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Torts -- Misrepresentation -- Requisite of Scienter

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The district court reasoned the unripe fruit was not being held by taxpayer for sale in the ordinary course of his business, as his business was the selling of *mature fruit*. To the contrary, the Tax Court held that, although the fruit was sold prior to maturity along with the land, the form of the transaction does not change the fact that the fruit was being held by taxpayer for sale in the ordinary course of his business.

It is difficult to see how it can be reasoned that the crops were not held primarily for sale in the ordinary course of business. It is true taxpayer was in the business of selling mature fruit. But are crops any less "held" by him primarily for sale because sold prior to maturity? Common sense and reason would suggest they are not. The mere form and time of the transaction should not control.[11] The crops are the only thing taxpayer is holding for sale in the ordinary course of his business. Effecting their sale prior to maturity along with the land should not change the nature of his holding.

One might argue that the words of the statute do not authorize allocation of the sale price for purposes of taxation. This is literally true, as the statute speaks in terms of business property as a unit. However, when the statute was drafted, it is doubtful whether this situation was contemplated. Keeping in mind the economic realities of the situation, it seems a reasonable construction of the statute to require allocation. Generally a farmer deducts the costs of raising his crops as ordinary business expenses. He should not be allowed to convert his profit into a capital gain by effecting their sale immediately prior to maturity along with the land.

MASON P. THOMAS, JR.

Torts—Misrepresentation—Requisite of Scienter

Defendant's agent, admittedly acting within the scope of his employment, falsely represented to plaintiff that the house which plaintiff was buying from defendant was constructed of brick veneer. Plaintiff relied on this representation and was thereby induced to make the purchase. The house in fact was built of "speed brick," an inferior type of construction. At the close of plaintiff's evidence the court granted a nonsuit on the ground that there was no proof of scienter. Held, new trial granted. ". . . a false representation positively made by one who ought in the discharge of his duty to have known the truth and who is consciously and recklessly ignorant whether it be true or false, may be regarded as fraudulent when made to induce a sale and reasonably relied on by the vendee."[1]

[11] Helvering v. Hammel, 311 U. S. 504 (1948).

[1] Atkinson v. Charlotte Builders, Inc., 232 N. C. 67, 68, 59 S. E. 2d 1 (1950).

The long recognized elements of fraud and deceit adopted by the North Carolina court from a textwriter[2] are: (1) a representation, (2) untrue in fact, (3) the person making it or the person responsible for it, knows it to be untrue, or is culpably ignorant (that is, recklessly and consciously ignorant) whether it be true or not, (4) made with the intent that it be acted upon, or in a manner fitted to induce action upon it, (5) plaintiff acts in reliance to his damage.[3]

As early as 1799, the court recognized that scienter was a necessary element of fraud and deceit;[4] the defendant must know that he is telling a falsehood or that he is practicing a concealment. This was modified somewhat in the case of *Hamrick v. Hogg*[5] where the rule was laid down that a representation must be false in fact; defendant must be guilty of a moral falsehood; and the party making the representation must know or believe it to be false, or what is the same thing, have no reason to believe it to be true. This modification gelled in *Whitehurst v. Life Ins. Co. of Va.*[6] into what is modern-day law. It was there said, ". . . if a party to a bargain avers the existence of a material fact recklessly, or affirms its existence positively, when he is consciously ignorant whether it be true or false, he may be held responsible for a falsehood; and this doctrine is especially applicable when the parties to a bargain are not upon equal terms with reference to the representation. . . ."[7] It

[2] POLLOCK, TORTS 283 (12th ed. 1923).

[3] Small v. Dorsett, 223 N. C. 754, 28 S. E. 2d 514 (1943); Ward v. Heath, 222 N. C. 470, 24 S. E. 2d 5 (1943); Harding v. Southern Loan & Ins. Co., 218 N. C. 129, 10 S. E. 2d 599 (1940); Whitehurst v. Life Ins. Co. of Va., 149 N. C. 273, 62 S. E. 1067 (1908). It is generally considered that the representation must be of a material fact. The North Carolina court also has held that the representation can be a concealment as well as a statement of fact. Isler v. Brown, 196 N. C. 685, 146 S. E. 803 (1929); Cash Register Co. v. Townsend, 137 N. C. 652, 50 S. E. 306 (1905); Saunderson v. Ballance, 55 N. C. 322 (1856); Brown v. Gray, 51 N. C. 103 (1858); Gerkins v. Williams, 48 N. C. 11 (1855); Case v. Edney, 26 N. C. 93 (1843).

[4] Irwin v. Sherril, 1 N. C. (Taylor) 1 (1799). If bare naked lie the truth or falsity of which is unknown, no action maintainable; if known falsehood and loss suffered, action will lie.

[5] 12 N. C. 350 (1827).

[6] Whitehurst v. Life Ins. Co. of Va., 149 N. C. 273, 62 S. E. 1067 (1908) (Agent misrepresented to blind plaintiff that insurance policy provision allowed plaintiff to collect the total premiums paid plus 4% interest at the end of ten years.).

[7] For cases involving this doctrine prior to the *Whitehurst* case: *e.g.*, Modlin v. Roanoke R.R. & Nav. Co., 145 N. C. 218, 58 S. E. 1075 (1907); Cash Register Co. v. Townsend, 137 N. C. 652, 50 S. E. 306 (1905); Ramsey v. Wallace, 100 N. C. 75, 6 S. E. 638 (1888); Cobb v. Fogalman, 23 N. C. 440 (1841). Subsequent to the *Whitehurst* case: *e.g.*, Vail v. Vail, 233 N. C. 109, 63 S. E. 2d 202 (1951); Brooks Equipment & Mfg. Co. v. Taylor, 230 N. C. 680, 55 S. E. 2d 311 (1949); Small v. Dorsett, 223 N. C. 754, 28 S. E. 2d 514 (1943); Harding v. Southern Loan & Ins. Co., 218 N. C. 129, 10 S. E. 2d 599 (1940); Silver v. Skidmore, 213 N. C. 231, 195 S. E. 775 (1938); Stone v. Doctors' Lake Milling Co., 192 N. C. 585, 135 S. E. 449 (1926); Bell v. Harrison, 179 N. C. 190, 102 S. E. 200 (1920); Pate v. Blades, 163 N. C. 267, 79 S. E. 608 (1913); Tarault v.

can be gathered from this that scienter and its equivalent, reckless disregard of the truth, are not present where there is innocence. The party making the misrepresentation must be conscious that it is false, or, what is in the eyes of the court the same thing, he must be conscious that he knows neither the truth nor falsity of the misrepresentation.

There are several exceptions to this general requirement of scienter in an action for fraud and deceit. A director of a corporation has the duty to know the financial condition of his corporation, and where he misrepresents such condition he will be held liable for fraud and deceit without a showing of scienter.[8] The president of a corporation is deemed to have knowledge of an inventory made five days prior to the misrepresentation.[9] Scienter was presumed where the seller who made the misrepresentation was the inventor;[10] the same presumption is made where the seller was the manufacturer;[11] and in a strong dictum the court said that a vendor or lessor may be held guilty of fraud and deceit by reason of material, untrue representations in respect to his own business or property, the truth of which representation the vendor or lessor is bound and must be presumed to know.[12] Where a relationship of trust and confidence exists between parties, the failure to disclose all material facts, is a breach of the duty owