to be recognized that:

Society, in granting freedom of contract, did not guarantee that all members of the community would be able to utilize it to the same extent. The free use that can be made of contract will depend on the system governing the distribution of property: to the extent that the law sanctions an unequal distribution of property, freedom of contract inevitably becomes a one-sided privilege.¹⁵⁴

The reaction was the enactment of a host of legislation regulating contracts of all kinds, e.g., insurance, labor, utilities, and mortgages.¹⁵⁵

The courts' rethinking of the practical and moral force behind freedom of contract was perhaps prompted by a change in legal philosophy generally. Writers in the early 20th century wrote of the legal system in terms of its normative functions, that is, of "'ought propositions', which could be, within [their] own terms, valid and illuminating, regardless of the moral quality of those norms, and indeed independent of all extraneous ethical, social, economic, or political values."¹⁵⁶ In other words, the legal "ought," the norm, was viewed as a purely formal character, subject to evaluation of its own terms and logic, not of any other scientific or sociological standards.¹⁵⁷ The law's purpose is to cause adherence to these oughts.¹⁵⁸ Pound stated that:

152. See, e.g., *Lochner v. New York*, 198 U.S. 45, 57 (1904); *Adair v. United States*, 208 U.S. 161, 179–80 (1907); *Coppage v. Kansas*, 236 U.S. 1, 26 (1914).

153. See DAVID N. MAYER, *LIBERTY OF CONTRACT* 103–10 (2011) (discussing various ameliorative legislation during this era); Kennedy, *supra* note 65, at 117–18, 120, 123–24 (discussing the abandonment of freedom of contract for reasons of policy and in the public interest).

154. KESSLER & SHARP, *CASES ON CONTRACT* iii–xvi (rev. ed. 1950), as reprinted in MORRIS R. COHEN & FELIX S. COHEN, *READINGS IN JURISPRUDENCE AND LEGAL PHILOSOPHY* 143–44 (Erwin N. Griswold et al. eds., 1951).

155. MAYER, *supra* note 153, at 103–10.

156. KELLY, *supra* note 35, at 356.

157. *Id.* at 387.

158. *Id.* at 386.

Looked at functionally, the law is an attempt to reconcile, to harmonize, to compromise . . . overlapping or conflicting interests, either through securing them directly and immediately, or through securing certain individual interests . . . so as to give effect to the greatest number of interests or to the interests that weigh most in our civilization, with the least sacrifice of other interests . . . I venture to think of problems of eliminating friction and precluding waste in human enjoyment of the goods of existence, and of the legal order as a system of social engineering whereby these ends are achieved.¹⁵⁹

This proposition is an expression of the views of the positivists. For the positivists, law is what the lawmakers have laid down.¹⁶⁰ Its function is to achieve adherence.¹⁶¹ The law is unconcerned with any particular end or moral standard.¹⁶² This is because human societies have no necessary or inherently desirable ends, only competing desires or interests, which are favored by the majority, or those with the most influence win out.¹⁶³ The law can legitimately impose liability on conduct without any pretense that such conduct is morally wrong or otherwise blameworthy.¹⁶⁴ Law operates by the threat of the bayonet in one's back or the rope.¹⁶⁵

These notions operated to push more courts to place limits on, or abandon, *caveat emptor*. While the courts reiterated the longstanding exceptions (i.e., where there was affirmative fraud, active concealment, or the inability of the buyer to inspect the property), courts adopted new principles that extended the exceptions to make the maxim inapplicable. For instance, where the vendor had special knowledge not apparent to the purchaser, and he was aware that the purchaser was acting under a misapprehension as to facts that would be important to the purchaser, he had a duty to disclose.¹⁶⁶ Also,

159. Roscoe Pound, *A Theory of Social Interests* 15, 16 (1921), reprinted in J. HALL, READINGS IN JURISPRUDENCE 238, 245-46 (Jerome Hall ed., 1938).

160. ROGER COTTERREL, THE POLITICS OF JURISPRUDENCE: A CRITICAL INTRODUCTION TO LEGAL PHILOSOPHY 118, 121, 126 (1989).

161. *Id.*; see also Justice Oliver Wendell Holmes, *Admiral Dewey*, in THE OCCASIONAL SPEECHES OF JUSTICE OLIVER WENDELL HOLMES 169-72 (Mark DeWowe, ed., 1962); H.L.A. Hart, *Positivism and the Separation of Law and Morals*, 71 HARV. L. REV. 593, 597-601 (1958).

162. Steven R. Perry, *Holmes v. Hart*, in THE PATH OF THE LAW AND ITS INFLUENCE: THE LEGACY OF OLIVER WENDELL HOLMES, JR. 158, 181 (Steven J. Burton, ed., 2000); see also Oliver Wendell Holmes, *The Path of the Law*, 10 HARV. L. REV. 457-58, 460, 469 (1897); Hart, *supra* note 161, at 602-04, 624, 626 (1958).

163. See Hart, *supra* note 161, at 602-604, 624, 626 (1958).

164. David Luban, *The Bad Man and the Good Lawyer: A Centennial Essay on Holmes's the Path of the Law*, 72 N.Y.U. L. REV. 1547, 1551-52 (1997).

165. Holmes, *supra* note 162, at 457; see also Luban, *supra* note 164, at 1554.

166. See *Holcomb v. Zinke*, 365 N.W.2d 507, 511 (N.D. 1985); *Smith v. Nat'l Resort Cmty., Inc.*, 585 S.W.2d 655, 659-60 (Tex. 1979); *Wilhite v. Mays*, 232 S.E.2d 141, 142-43 (Ga. 1976) (holding buyer agreed to purchase a house unaware of a major defect in the house's underground sewerage system of which the seller had knowledge of and knew the defective condition would affect the buyer's decision to purchase);

where the condition posed a danger to health and safety, the vendor was obligated to make disclosures, whether or not the buyer could have discovered the defect.¹⁶⁷ Further, courts began charging vendors with obligations to disclose defects, not only of which they had actual knowledge, but also those of which the vendor should have known.¹⁶⁸ As before, sellers were not allowed to defend against a charge of misrepresentation or fraud on the basis that the purchaser was too credulous, that she should not have believed him.¹⁶⁹

A. *Responses: Entrepreneurs and Rascals*

Parties determined to regain the advantage of superior knowledge devised entrepreneurial responses. Rational marketplace actors will implement measures aimed at limiting exposure to liability. First, they will describe precisely the obligations undertaken—the scope of the work, limits, and exceptions. Then, they will incorporate disclaimers—about what the work does not entail and what the actors have not undertaken or represented. Last, they will define the remedies—the contract price, but not consequential damages. Under the new regime requiring honest disclosures, if buyers could insist upon honest disclosures, sellers would make representations but suggest that buyers look for themselves and extract promises from buyers that they were not relying upon any of seller's representations. In addition, where sellers make representations on which they intended a buyer to rely, sellers would insist those representations were not made for the benefit of any other party and should not be used for any other purpose. While these measures on their face seem entirely unobjectionable, problems arise when it is later revealed that sellers did make false representations with intent that buyers rely, and buyers did rely to their injury.

Addressing the circumventions of new standards of probity, courts have fallen into three discernible camps: (1) enforcing the contracts as a matter of free will; (2) striking down the contracts that violate standards of honesty or are fraudulent; and (3) examining the transactions

see also *Brooks v. Ervin Constr. Co.*, 116 S.E.2d 454, 458 (N.C. 1960) (holding the vendor failed to disclose that the lot consisted of disturbed earth as a result of the vendor's burying wood, branches, and other debris the vendor burned in a large hole on the lot); *Kaze v. Compton*, 283 S.W.2d 204, 208 (Ky. 1955) (holding the vendors concealed the existence of a drain tile which ran beneath the house causing water to accumulate under the house and in the yard); *Rothstein v. Janss Inv. Corp.*, 113 P.2d 465, 469–70 (Cal. Ct. App. 1941) (holding buyer relied on false representations that the property lot was solid and did not contain a fill made by the sellers agent, who had knowledge that said lot was a fill-in lot).

167. See *Fennell Realty Co. v. Martin*, 529 So. 2d 1003, 1005 (Ala. 1988); *Cashion v. Ahmadi*, 345 So. 2d 268, 271 (Ala. 1977), *superseded by statute*, ALA. CODE § 34-37-4 (1975), as recognized in *Fisher v. Comer Plantation, Inc.*, 772 So. 2d 445 (Ala. 2000).

168. *Gasteiger v. Gillenwater*, 417 S.W.2d 568, 571–72 (Tenn. 1967); *Lingsch v. Savage*, 29 Cal. Rptr. 201 (Dist. Ct. App. 1963).

169. *Johnson v. Owens*, 140 S.E.2d 311, 314 (N.C. 1965).

on a case-by-case basis, ignoring buyers' formal representations of no reliance, and looking for evidence of reliance in fact.

1. Disclaimers, Free Will, and Fools

One line of cases takes the hard, unsympathetic stance that the buyer can find no relief from the courts where the buyer has foolishly trusted the seller and formally stated that he has not. In *Teer v. Johnston*,¹⁷⁰ recounted above, the buyers contended they signed the purchase agreement based on the representations set forth in the disclosure statement.¹⁷¹ It was undisputed that neither the disclosure statement nor the representations made in the disclosure statement were added as an addendum to the purchase agreement.¹⁷²

In their action for rescission based on intentional fraud, the buyers faced several hurdles that proved insurmountable: *caveat emptor*, merger, and the "as is" clause.¹⁷³ First, Alabama still adhered to *caveat emptor* with respect to used homes, except that a seller must disclose conditions that threaten health and safety.¹⁷⁴ Second, in order for the Teers to recover for fraudulent misrepresentation, they had to establish the fraudulent misrepresentation survived the execution and delivery of the contract.¹⁷⁵ Not only was there no survival, the disclaimer clause operated to keep out parol evidence or polar representations from the contract.¹⁷⁶ Third, the court found that the "as is" clause negated the element of reliance necessary for a cause of action for fraud.¹⁷⁷ In the end, the court admonished buyers that *caveat emptor* still prevails in the state, and the onus was on the buyer to conduct his own investigations. Indeed the buyer's wariness should be heightened in the face of "disclaimer" and "as is" clauses.¹⁷⁸ This was a hard position to leave the buyer in, considering any wariness the buyer might otherwise have had was put off by the seller's false representations about the property condition before signing.

The Georgia courts also have turned away the duped buyer, leaving him to what he ostensibly bargained for. In *Novare Group, Inc. v. Sarif*, the buyer purchased a condominium unit, expecting to have a particular view based upon representations by the developer.¹⁷⁹ All the while, the developer had planned to construct another building that would block that view.¹⁸⁰ The court rejected the buyer's plea for

170. *Teer v. Johnston*, 60 So. 3d 253, 253 (Ala. 2010).

171. *Id.* at 255.

172. *Id.* at 255.

173. *Id.* at 256–58.

174. *Id.* at 256.

175. *Id.* at 257.

176. *Id.* at 261.

177. *Id.* at 258.

178. *Id.* at 261.

179. *Novare Group, Inc. v. Sarif*, 718 S.E.2d 304, 306 (Ga. 2011).

180. *Id.*

rescission saying, “it is well-settled law in Georgia that a party who has ‘the capacity and opportunity to read a written contract cannot afterwards set up fraud in the procurement of his signature to the instrument’ based on oral representations that differ from the terms of the contract.”¹⁸¹ Indeed, only when a party can show that he has somehow been prevented from reading the contract, will a claim for fraud be heard.¹⁸² Because the purchasers signed agreements that expressly stated that the views might change over time, they could not have relied upon any oral representations of the sellers so far as the law was concerned.¹⁸³ The entire agreement between the parties was set forth in the terms of the written contract—the purchasers affirmed the contract that contained a merger or disclaimer provision that “oral representations [could not] be relied upon as correctly stating the representations of seller.”¹⁸⁴ This meant that the buyers were estopped from asserting reliance on a representation that was not part of the contract.¹⁸⁵ Inasmuch as justifiable reliance is an essential element of a claim of fraud, negligent misrepresentation, and the Fair Business Practices Act (“FBPA”) claims,¹⁸⁶ the purchasers could not sustain any of the causes of action that required justifiable reliance.¹⁸⁷

New York courts are in accord with Georgia and Alabama, essentially finding a buyer’s execution of a contract with a disclaimer clause

181. *Id.* at 308 (citing *Craft v. Drake*, 260 S.E.2d 475, 477 (Ga. 1979)). In *Craft*, the plaintiff alleged that a bank officer fraudulently induced him to execute certain notes by misrepresenting that the plaintiff’s home would not be used as collateral for the note. However, the express terms of the note stated that the holder would have a security interest in any property held by the plaintiff at the time of execution or subsequently acquired. The court held that because the oral misrepresentation was directly contradicted by the language of the agreement, and because the statements were promissory in nature as to future acts, the plaintiff was bound by the terms of the note he signed. See *Craft*, 260 S.E.2d at 475.

182. *Novare*, 718 S.E.2d at 308 (citing *Beckwith v. Peterson*, 181 S.E.2d 51, 52–53 (Ga. 1971)).

183. *Id.* at 308.

184. *Id.* at 307.

185. *Id.* at 309 (citing *First Data POS, Inc. v. Willis*, 546 S.E.2d 781, 785 (Ga. 2001)).

186. *Id.* (citing *Tiismann v. Linda Martin Homes Corp.*, 637 S.E.2d 14, 16 (Ga. 2006)) (reliance element of common law misrepresentation is incorporated into the causation element of an individual claim under the FBPA); *City Dodge, Inc. v. Gardner*, 208 S.E.2d 794, 797 (Ga. 1974) (noting that justifiable reliance is an essential element of a fraud claim); *Real Estate Int’l, Inc. v. Buggay*, 469 S.E.2d 242, 245 (Ga. 1996) (noting that justifiable reliance is essential element of a negligent misrepresentation claim).

187. *Novare*, 718 S.E.2d at 308. Nevertheless, purchasers also argued that the determination of justifiable reliance is a jury question, but the court explained that “[w]hile justifiable reliance may be a jury question in a fraud case where no contract exists or where the contract has become void, it is a question of law in a case where the contract language prevails and the contract’s merger clause precludes reliance on oral representations.” *Id.* at 309. The court compared *City Dodge* holding that justifiable reliance is a jury question where the contract containing the merger clause was found invalid due to an antecedent fraud, with *First Data POS* holding as a matter of law that a valid merger clause precludes any subsequent claim for deceit based on pre-contractual representations. *Id.*

as conclusive on the parties' undertakings and representations.¹⁸⁸ The courts in Florida are on both sides of the issue.¹⁸⁹ Some hold that a merger or integration clause does not preclude an action based upon oral representations that fraudulently induced the entering into the contract,¹⁹⁰ while others hold that actions are barred when oral representations are expressly contradicted by the written instrument.¹⁹¹

2. Disclaimers in the Face of Knowing False Statements

Another group of courts see through the subterfuge of "as is" and disclaimer-of-reliance clauses and find their use in the scenarios discussed below to be fraudulent.¹⁹² The California courts have been most definitive in their position:

188. See *Dolansky v. Frisillo*, 939 N.Y.S.2d 210, 214 (N.Y. App. Div. 2012) (allegations of "fraudulent inducement may not be maintained if specific disclaimer provisions in the contract of sale disavows reliance upon oral representations"); *Tarantul v. Cherkassky*, 923 N.Y.S.2d 133, 135 (N.Y. App. Div. 2011) (holding that buyers had expressly represented that "the sellers had not made any representation as to the physical condition or any matter or thing affecting or relating to the property or the contract except as specifically set forth therein, and that the buyers were relying on their own inspection of the property"); *Laxer v. Edelman*, 75 A.D.3d 584, 586 (N.Y. App. Div. 2010); *Bedowitz v. Farrell Dev. Co.*, 289 A.D.2d 432, 433 (N.Y. App. Div. 2001); *Cohan v. Sicular*, 214 A.D.2d 637, 638 (N.Y. App. Div. 1995); *Bd. of Managers. of the Chelsea 19 Condo. v. Chelsea 19 Assocs.*, 905 N.Y.S.2d 8, 10 (N.Y. App. Div. 2010) (plaintiffs were foreclosed from establishing reliance by the specific disclaimers and by their undertaking to conduct their own investigation); *but see DiBuono v. Abbey, LLC*, 944 N.Y.S.2d 280, 284 (N.Y. App. Div. 2012) ("While a general merger clause is ineffective to exclude parol evidence of fraud, a specific disclaimer will defeat any allegation that the contract was executed in reliance on contrary oral representations.").

189. *Adrian Roggenbuck Trust v. Dev. Res. Grp., LLC*, 505 F. Appx. 857, 861–62 (11th Cir. 2013); *Noack v. Blue Cross & Blue Shield of Fla., Inc.*, 742 So. 2d 433, 434 (Fla. Dist. Ct. App. 1999); *Ortiz v. Orchid Springs Dev. Corp.*, 504 So. 2d 510, 510 (Fla. Dist. Ct. App. 1987); *see also Levinson v. Preferred Home Mortg. Co.*, No. 12-80300-CIV., 2013 WL 588517, at *6 (S.D. Fla. Feb. 13, 2013) (finding that disclaimers of reliance had the effect of directly repudiating any prior statements that the seller or lender may have made directly or indirectly through their agents and expressly contradicted the plaintiffs' claims about being fraudulently induced to purchase based on any representations by the defendants regarding the value of the property and as a matter of law, they defeat the element of reasonable reliance necessary for a fraudulent inducement claim); *G Barrett LLC v. Ginn Co.*, 494 F. App'x. 944, 946–47 (11th Cir. 2012) (holding that a purchaser of property parcel did not act in reliance on any false representation by mortgagee regarding property value so as to establish *prima facie* case of fraudulent inducement, under Florida law, where loan application contained purchaser's express disclaimer of reliance on any representation as to property value).

190. *Mejia v. Jurich*, 781 So. 2d 1175, 1178 (Fla. Dist. Ct. App. 2001); *Romo v. Amedex Ins. Co.*, 930 So. 2d 643, 650–53 (Fla. Dist. Ct. App. 2006) (holding that reasonable reliance remained a disputed issue of fact despite a contract's disclaimer).

191. *Hillcrest Pac. Corp. v. Yamamura*, 727 So. 2d 1053, 1056 (Fla. Dist. Ct. App. 1999).

192. To establish a right to relief for a claim of fraudulent representation or concealment, a plaintiff must establish the following elements:

representation or, where there is a duty to disclose, concealment of a
(a) fact,

A party to a contract who has been guilty of fraud in its inducement cannot absolve himself . . . from the effects of his . . . fraud by any stipulation in the contract, either that no representations have been made, or that any right that might be grounded upon them is waived. Such a stipulation or waiver will be ignored, and parol evidence of misrepresentations will be admitted, for the reason that fraud renders the whole agreement voidable, including the waiver provision.¹⁹³

The use of such clauses is affirmative fraud in Ohio. In *Northpoint Properties, Inc. v. Charter One Bank*,¹⁹⁴ the parties agreed to the sale and purchase of a 15-story commercial office building.¹⁹⁵ The sale contained disclaimers regarding representations and warranties.¹⁹⁶ Thereafter, it was discovered that the fire-suppression system was not working properly and the drinking water had a bad taste.¹⁹⁷ The buyer sued. However, the contract and purchasing instructions pro-

-
- (b) which is material to the transaction at hand, made falsely, with knowledge of its falsity, or with such utter disregard and recklessness as to whether it is true or false that knowledge may be
 - (c) inferred,
 - (d) with the intent of misleading another into relying upon it,
 - (e) justifiable reliance upon the representation or concealment, and
 - (f) a resulting injury proximately caused by the reliance.

Northpoint Props, Inc. v. Charter One Bank, No. 94020, 2011 Ohio App. LEXIS 2206, at *32 (Ohio Ct. App. May 26, 2011) (quoting *Groob v. KeyBank*, 843 N.E.2d 1170, 1178 (Ohio 2006)).

193. *Kenneally v. Bank of Nova Scotia*, 711 F. Supp. 2d 1174, 1187 (S.D. Cal. 2010) (alteration in original) (quoting *McClain v. Octagon Plaza, LLC*, 71 Cal. Rptr. 3d 885, 893 (Ct. App. 2008) (contractual disclaimer of reliance did not bar claims against the developers for fraud under 15 U.S.C. § 1703(a)(2)(B) of the Land Sales Act, fraud under CAL. CIV. CODE § 1709, or unfair competition and false advertising under CAL. BUS. & PROF. CODE §§ 17200, 17500, regarding the size of condominium units)). In *Kenneally*, “[t]he purchase contract stated [the] unit would be 1404 square feet The [Seller’s] . . . website . . . further represented that units with the floor plan of [the unit] would be ‘1395–1404 sq. ft. approx.’ In fact, the size of the unit, as measured by an independent appraiser, [was] 1248 square feet, 156 square feet smaller than the size claimed in the contract and 148 square feet smaller than the lower bounds of the range on the . . . website.” *Id.* at 1178. The contract stated: “‘Buyer by its execution of this Agreement agrees that it is not relying upon any brochures, sales documents, or oral statements by Seller or Seller’s agents regarding the square footage of the Condominium.’” *Id.* at 1179. The plaintiffs maintained that “[a]s [the Purchase Agreement] attempts to waive Buyer’s reliance on such documentation and statements as they relate to the purchase of units . . . effectively allowing the Seller to offer a unit of any size and composition it chooses, the contract [would be] illusory.” *Id.* (emphasis added). The court could not “conclude that the ‘no reliance’ provisions in the Purchase Agreement render[ed] Plaintiff’s alleged reliance unreasonable as a matter of law.” *Id.* at 1186; see also *Hinesley v. Oakshade Town Ctr.*, 37 Cal. Rptr. 3d 364, 372 (Ct. App. 2005) (“[A] per se rule that an integration/no oral representations clause establishes, as a matter of law, that a party claiming fraud did not reasonably rely on representations not contained in the contract is inconsistent with California law.”).

194. *Northpoint Props., Inc.*, 2011 Ohio App. LEXIS 2206.

195. *Id.* at *2–3.

196. *Id.* at *8.

197. *Id.*

vided that the building was being sold in its “as is, where is” condition and contained disclaimers regarding representations and warranties that buyers could only rely on their own inspections and investigations of the property.¹⁹⁸ Rejecting the seller’s defense based on the nature of the contract and disclaimer clause, the court explained that while an “as is” clause does bar a claim for nondisclosure, it does not bar a claim of affirmative fraud, such as fraudulent concealment or misrepresentation.¹⁹⁹ Moreover, a seller’s use of a disclaimer clause does not necessarily shield him from liability or negate justifiable reliance by the buyer. General disclaimers do not insulate sellers who knowingly make false statements.²⁰⁰ The court also ruled that the parol evidence rule does not bar the introduction of evidence of the fraud that induced the written contract.²⁰¹

Similarly, the Oklahoma Supreme Court has recognized that the very fact of the material representation is itself enough to justify a buyer’s reasonable reliance on its accuracy, not needing to cast buyer’s conduct as unduly stupid or gullible. In *Bowman v. Presley*,²⁰² the court ruled that a buyer can reasonably rely on seller’s assurances of size, without being required to determine the truth or falsity of the fact represented. The common-law doctrine of *caveat emptor* does not reach situations where a purchaser of real property has relied upon a positive representation of material fact.²⁰³

The Arkansas courts have stated emphatically what a seller’s burden is in trying to avoid liability in an “as is” sale. In *Williams v. Hertzog*, the court ruled that in order for a seller’s liability to be relieved under a buyer’s disclaimer provision, the seller must first inform the buyer as to the true condition of the property, not merely the condition of the house as described in the disclosure agreement.²⁰⁴ The true condition of a property is not disclosed to the buyer when a condition is hidden or misrepresented by the seller.²⁰⁵ Thus, a seller cannot include an “as is” provision in a realty contract, make a fraudulent misrepresentation, and then attempt to shield himself from liability based on those misrepresentations by virtue of the “as is”

198. *Id.* at *6–9.

199. *Id.* at *33 (citing *Tipton v. Nuzum*, 616 N.E.3d 265 (Ohio Ct. App. 1992)).

200. *Id.* (citing *In re Nat’l Century Fin. Enters., Inc.*, Inv. Litig., 541 F. Supp. 2d 986, 1005 (S.D. Ohio 2007)).

201. *Id.* (citing *Galmish v. Cicchini*, 734 N.E.2d 782, 789 (Ohio 2000)); *see also* *Deschamps v. Treasure State Trailer Court Ltd.*, 230 P.3d 800, 806 (Mont. 2010) (showing where alleged oral promise directly contradict the terms of an express written contract, the parol evidence rule applies; the exception only applicable where the alleged fraud does not relate directly to the subject of the contract).

202. *Bowman v. Presley*, 212 P.3d 1210 (Okla. 2009).

203. *Id.* at 1221.

204. *Williams v. Hertzog*, No. CA06-560, 2007 Ark. App. Ct. LEXIS 265, at *6 (Apr. 11, 2007).

205. *Id.* at *1.

provision.²⁰⁶ Otherwise, “[i]f the as-is provision is given effect where the sellers made a fraudulent misrepresentation, then the disclosure form included in the realty contract is merely an illusory term of the parties’ agreement that induces fraudulent reliance.”²⁰⁷

3. Representations and Reliance in Fact

Texas courts, in the third group, have labored hard to strike a balance between protecting parties’ ability to bargain freely and protecting honesty in contractual relations. These courts make a distinction between sellers’ disclaimers about representations outside the contract and buyers’ disclaimer of, or reliance on, representations. Recently, the Texas Supreme Court took great pains to draw that line. In *Italian Cowboy Partners, Ltd. v. Prudential Insurance Company of America*, the Court stated it had recognized decades ago that a merger clause “does not waive the right to sue for fraud should a party later discover that the representations it relied upon before signing the contract were fraudulent.”²⁰⁸ The principal issue in the case was whether “disclaimer-of-representations language within a lease contract amount[ed] to a standard merger clause, or also disclaim[ed] reliance on representations, thus negating an element of the petitioner’s claim for fraudulent inducement of that contract.”²⁰⁹ The Secchis, owners and operators of the Italian Cowboy restaurant, terminated a lease because of a persistent gas odor and filed suit against Prudential In-

206. *Id.* at *17–18.

207. *Id.* at *18. *See also* Pickering v. Garrison, No. CA08-810, 2009 Ark. App. LEXIS 87, at *15 (Feb. 18, 2009) (holding “as is” and disclaimer-of-reliance clauses did not *require* judgment for seller; but justifiable reliance on representations by sellers, even where buyer has conducted his own investigation, is a question for the jury); *but see* Worley v. City of Jonesboro, 385 S.W.3d 908, 911 (Ark. Ct. App. 2011) (holding reliance not justified where owner qualified representations, not false, and buyer did not read inspection report); *see also* Bauer v. Giannis, 834 N.E.2d 952, 962 (Ill. App. Ct. 2005) (holding “as is” language in a real estate sale contract does not shield a seller from liability for fraud); *S. Dev. Co. v. Pima Capital Mgmt. Co.*, 31 P.3d 123, 129 (Ariz. Ct. App. 2001) (holding a vendor must disclose latent defects in property that are known to the vendor notwithstanding the existence of a burden-shifting “as is” clause or disclaimer of warranties); *Wilson v. Century 21 Great W. Realty*, 18 Cal. Rptr. 2d 779, 782 (Ct. App. 1993) (holding “as is” language in realty sales contract does not shield seller or its agent from liability for affirmative or negative fraud); *Mackintosh v. Jack Matthews & Co.*, 855 P.2d 549, 551 (Nev. 1993) (noting that most states do not permit an “as is” clause to shield a seller who has fraudulently misrepresented the condition of property or who has intentionally concealed known defects); *Stemple v. Dobson*, 400 S.E.2d 561, 567 (W. Va. 1990) (holding “as is” clause in a real estate sale contract will not relieve the vendor of his or her obligation to disclose a condition that substantially affects the value or habitability of the property, is known to the vendor but not to the purchaser, and would not be disclosed by reasonable and diligent inspection); *Richey v. Patrick*, 904 P.2d 798, 803 (Wyo. 1995) (holding in the case of an actual misrepresentation or fraud, an “as is” clause will not relieve the seller of liability).

208. *Italian Cowboy Partners, Ltd. v. Prudential Ins. Co. of Am.*, 341 S.W.3d 323, 327 (Tex. 2011).

209. *Id.* at 327–28.

surance Company of America, the landlord, and property manager, Prizm Partners.²¹⁰ The Secchis sought to rescind the lease and recover damages for fraud and breach of the implied warranty of suitability.²¹¹ During lease negotiations, Fran Powell, Prizm's management director, told the Secchis that the restaurant building the Secchis were interested in leasing was practically new, was in perfect condition, and had no problems whatsoever.²¹² When the Secchis' general contractor in charge of remodeling was told by another tenant that the location was plagued with a severe odor, the Secchis confronted Powell who again denied any problems and stated it was the "first time" she had ever heard this information.²¹³ The Secchis subsequently learned from the former manager of the restaurant which previously leased the space, that the sewer gas odor was present during their tenancy, and Powell knew about the odor and was present on the premises when the smell was present.²¹⁴ Powell had personally characterized the odor in the prior restaurant as "horrid," "ungodly," and a smell that would make "one gag."²¹⁵ The trial court ruled in favor of the Secchis, finding Powell had superior knowledge during the lease negotiations and made statements of fact, known to be false when made, and the Secchis in signing the lease relied upon those false statements.²¹⁶ The trial court further found Powell's conduct, and attempted cover-up, evidenced consciousness of guilt of her pre-lease misrepresentations.²¹⁷ On appeal, Prudential argued the following provisions contained in the Secchis' lease negated the reliance element of the Secchis' claim:

14.18 Representations. Tenant acknowledges that neither Landlord nor Landlord's agents, employees or contractors have made any representations or promises with respect to the Site, the Shopping Center or this Lease except as expressly set forth herein.²¹⁸

14.21 Entire Agreement. This lease constitutes the entire agreement between the parties hereto with respect to the subject matter hereof, and no subsequent amendment or agreement shall be binding upon either party unless it is signed by each party²¹⁹

The Texas Supreme Court first noted the parties were in dispute as to whether the lease provisions constituted a disclaimer, or simply amounted to a merger clause, which would not disclaim reliance.²²⁰

210. *Id.* at 328.

211. *Id.*

212. *Id.*

213. *Id.* at 329.

214. *Id.* at 330.

215. *Id.* at 330-31.

216. *Id.* at 331.

217. *Id.*

218. *Id.* at 328.

219. *Id.* at 328, 331.

220. *Id.* at 333.

Despite the parties' contradictory recollections of what transpired, the Court approached the issue as one of law, allowing it to determine the legal import of the clause.²²¹ Prudential argued the language in 14.18 constituted a disclaimer, asserting that Italian Cowboy "impliedly agreed not to rely on any external representations by agreeing that no external representations were made."²²² The Court disagreed, noting, "Standard merger clauses, however, often contain language indicating that no representations were made other than those contained in the contract, without speaking to reliance at all."²²³ After reviewing the contractual language, the Court concluded the only reasonable interpretation of the contract was that the parties "intended nothing more than the provisions of a standard merger clause, and did not intend to include a disclaimer of reliance on representations."²²⁴ The court distinguished the language used from that used in two earlier cases in which the parties expressly disclaimed reliance, explaining:

There is a significant difference between a party disclaiming its reliance on certain representations, and therefore potentially relinquishing the right to pursue any claim for which reliance is an element, and disclaiming the fact that no other representations were made. In addition to differences in the contract's language, the facts surrounding this lease agreement differ significantly from those in *Schlumberger* and *Forest Oil*, where we could more easily determine that the parties intended once and for all to resolve specific disputes. A lease agreement, as here, which is the initiation of a business relationship, should be all the more clear and unequivocal in effectively disclaiming reliance and precluding a claim for fraudulent inducement, lest we "forgive intentional lies regardless of context."²²⁵

The Court emphasized that the term "rely" did not appear in any form in the *Italian Cowboy* lease, unlike the settlement documents in *Schlumberger* and *Forest Oil*.²²⁶ Thus, as a matter of law, the *Italian Cowboy* lease did not disclaim reliance and accordingly, did not defeat the fraudulent inducement claim.²²⁷

221. *Id.*

222. *Id.* at 334.

223. *Id.*

224. *Id.*

225. *Id.* at 335 (emphasis in original) (citations omitted).

226. *Id.* at 336.

227. The ruling here built upon, and did not disturb, principles seemingly well-settled by its lower courts. In *Williams v. Dardenne*, 345 S.W.3d 118 (Tex. App.—Houston [1st Dist.] 2011, pet granted), the Dardennes asserted that the Williamses fraudulently concealed the condition of the house foundation by failing to disclose an engineering letter. The jury found in favor of the Dardennes on their fraudulent inducement claim, but because the Williamses did not raise any challenge to the jury's findings except lack of causation and reliance, the court assumed that the Williamses' failure to disclose the engineering letter was fraudulent—i.e., material to the transaction, known to be false or misleading, and intended to induce reliance by the Dardennes—and would affirm the judgment if there was legally sufficient evidence that this

Two messages, seemingly in conflict, emerge from this case: sellers should take care to draft disclaimer of reliance clauses, and buyers should take care not to sign such clauses or to investigate the property for themselves.²²⁸ This produces a state of affairs not conducive to efficient or productive market transactions. In fact, the opposite results: the seller will make all manner of representations—truthful, false, varnished, and unvarnished—the value of which the buyer will have no means to assess. Depending upon the degree that buyer is risk averse, she will accept, relying on seller's representations, and sign a contract with a disclaimer clause, or she will refuse to sign the contract with a disclaimer clause and walk away. Neither party gains.

A third option for the buyer is to conduct her own inspection; a more costly proposition if, absent truthful disclosures from sellers, the buyer does not know where to look. Even so, the question is raised whether the seller's misrepresentations still matter. In *48 HORSEHILL, LLC, v. Kenro Corp.*,²²⁹ the court answered yes. There, the plaintiff alleged a failure by defendant to disclose the existence of harmful contamination.²³⁰ The contract provided:

ENVIRONMENTAL CONDITIONS. Purchaser shall have the right to have the Property inspected within thirty (30) days of the date of this Agreement for the existence of contamination by hazardous substances or wastes. In the event such inspection reveals

nondisclosure was the cause of the Dardennes' agreement to purchase the property "in its present condition," notwithstanding an "as is" clause in the contract. *Id.* See also *Prudential Ins. Co. of Am. v. Jefferson Assocs. Ltd.*, 896 S.W.2d 156, 162 (Tex. 1995) ("[A] seller cannot have it both ways: he cannot assure the buyer of the condition of a thing to obtain the buyer's agreement to purchase 'as is,' and then disavow the assurance which procured the 'as is' agreement;" "'as is' clause is not effective to negate causation when agreement was induced by 'fraudulent representation or concealment of information by the seller'"). Under certain circumstances, a buyer's independent inspection of the property may conclusively defeat two elements of a fraud claim: causation and reliance, if it reveals to the buyer the same information that the seller allegedly failed to disclose. See *Pairett v. Gutierrez*, 969 S.W.2d 512, 517 (Tex. App.—Austin 1998, pet. denied) (reversing summary judgment on basis of "as is" clause when there was evidence that seller knew of home's foundation problems but affirmatively represented to buyer that they were not aware of any foundation problems).

228. However, where the language of the disclaimer is clear, negotiated by knowledgeable parties at arm's length, it might be enforceable. *In re Capco Energy, Inc.*, 669 F.3d 274, 283 (5th Cir. 2012) (waiver-of-reliance clause negates fraudulent inducement claim); *Curtis Inv. Co. v. Bayerische Hypo-und Vereinsbank, AG*, 341 F. App'x 487, 491–92 (11th Cir. 2009) (holding common law fraud claims barred by merger clause where party signs contract containing disclaimer provision and retains benefit of contract); *Stokes v. Lusker*, 425 F. App'x 18 (2d Cir. 2011) (holding common law fraud claim barred by express disclaimer of reliance); *Schlumberger Tech. Corp. v. Swanson*, 959 S.W.2d 171, 180 (Tex. 1997) (holding clear and express disclaimer of reliance conclusively negates as a matter of law the element of reliance on representations about feasibility and value of sea diamond mining project).

229. *48 Horsehill, LLC v. Kenro Corp.*, No. A-2682-04T5, 2006 N.J. Super. LEXIS 707 (Jan. 17, 2006).

230. *Id.* at *22–24.

the presence of any quantity of hazardous substances or wastes, the Purchaser shall have the option to cancel this Agreement or notify Seller in writing within thirty (30) days of the date of this Agreement (time being of the essence) and provide Seller with a copy of the report.²³¹

The seller argued that because the buyer commissioned its own inspection of the property, the essential element of reliance is missing.²³² That a buyer who does not look for himself is an important factor in determining a seller's liability,²³³ it still did not resolve the question of whether the buyer relied on the results of the buyer's own inspection and not on the seller's nondisclosure prior to purchase of property containing latent defects allegedly known to the seller.²³⁴ As the buyer claimed, the independent investigation was not only limited, but also obscured by the seller's supposedly intentional hiding of the contamination under a concrete patch.²³⁵ Thus, it was of no consequence that the buyer conducted its own due diligence because the seller failed to provide all information critical to the evaluation—a fact upon which the buyer may have justifiably relied. In other words, in light of the seller's alleged concealment of trichloroethylene ("TCE") contamination, the buyer's use of an outside inspection service did not foreclose its right to pursue fraud and misrepresentation claims at trial.²³⁶ The buyer was still entitled to rely on the fact that sellers would not willfully conceal environmental contamination on the property in finalizing the contract of sale.²³⁷ The buyer's reliance on its own physical inspection for visible damage did not mean it was eschewing reliance on seller's alleged willful omissions.²³⁸

V. CONTRACT LIMITS ON WHO CAN RELY

Contract clauses limiting the right to use, and hence rely upon, services provided under the contract seem no more than an invocation of the concept of privity. The strict requirement of privity limits a defendant's risk exposure to foreseeable parties and events.²³⁹ This function is consistent with the theory of contract law that prevailed over the last several centuries, that is, from contract law as morally binding

231. *Id.* at *25.

232. *Id.* at *24–25.

233. *Id.* at *25 (citing *Golden v. Nw. Mut. Life Ins. Co.*, 551 A.2d 1009, 1014 (N.J. Super. Ct. App. Div. 1988)).

234. *Id.* at *25–26 (citing *Byrne v. Weichert Realtors*, 675 A.2d 235, 241 (N.J. Super. Ct. App. Div. 1996)).

235. *Id.* at *3–4, *34.

236. *Id.*

237. *Id.*

238. *See also* *M & D, Inc. v. McConkey*, 573 N.W.2d 281, 282 (Mich. Ct. App. 1997); *Williams v. Dardenne*, 345 S.W.3d 118 (Tex. App.—Houston [1st Dist.] 2011 writ denied).

239. *Walpert, Smullian & Blumenthal, P.A. v. Katz*, 762 A.2d 582, 596 (Md. 2000).

as a matter of conscience,²⁴⁰ to contract law as a matter of wills,²⁴¹ all obligation flowing without restraint by the government.²⁴²

In the most common context, privity means being a party. Historically, this has meant that third parties, no matter how important the issue or how much injury may result, had no right to enforce the contract; either in obtaining prospective relief or damages.²⁴³ This was to protect the expectations and bargains of the parties.²⁴⁴ The agreement is crafted based upon an assessment of the parties' needs and expectations, as well as willingness and ability of the other party to perform. One English judge, Crompton J., felt that it would be "monstrous to allow a party to sue on a contract who could not be sued on it."²⁴⁵ Frederick Pollock stated broadly that "the agreement of contracting parties could not confer any right to enforce the contract on a third person."²⁴⁶ He also insisted on the corollary of the rule, that obligations could only be imposed on parties by their own will, or by the law, but not by the contracts of others.²⁴⁷ There were disparate views on whether third-party-beneficiaries could be in privity with the formal parties. Joseph Chitty argued for a rule disallowing an action by strangers to the consideration unless one of the parties to the contract could be seen as their agent.²⁴⁸

A. Judicial and Legislative Abrogation of Privity

The history of contract privity has not been a linear experience, but one that has taken detours driven largely by prevailing legal theory

240. POUND, *supra* note 58, at 253–54.

241. See discussion *supra* text accompanying notes 59–97.

242. See generally Cohen, *supra* note 64.

243. *Verosol B.V. v. Hunter Douglas, Inc.*, 806 F. Supp. 582, 586 (E.D. Va. 1992) ("[A] stranger to a contract ordinarily has no rights under it and cannot sue to enforce it or take advantage of its breach."); *Twine v. Liberty Nat'l Life Ins. Co.*, 311 So. 2d 299, 305 (Ala. 1975); *Anderson v. First Northtown Nat'l Bank*, 361 N.W.2d 116, 118 (Minn. Ct. App. 1985).

244. 13 RICHARD A. LORD, *WILLISTON ON CONTRACTS* §37:1 (Jack K. Levin ed., 4th ed. 2000); *Winterbottom v. Wright*, 10 M. & W. 109 (1842) (denying a coachman recovery for breach of warranty against a third party for injuries sustained as the result of defects the coach caused by the third party. The Court noted, "There is no privity of contract between the parties; and if the plaintiff can sue, every passenger, or even every person passing the coach who was injured by the upsetting coach, might bring a similar action. Unless we confine the operation of such contracts as this to the parties who entered into them, the most absurd and outrageous consequences to which I can see no limit would ensue.").

245. 12 MICHAEL LOBBAN, *THE OXFORD HISTORY OF THE LAWS OF ENGLAND* 388 (Sir John Baker ed., Vol. XII 2010). But see *Tweddle v. Atkinson*, 101 E.C.L. 393 (1861); *Price v. Easton*, 24 E.C.L. 193 (1833) (third party unable to sue due to lack of privity through an agency or trust relationship).

246. LOBBAN, *supra* note 245, at 390.

247. *Id.*

248. JOSEPH CHITTY, *A PRACTICAL TREATISE ON THE LAW OF CONTRACTS, NOT UNDER SEAL; AND UPON THE USUAL DEFENSES TO THE ACTIONS THEREON* 48 (2d ed. 1834).

and then by larger policy concerns and evolving notions of justice and fairness. While a breach of warranty claim was limited to a party to the warranty,²⁴⁹ a non-party's reliance upon the negligence theory enabled circumvention of the privity bar.²⁵⁰ However, if a tort is based on a theory of duty owed by the defendant because of the contractual relationship, privity of contract between the parties must exist.²⁵¹

In recent times, there has been a discernible trend toward altering, if not altogether eliminating, the privity doctrine.²⁵² One area where there has been significant, although not universal, movement away from the requirement of privity for legal rights is in the context of new home construction.²⁵³ Decades ago, as part of the general movement away from *caveat emptor* in cases focused on used homes, courts began to find implied warranties of workmanlike quality in new homes.²⁵⁴ But, whether that warranty would run to benefit subsequent purchasers was an issue still in debate, although many courts and commentators had endorsed this additional step.²⁵⁵ The principal

249. 18 RICHARD A. LORD, WILLISTON ON CONTRACTS §52:38 (Jack K. Levin ed., 4th ed. 2001). See also *Winterbottom*, 10 M. & W. 109 (1842).

250. *Henningsen v. Bloomfield Motors, Inc.*, 161 A.2d 69 (N.J. 1960).

251. *Blake v. John Doe I*, 623 N.E.2d 1229, 1232–33 (Ohio Ct. App. 1993).

252. P. S. ATIYAH, AN INTRODUCTION TO THE LAW OF CONTRACT 265 (3d ed. 1981) (“[T]here has been a constant tendency for contractual rights to be extended in their scope so as to affect more and more persons who cannot be regarded as parties to the transaction.”); WILLIAM R. ANSON, PRINCIPLES OF THE LAW OF CONTRACT 335 (Arthur L. Corbin ed., 3d Am. Ed. 1919) (“To many students and practitioners of the common law privity of contract became a fetish. As such, it operated to deprive many a claimant of a remedy in cases where according to the mores of the time the claim was just.”).

253. *Kirk v. Ridgway*, 373 N.W.2d 491, 492–93 (Iowa 1985); *Speight v. Walters Dev. Co.*, 744 N.W.2d 108, 114 (Iowa 2008) (holding that subsequent purchasers were entitled to recover against the builder on a theory of breach of implied warranty of workmanlike construction despite a lack of privity. The court reasoned that it would follow modern trend of eliminating the privity requirement in this context “to ameliorate the harsh doctrine of *caveat emptor*” and because “the [implied warranty] obligations on the part of the seller were imposed by operation of law, and did not depend for their existence upon express agreement of the parties in privity was not necessary.”); *Cosmopolitan Homes, Inc., v. Weller*, 663 P.2d 1041, 1046 (Colo. 1983); *Richards v. Powercraft Homes, Inc.*, 678 P.2d 427, 427 (Ariz. 1984) (holding that the subsequent purchasers of a home may maintain actions for breach of implied warranty of habitability and construction in a workmanlike manner against the home's builder, absent privity with the builder); see also *Lofts at Fillmore Condo. Ass'n v. Reliance Commercial Constr., Inc.*, 190 P.3d 733 (Ariz. 2008) (holding that contractual privity does not bar an action for breach of implied warranty of habitability and workmanlike construction by a buyer against a homebuilder who was not also the vendor of the residence); *Nichols v. R.R. Beaufort & Assoc., Inc.*, 727 A.2d 174, 179 (R.I. 1999) (holding that subsequent purchasers could sue the builder for latent defects in the home on a theory of breach of implied warranty of habitability and workmanlike construction despite a lack of privity with the builder).

254. *Richards*, 678 P.2d at 429.

255. See *Speight*, 744 N.W.2d at 112 n.2 (Iowa 2008) (listing 19 state court decisions allowing recovery by subsequent purchasers); see generally Sean M. O'Brien, Note, *Caveat Vendor: A Case for Granting Subsequent Purchasers a Cause of Action Against Builder-Vendors for Latent Defects in the Home*, 20 J. CORP. L. 525, 527, 530

doctrinal objection to affording subsequent purchasers the same protection as new-home purchasers was the lack of contractual privity.²⁵⁶ Many courts recognized, however, that the implied-warranty obligation is one imposed by operation of law and²⁵⁷ that "it is a judicial creation and does not, in itself, arise from the language of any contract between the builder-vendor and the original purchaser."²⁵⁸ This means that no principle of contract law should bar recovery by a remote purchaser.²⁵⁹ Courts have pointed out the subsequent purchaser stands in the same position as the original purchaser—with no more opportunity to examine the builder's methods and standards and must, to the same extent, rely on the builder-vendor's knowledge and experience.²⁶⁰ The thinking is that the "mere fortuity of an intervening owner—often . . . for only a short time—provides no basis for denying a home buyer the protection afforded by the implied warranty of good workmanship."²⁶¹ The most "practical objection to ex-

(1995) (observing that the "increasing trend is to recognize a cause of action for subsequent home buyers" and that predicated recovery "on whether the plaintiff was the original or subsequent purchaser . . . is unjust and illogical"); Linda M. Libertucci, Comment, *Builder's Liability to New and Subsequent Purchasers*, 20 SW. U. L. REV. 219, 228 (1991) (noting that the "current trend" is to extend implied warranty protection to subsequent purchasers and concluding that "[p]ublic policy demands that builder-vendors be held liable to both new and subsequent purchasers for hidden defects in housing").

256. See, e.g., *Richards*, 678 P.2d at 427; *Lofts at Fillmore Condo. Ass'n, Inc.*, 190 P.3d at 733.

257. See *O'Brien v. Comstock Foods, Inc.*, 212 A.2d 69, 70–71 (Vt. 1965) (explaining that implied warrant of merchantability is "imposed by law . . . apart from considerations entirely contractual" and thus rejecting "illogic and injustice" of applying contractual privity to restrict liability); *Terlinde v. Neely*, 271 S.E.2d 768, 769 (S.C. 1980) ("Extension of implied warranties to subsequent purchasers is based upon sound legal and policy considerations."); *Barnes v. Mac Brown & Co., Inc.*, 342 N.E.2d 619, 620 (Ind. 1976) (public policy compels a change in the law); *Redarowicz v. Ohlendorf*, 441 N.E.2d 324, 330 (Ill. 1982) ("The warranty of habitability is creature of public policy."); *George v. Veach*, 313 S.E.2d 920, 922 (N.C. 1984) ("An implied warranty arises by operation of law.").

258. *Speight*, 744 N.W.2d at 114.

259. *Id.* The Illinois Supreme Court reached a similar conclusion, observing that, while the implied warranty just begs the question of liability to a third-party for injuries sustained as the result of defects, the warranty was created to protect home purchasers, and "exists independently," and thus "[p]rivacy of contract is not required." *Redarowicz*, 441 N.E.2d at 330.

260. *Long Trail House Condo. Ass'n v. Engelberth Const., Inc.*, 59 A.3d 752, 765 (Vt. 2012).

261. *Id.* at 765 (citing *Redarowicz*, 441 N.E.2d at 330, for the proposition that "the compelling public policies underlying the implied warranty of habitability should not be frustrated because of the short intervening ownership of the first purchaser."); *Speight*, 744 N.W.2d at 114 ("[T]he public policy justifications supporting our decision to recede from the doctrine of caveat emptor in the sale of new homes by builder-vendors equally apply to the sale of used homes to subsequent purchasers."); *Lempke v. Dagenais*, 547 A.2d 290, 294 (N.H. 1988) ("The mitigation of *caveat emptor* should not be frustrated by the intervening ownership of the prior purchasers."); *Aronsohn v. Mandara*, 484 A.2d 675, 680 (N.J. 1984) ("The contractor should not be relieved of liability for unworkmanlike construction simply because of the fortuity that the prop-

tending implied-warranty protection to a subsequent owner is the concern that it might expand the risks for builder-vendors beyond those for which they contracted, and ultimately increase the costs of construction.”²⁶² This objection is unfounded because “[t]he builder already owes a duty to construct the home in a workmanlike manner . . . extension to a subsequent purchaser, within a reasonable time, will not change this basic obligation.”²⁶³ As the Illinois Supreme Court has observed, “[w]e are an increasingly mobile people” and a builder-vendor should therefore “know that a house he builds might be resold within a relatively short period of time and should not expect that the warranty will be limited by the number of days that the original owner chooses to hold onto the property.”²⁶⁴ Most courts, however, have limited a builder-vendor’s exposure by requiring that claims for latent defects be brought within a reasonable period after completion of the construction.²⁶⁵

erty on which he did the construction has changed hands.”); *Terlinde*, 271 S.E.2d at 770 (holding that “[t]he only logical application of the principles” underlying the implied warranty of workmanship requires a holding that it “extends to subsequent home purchasers for a reasonable amount of time”); *Sewell v. Gregory*, 371 S.E.2d 82, 85–86 (W. Va. 1988) (holding that all of the reasons for recognizing an implied warranty of workmanship in the sale of a new home “apply with equal strength to used homes”); *Moxley v. Laramie Builders, Inc.*, 600 P.2d 733, 736 (Wyo. 1979) (“[A]ny reasoning which would arbitrarily interpose a first buyer as an obstruction to someone equally as deserving of recovery is incomprehensible.”).

262. *Long Trail*, 59 A.3d at 765.

263. *Id.* at 765 (citing *Lempke*, 547 A.2d at 295); see also *Speight*, 744 N.W.2d at 114 (“The builder-vendor’s risk is not increased by allowing subsequent purchasers to recover for the same latent defects for which an original purchaser could recover.”); *Keyes v. Guy Bailey Homes, Inc.*, 439 So. 2d 670, 673 (Miss. 1983) (reasoning that builder “already owes a duty to construct the home in a workmanlike manner” so that extension of liability to subsequent home purchaser will require “no greater effort [by] . . . the builder to protect himself”); *Nichols v. R.R. Beaufort & Assoc., Inc.*, 727 A.2d 174, 180 (R.I. 1999) (“[A]llowing subsequent owners to maintain a similar cause of action . . . will not drastically enlarge this basic obligation of the home builder.”). “The risk is also clearly one that builder-vendors should foresee.” *Long Trail*, 59 A.3d at 765.

264. *Redarowicz*, 441 N.E.2d at 331.

265. See, e.g., *Lempke*, 547 A.2d at 297 (“The implied warranty of workmanlike quality for latent defects is limited to a reasonable period of time.”); *Nichols*, 727 A.2d at 181–82 (holding that, to avoid unlimited exposure, “we restrict the coverage of the implied warranties . . . to those latent defects that subsequent owners discover within a reasonable period of time after these home contractors have substantially completed their work”); *Terlinde*, 271 S.E.2d at 769 (“The length of time for latent defects to surface . . . should be controlled by the standard of reasonableness.”); *Moxley*, 600 P.2d at 736 (holding that a home builder’s implied warranty “extends to subsequent purchasers for a reasonable length of time”). The same rule applies in Vermont for initial homebuyers, and would apply with equal force to subsequent purchasers. See *Heath v. Palmer*, 915 A.2d 1290, 1293 (Vt. 2006) (“[T]he general rule is that the duration of the implied warranty of habitability and good workmanship is determined by a ‘standard of reasonableness.’”).

1. Foreseeability as a Proxy for Privity

The most compelling basis for allowing non-parties an action against a party to a contract seems to be the substitution of foreseeability in place of privity. In this way, when no contractual privity exists, courts will recognize a duty of care to a third party who suffered an economic loss and when the contracting parties intend to confer a benefit on the third party.²⁶⁶ Some courts have recognized a duty of care to a non-contracting third party when the defendant has knowledge that the third party would rely on the defendant's work.²⁶⁷ A plaintiff asserting a non-party claim must show that he or she is a part of a class specifically intended to be the beneficiaries of the contract.²⁶⁸ The scenarios where such situations might arise include title searches, surveys, housing inspections, and appraisers.²⁶⁹

Some state statutes have eliminated the requirement of privity altogether.²⁷⁰ The Mississippi Code provides that "[i]n all causes of action for personal injury or property damage or economic loss brought on account of negligence, strict liability or breach of warranty . . . , privity shall not be a requirement to maintain said action."²⁷¹ In *Touche Ross & Co. v. Commercial Union Insurance Co.*, the Mississippi Supreme Court addressed the relevance of privity where the issue was identified as whether an "independent auditor [is] liable to a third party, who, though lacking privity, relies to his detriment on financial statements negligently prepared."²⁷² The court answered in the affirmative, stating:

[A]n independent auditor is liable to reasonably foreseeable users of the audit, who request and receive a financial statement from the audited entity for a proper business purpose, and who then detrimentally rely on the financial statement, suffering a loss, proximately caused by the auditor's negligence. Such a rule protects third parties, who request, receive and rely on a financial statement, while it also protects the auditor from an unlimited number of po-

266. *Shofer v. Stuart Hack Co.*, 723 A.2d 481, 487 (Md. Ct. Spec. App. 1999).

267. See, e.g., *Walpert, Smullian & Blumenthal, P.A. v. Katz*, 762 A.2d 582, 594 (Md. 2000). In *Walpert*, the Court of Appeals of Maryland held an accountant liable for economic losses suffered by the third-party plaintiffs because the plaintiffs met face-to-face with the accountant and told him that they were relying on his audit. *Id.*

268. *Shofer*, 723 A.2d at 487.

269. See *infra* discussion accompanying notes 279 to 306.

270. See VA. CODE ANN. § 8.2-318 (West 2013); TENN. CODE ANN. § 29-34-104 (West 2013); see generally, R.D. Hursh, *Privity of Contract as Essential to Recovery in Action Based on the Theory Other Than Negligence, Against Manufacturer or Seller of Product, Alleged to Have Caused Injury*, 75 A.L.R.2d 39 (1961).

271. MISS. CODE ANN. § 11-7-20 (West 1976).

272. *Touche Ross & Co. v. Commercial Union Ins. Co.*, 514 So. 2d 315, 318 (Miss. 1987).

tential users, who may otherwise read the financial statement, once published.²⁷³

The Mississippi Supreme Court later clarified this rule in *Hosford v. McKissack*, a case involving duties of care in performing another kind of professional service.²⁷⁴ There, a real estate company hired a termite-inspection company.²⁷⁵ Later, the real estate company sold the home and notified the buyer that the pest control company's report stated the home was free of termites.²⁷⁶ After learning the report was erroneous, the buyer sued the pest control company for negligent misrepresentation.²⁷⁷ The trial court cited *Touche Ross* and dismissed the buyer's claims on summary judgment, reasoning that the buyer "lacked privity" and was "outside the circle of foreseeability."²⁷⁸ The Mississippi Supreme Court then reversed.²⁷⁹ First, the Court noted Mississippi had eliminated the privity requirement by statute.²⁸⁰ Second, arguably broadening the *Touche Ross* rule, the Court held "while those who request and receive an audit report or a termite inspection report may be within the ambit of the defendant's duty, it does not follow on principle that those who do not formally request the report of and from its maker are excluded."²⁸¹ The liability is "to reasonably foreseeable users," not just to those who request the work.²⁸²

273. *Id.* at 322–23. See also *Credit Alliance Corp. v. Arthur Andersen*, 483 N.E.2d 110, 118 (N.Y. 1985) (for determining whether a "near privity" relationship is present: (1) the defendant must have been aware that its representation would be used for a particular purpose; (2) the defendant must have intended that a known party or parties would rely thereon in furtherance of that purpose; and (3) there must have been some conduct on the part of the defendant linking it to that party or parties' reliance); *Gould v. Winstar Commc'ns, Inc.*, 692 F.3d 148 (2d Cir. 2012) (where shareholders could not evidence reliance upon auditor's representation, or that auditor acted with scienter, no recovery was permitted against the auditor); *Eldred v. McGladrey*, 468 N.W.2d 218, 220 (Iowa 1991) (Where plaintiff-investor's only established inferred reliance on auditor's representations, there could be no recovery against the accounting firm on negligent and fraudulent misrepresentation, holding that "while we have rejected the requirement of privity, we share his concern that accountants should not be exposed to 'a liability in an indeterminate amount for an indeterminate time to an indeterminate class.'" There must be some direct reliance on the representation in order for the investor to recover). In *AUSA Life Ins. Co. v. Ernst & Young*, 206 F.3d 202, 222–23 (2d Cir. 2000), the Court of Appeals reversed the district court's finding that there was a lack of privity between plaintiff-investors and a corporation's independent auditor under Section 10-b of the Securities Exchange Act, because the auditor did know that plaintiffs would rely on their reports thereby satisfying the "near privity" test from *Credit Alliance*. On remand, the lower court was instructed to make a determination as to the fraud claims alleged by plaintiffs, in light of this privity determination.

274. *Hosford v. McKissack*, 589 So. 2d 108 (Miss. 1991).

275. *Id.* at 109.

276. *Id.*

277. *Id.* at 110.

278. *Id.* at 110–11.

279. *Id.* at 112.

280. *Id.* at 110. See also MISS. CODE ANN. § 11-7-20 (1975).

281. *Hosford*, 589 So. 2d at 111.

282. *Id.* at 110.

In *Paul v. Landsafe Flood Determination Inc.*, the Fifth Circuit addressed the issue of a surveyor's liability to a homeowner who suffered damage to a home located in a flood zone.²⁸³ Apparently, the surveyor, hired by the lender to make a flood area determination, incorrectly stated the home was not in a flood zone.²⁸⁴ The borrower did not obtain flood insurance.²⁸⁵ When Hurricane Katrina struck, the home suffered substantial damages.²⁸⁶ The borrower sued the surveyor under Mississippi law.²⁸⁷ The surveyor defended on the grounds of absence of privity.²⁸⁸ The Fifth Circuit found that Mississippi had abolished the privity requirement²⁸⁹ and instead, foreseeability had been substituted.²⁹⁰

The court explained that, as with the *Hosford* pest control report, this flood-zone determination was made for a specific transaction.²⁹¹ Yet, the concern about flooding was no different from that about pests, both threatened injury to the value and use of the property.²⁹² Even though there was no privity with Landsafe since the flood-zone report was not prepared specifically for the property owner,²⁹³ what was important was that it was reasonably foreseeable that the property owner would receive and rely on Landsafe's report in deciding whether to go forward with the purchase.²⁹⁴ While the analysis might be different depending on whether flood insurance was required by the mortgage, the circumstances here were enough to hold that "the erroneous flood-zone determination was the kind of professional opinion, developed in the course of a party's business and supplied for the guidance of others in a transaction, on which justifiable and detrimental reliance by a reasonably foreseeable person might be shown to have occurred."²⁹⁵ As foreseeability was the key to liability, Landsafe could not limit its liability by placing a disclaimer on its flood-zone

283. *Paul v. Landsafe Flood Determination, Inc.*, 550 F.3d 511, 513 (5th Cir. 2008).

284. *Id.* at 512.

285. *Id.*

286. *Id.*

287. *Id.* at 512–13.

288. *Id.* at 515–16.

289. *Id.* at 516.

290. *Id.*

291. *Id.*

292. *Id.*

293. *Id.*

294. *Id.* The court continued on to reject Landsafe's argument to adopt the narrow view expressed in *Audler v. CBC Innovis, Inc.*, 519 F.3d 239, 250–51 (5th Cir. 2008) (holding expert hired by lender to make flood control determination had owed no duty to property owner, nor was the owner an intended beneficiary). For a broader overview of the issues in *Audler*, see *Landsafe*, 550 F.3d at 516–17. See generally *Delgado v. Kornegay*, 395 N.Y.S.2d 126 (Sup. Ct. 1977) (where a purchaser of a home relied on an inspection report ordered by the seller stating there was no evidence of termite infestation or damage—purchaser brought an action against the inspector. The court held the inspector could be liable to the purchaser as a third-party beneficiary where the inspector knew the property was in the process of being sold).

295. *Landsafe*, 550 F.3d at 518.

determination provided to the lender pursuant to the Flood Disaster Protection Act that it should not be used for any other purpose.²⁹⁶

In case of real-property appraisers, there seems to be a decided, although slow, trend in favor of making the appraisers liable to home buyers for defective appraisals, even though the lenders, for purposes of complying with their underwriting standards, typically hire the appraisers.²⁹⁷ There appears to continue to be two schools of thought on the liability of title abstractors to parties who did not order the title search, but who nonetheless rely on the report.²⁹⁸ In *Williams v. Polgar*, after an exhaustive study of how courts around the country treated the issue, the Michigan Supreme Court adopted the rule that title abstractors can be liable to parties who reasonably rely upon abstracts, where that reliance was reasonably foreseeable by the abstractor.²⁹⁹

VI. THE LAW'S CONSCIENCE: INTUITION AND PUBLIC POLICY

The Author has attempted to show that the rules governing market relations have not been static. Instead, they have been shaped and urged by a host of ends—social ordering, economic prosperity, and most recently, conscience. Trying to discern, then summon up, the conscience of market actors may be fruitless if the actors lack any moral compass or sympathetic moorings. Conscience, like morality, is often thought an individualistic notion, determined by a myriad of psychological and cultural factors.³⁰⁰ Even if we find it appropriate to make open references to conscience to determine duties and liabilities, whose conscience should be the standard—that of the judges, ac-

296. *Id.* at 518–19. See also *Tartera v. Palumbo*, 453 S.W.2d 780 (Tenn. 1970) (holding a lack of privity between a surveyor and injured plaintiff by the surveyor's negligent performance to provide an accurate survey will not relieve the surveyor of liability where it was known or foreseeable that the plaintiff would rely on the results of the survey).

297. See Shelby D. Green, *Re-appraising the Appraisers: Expanding Liability to Buyers and Borrowers in the Story of the 2008 Financing Industry Crisis*, 25 PROB. & PROP. 11 (2011).

298. *First Am. Title Ins. Co. v. First Title Serv. Co. of the Fla. Keys*, 457 So. 2d 467, 470 (Fla. 1984) (holding that contractual privity is required) (abstractors cannot be liable); *Williams v. Polgar*, 215 N.W.2d 149, 150 (Mich. 1974) (abstractors may be liable).

299. *Polgar*, 215 N.W.2d at 11–18. The court found the common law rule requiring privity to hold an abstractor liable arose at a time when “abstracts would be used by real estate owners.” *Id.* at 11–12. But as time progressed, the class of people relying on abstracts expanded and the abstractor's liability accordingly was extended to parties the abstractor knew would rely. *Id.* at 14. Finding the privity requirement so riddled with exceptions, this court could not find a principled basis for not eliminating it in the case of parties who foreseeably would rely upon the abstract. *Id.* at 16–17. This group would include grantees, where the grantor has initiated a contract for abstracting services. *Id.* at 23.

300. See Laura S. Underkuffler, *Individual Conscience and the Law*, 42 DEPAUL L. REV. 93, 94–96 (1992).

cording to religious precepts or natural law? But we need not trouble ourselves too much with this issue, for there is a conscience that is readily perceived that operates at all times and can be fairly imposed on actors in the marketplace. It is the law's conscience as revealed in a kind of morality—a normative idea that can exist alongside that of contract autonomy.

A. *Conscience as an Imperative for Moral Markets*

The free-market mantra—that market actors are cold-hearted, narrowly pursuing their self-interest, and efficient markets must be free from government restraint, operating according to their own values—is being contested. Recently,³⁰¹ a group of scholars, law professors, economists, anthropologists, cognitive scientists, neuroscientists, political scientists, primatologists, and philosophers³⁰² came together to explore the claim that a range of non-economic values are yet reflected in markets, and to consider the effects of markets on human welfare.³⁰³ They strived to show that the view of markets as defined and driven solely by selfish competition, so often attributed to Adam Smith, is a misconception.³⁰⁴ There was an opening for this discussion inasmuch as the question whether markets and market participants might be inherently immoral had not been confirmed, nor was there solid evidence to substantiate it.³⁰⁵ To the contrary, the authors believed:

[m]arkets are moral in two senses. Moral behavior is necessary for exchange in moderately regulated markets, for example, to reduce cheating without exorbitant transactions costs. Market exchange itself can also lead to an understanding of fair exchange and in this way build social capital in non-market settings. Research has shown that the values that create social capital are a potent stimulus for economic development.³⁰⁶

Debunking the common conception of a market characterized by cupidity, they show instead a kind of morality operating and that the very freedom to exchange in markets celebrates individual dignity and choice.³⁰⁷

301. Michael C. Jensen, *Foreword to MORAL MARKETS: THE CRITICAL ROLE OF VALUES IN THE ECONOMY* (Paul J. Zak ed., 2008).

302. Paul J. Zak, *Introduction to MORAL MARKETS: THE CRITICAL ROLE OF VALUES IN THE ECONOMY* xvi (Paul J. Zak ed., 2008).

303. *Id.* at x.

304. *Id.* at xi.

305. *Id.* at xv–xvi.

306. *Id.* at xvii (citing Paul J. Zak & Stephen Knack, *Trust and Growth*, 111 *ECON. J.* 295, 295 (2001)).

307. *Id.* at xvii.

Professor Lynn Stout addressed head on the issue of conscience in market transactions.³⁰⁸ The seller who knowingly makes false statements about a property he seeks to sell, then seeks to shield himself from liability through a disclaimer clause, might be defined as “homo economicus,” a member of that “mythical species” of rational maximizers.³⁰⁹ Depending on one’s perspective, “homo economicus” could be viewed as a sociopath, “the hallmark [of which is] extreme selfishness as shown by a willingness ‘to lie, cheat, take advantage, [and] exploit.’”³¹⁰ But, there is a plethora of studies that show that self-interest is not the only driver of behavior in market transactions; most people routinely act to consider the welfare of others.³¹¹ In the end, Stout maintains there is an over-emphasis in the literature on selfish behavior, and that we should stop to see that:

[i]f conscience is indeed an omnipresent and powerful force, and if we can find some way to use it deliberately to change human behavior, it may offer enormous leverage in any quest to promote a better, more just, and more productive society. Before we can hope to employ the force of conscience, however, we must first understand it. Before we can understand conscience, we must first recognize it exists and take it seriously as a source of human behavior.³¹²

While Stout’s suggestion to make efforts to perceive and invoke the conscience of individual actors should be taken seriously, there is yet the law’s conscience that can be invoked, to address economically and socially unwholesome and exploitative conduct.³¹³ The law’s conscience can be viewed as an imperative “embedded in the law, greater than the temporal responses of mere judges”³¹⁴ It is “[a] compunction [that] underlies the whole spectrum of the common law”³¹⁵ In essence, “[i]t is the law’s ultimate abhorrence of ex-

308. Lynn Stout, *Taking Conscience Seriously*, in *MORAL MARKETS: THE CRITICAL ROLE OF VALUES IN THE ECONOMY* 157 (Paul J. Zak ed., 2008). Nobel Prize winners James Buchanan and Gary Becker have been leading the study of “rational choice” as applied to explain a host of phenomena, including crime, education, corporate governance, and even law-makers. The law and economics legal studies movement embraces the idea of selfish rationality to legal rules and institutions. *Id.* at 158.

309. *Id.*

310. *Id.* at 158–59 (quoting BENJAMIN WOLMAN, *THE SOCIOPATHIC PERSONALITY* 42 (1987)). Under the American Psychiatric Association’s Diagnostic and Statistical Manual of Mental Disorders, Homo Economicus could be said to have anti-social personality disorder, where he exhibits behaviors such as “failure to conform to social norms with respect to lawful behaviors,” engage in deceit or conning others for personal profit or pleasure and lack of remorse having hurt, mistreated, or stolen from another. *Id.* at 159 (citing AM. PSYCHIATRIC ASS’N, *DIAGNOSTIC AND STATISTICAL MANUAL OF MENTAL DISORDERS* (2000)).

311. *Id.* at 160.

312. *Id.* at 170.

313. See Justice E.W. Thomas, *The Conscience of the Law*, 8 WAIKATO L. REV. 1, 3 (2000) (N.Z.).

314. *Id.*

315. *Id.*

ploitation: no person may exploit another in the sense of taking or obtaining an unfair advantage at the other's expense."³¹⁶ This conscience precludes exploitation.³¹⁷ The Honorable Justice Thomas uses the word exploitation to mean unfair imposition upon another,³¹⁸ and states that exploitation is wrong because the law presumes that each of us is equally deserving of respect in such regard as confirms our humanity.³¹⁹

The moral overtones of conscience are undeniable, but this is no ground to repudiate its necessity, existence, or legitimacy. When it operates, conscience does so to reflect and impose upon actors the expectations of the community as to what is fundamentally required in human relations.³²⁰ Though perhaps not born at the same time as law, but certainly matured alongside and in response to it, the law's conscience has served to efface the seemingly absurd and surely harsh aspects of law.³²¹ It became essential when society's prevailing philosophical precepts embraced freedom of choice and freedom of action.³²² That idea provided the predicate for an economic regime in which freedom of choice was endemic and capitalism became the inevitable economic order.³²³ From the *laissez-faire* economies of the 19th century, through the regulated or mixed economies of the mid-20th century, to the free market and global economies of today, freedom from interference has been and remains a fundamental premise. The belief is that efficient and competitive markets require freedom from exogenous governmental interference.³²⁴ Thus unconstrained without external checks, where the prevailing philosophy is "every man for himself and the devil take the hindmost,"³²⁵ *laissez-faire* can lead to a brutish, Hobbesian world where one with either political or economic power is wont and does exploit the one without. Where this does occur, the law's conscience steps in to curtail individual freedom, where that exercise is exploitative. The conscience of the law operates as a bulwark to safeguard the autonomy and dignity of the less powerful and may be interposed, in a measured way, to correct wrongful conduct in contract relations.³²⁶ But it should not be invoked merely to assist those who enter into an imprudent or improvident deal.³²⁷

316. *Id.*

317. *Id.*

318. *Id.* n.8.

319. *Id.* at 4.

320. *Id.*

321. James Barr Ames, *Law & Morals*, 22 HARV. L. REV. 97, 102 (1908) (discussing early common law failure to see the moral quality in self-defense and that the law exposed a debtor who omitted to obtain a written discharge, to paying twice).

322. Thomas, *supra* note 313, at 5.

323. *Id.* at 6. See discussion, *supra* Part II(A).

324. *Id.* at 6.

325. HOBBSAUM, *supra* note 27, at 200.

326. *Id.* at 15 (quoting *Bridge v. Campbell Discount Co.*, AC 600, 626 (1962)).

327. *Id.*

This means that when the parties have entered into a contract open-eyed to all that can be observed, that bargain struck has the force of law.³²⁸ On the other hand, when a party, with eyes wide open, enters into negotiations but then is told not to look because there is nothing untoward to be found, and in fact there are troubling discoveries, this is a case for the law to intervene.

B. *Inefficiencies and Externalities*

The dialogue on the role and virtues of self-interest in market transactions is as long-standing as there are markets.³²⁹ Proponents of self-interested free markets recognize the seeming conflict between traditional moral advice, on the one hand, and egoism and greed on the other but assert that institutional interventions act to mediate these two ends in such a way that self-interest deserves moral endorsement.³³⁰ To be sure, no one has argued for a market characterized solely by dishonest and fraudulent practices, or one wholly devoid of scruples, as all right-thinking honest people seem to agree that few societies leave the market to operate wholly without constraints.³³¹ Individualism or self-interest, where allowed to run loose without bounds, will eventually prove destructive of individuals and society. Indeed, over the centuries, we have seen market freedoms limited for moral or sentimental reasons.³³²

A market without morals cannot be squared with accepted economic models. Not only are there no gains in efficiency, but the costs are great—buyers pay too much and wealth is decreased, not maximized, because of the inability to obtain value from the property acquired; ex-post resolution of claims burdens the judicial system; and demoralization is high. Significantly, the absence of trust in market relations is most inefficient as it produces wasted time and resources gathering information and investigating that which would otherwise be avoided if the one party spoke truthfully and the other believed that party.³³³

328. *Id.* (citing Robert L. Hale, *Bargaining, Duress, and Economic Liberty*, 43 COLUM. L. REV. 603, 604 (1943)).

329. FINN, *supra* note 14, at 53.

330. *Id.*

331. See Kennedy, *supra* note 65, at 141–44; see also John F. Henry, *The Ideology of the Laissez Faire Program*, 42 J. ECO. ISSUES 209, 210 (2008); Joseph Stiglitz, *Distinguished Lecture on Economics in Government: The Private Uses of Public Interest: Incentives and Institutions*, 12 J. ECO. PERSP. 3, 3–4 (1998).

332. Kennedy, *supra* note 65, at 141–44.

333. See KENNETH ARROW, *THE LIMITS OF ORGANIZATION* 23 (1974) (describing the value of “trust as an important lubricant of a social system . . . extremely efficient . . . [saving] a lot of trouble to have a fair degree of reliance on other people’s word.”).

C. *The Call of Public Policy*

Well-defined public policy informs conscience and provides the relevant standards. Examples include the implied covenant of good faith and fair dealing;³³⁴ the unenforceability of unconscionable contracts; and the invalidity of contracts that purport to exculpate from liability for intentional wrongdoing.³³⁵ Professor Walter Gellhorn found the reasons for condemning such arrangements as grounded in public policy.³³⁶

From early times Anglo-American courts have refused to enforce illegal contracts, that is, those that are 'opposed to public policy,' . . . [whether it was the case that] the contract bore an element of criminality . . . a step in the commission of the crime (either by way of making its commission possible or by way of enjoying its fruits), [or] where the contract was merely shocking to the sense of justice and of the fitness of things . . . [The courts,] as representing the community conscience, declared that such contracts should not be executed with the court's assistance, . . . to assist in their enforcement . . . would be to encourage conduct which was inimical to the public welfare.³³⁷

This call for conscience in transactions is not a call for the highest moral values, either stemming from religious or secular influences, but for those most people agree upon—truthfulness and honesty.

1. New Framework for Disclaimer-of-Reliance Clauses

The threat to public welfare is equally great by the growing use of disclaimer-of-reliance clauses in property transactions for wrongful ends. What seems to be in order is a new idea, or public policy, on such disclaimer-of-reliance clauses, something on the order that follows:

334. Stout, *supra* note 308, at 186.

335. GRACE McLANE GISEL, CORBIN ON CONTRACTS: CONTRACTS CONTRARY TO PUBLIC POLICY § 85.18, at 455–71 (2003), LEXIS 15–85 Corbin on Contracts § 85.18 ("The general rule of exculpatory agreements is that a party may agree to exempt another party from tort liability if that tort liability results from ordinary negligence. Courts do not enforce agreements to exempt parties from tort liability if the liability results from that party's own gross negligence, recklessness, or intentional conduct.").

336. See Walter Gellhorn, *Contracts and Public Policy*, 35 COLUM. L. REV. 679, 679 (1935).

337. *Id.* Professor Gellhorn discussed the conundrum that courts face when a decision declining to enforce a contract, illegal under a statute, might be harmful to a party who did not knowingly agree to break the law. In finding the public policy on which a decision to enforce or not is made, Professor Gellhorn explains that judges' decision is not made on an "unassisted judgment of what is naturally and inherently just and right between man and man," but "upon authoritative legislative pronouncement and upon intelligent effort to procure informative data," as it relates to judgments formulated by constitutions, statutes, and prior judicial and non-judicial investigations. *Id.* at 695.

Judicial Attitude

- As a matter of course, the court should view such clauses with suspicion.
 - » Disclaimer-of-reliance and merger clauses are not inherently evil. Indeed, the laudable purposes are several: they serve to define and delineate the terms of the parties' deal, causing the parties to think about what has transpired between them; they serve to provide concrete evidence and thus further interests in judicial economy where proof of the terms of the agreement are memorialized in one document and does not rest upon after-bargain oral claims.
 - » However, these otherwise neutral and rational contracting tools have been employed perniciously—as tricks and devices for fraud.
- An anti-disclaimer orientation will result not only in more honest transactions, but will also yield efficiency gains.
 - » The parties will engage in ex-ante conduct calculated toward addressing the newly re-allocated burdens.
 - » While ex-ante transactions costs may be expected to rise, the shift in attitude may lead to decreased ex-post transaction costs—losses from the inability to use the property as planned, liability for injuries to third parties, and litigation expenses.

Integration and Truthfulness.

- The party invoking the protections of a merger or disclaimer-of-reliance clause must make a convincing showing of completeness.
 - » There must be a clause that he has made no representations regarding the property that was not memorialized in the written agreement and that assertion must be true.
 - » It will be incumbent upon buyers then to carefully read the written instrument before signing.
 - » While paradoxically, this requirement would require a recounting of all matters discussed in order to invoke the merger doctrine, that listing would preclude the introduction of extraneous and/or parol representations and terms. As such, it would not offend the parol evidence rule.
 - » The requirement might prompt some sellers to decide to provide no information, and where there is no duty to disclose, the costs of information gathering may be higher and will shift to buyer.

Representation to Offset Disclaimer.

- All disclaimer-of-reliance clauses must be complemented by a representation of truthfulness.
 - » There must be a clause containing representations and warranties by the one party that he or she has not intentionally withheld or misrepresented any fact about the quality or condition of the property material to the transaction.
 - » This will cause the other to identify all types of information that may be material to the deal and lead to some assessment

of the relative costs of gathering it as the parties commence bargaining. In this way, the requirement will prevent the fraudulent and/or abusive use of disclaimer-of-reliance clauses.

- » To the extent that this requirement causes the parties to deal more at arm's length, there may be some losses of those values inherent in a more trusting relationship.

Penalty Default.

- The requirement of an off-setting representation is an immutable rule that cannot be contracted away.
 - » This component serves to address the asymmetry of information, prompting a party with superior knowledge to reveal, honestly and completely, material information to the other party as necessary and avoiding inefficient strategic rent-seeking behavior by the withholding of information.
 - » While it does constrain some individual freedom, to allow a party to make false representations on which another relies to his injury would deny the other party's status as a free-choosing and rational actor.

Reliance by Third Parties.

- Disclaimer-of-reliance clauses cannot purport to limit liability to third-parties who foreseeably rely on the representations in the contract.
 - » Foreseeability should be determined by an assessment of all relevant factors, including the expressed intentions about the future use and disposition of the property and the common applications of the property.
 - » Some accounting for attenuation by time and use by the original and third parties must be made.

This approach is a new idea, just as the rule requiring disclosure was. It will be tested by the challenges that all new ideas face. They become normative through a process that first perceives the existing regime or rules as having failed, then searches for new ones that seem logical, fair, just, and now more than ever, efficient. Once the new idea is laid down, it must be scrupulously applied. Yet, in order for this new idea or policy to be successful, it must prove its viability—economic, administrative, social, and political—by showing that it is efficient, facile, efficacious, and productive.

VII. CONCLUSION

This Article has focused on the need for the law's intervention in contract relations as it relates to the use of disclaimer-of-reliance clauses, in order to bring this practice in line with current notions of honesty and fair play. This intervention best can be achieved through a prescribed protocol, which places the burdens of disclosure on the party best able to do so, while requiring the party also to be circumspect in the relation. The use of disclaimer-of-reliance clauses as they

are increasingly being used in the cases discussed here is incompatible with efficient market transactions. The uncounted negative externalities from such conduct can not be confined to the parties, but radiates into society—buyers face financial ruin from an unproductive property and third parties injury from dangerous conditions on the property. These circumstances occur not just because of information asymmetry, but because of strategic, rent-seeking conduct calculated to shroud or obscure from the other party the relevant facts. After-the-fact remedies proving less effective than prophylactic rules, it becomes essential that courts and legislatures intervene to impose new standards in bargaining. Absent intervention, through disclaimer-of-reliance clauses, *caveat emptor* may be revived. Our collective and evolving notions of efficiency, free will, and reason must be invoked to prevent retrenchment.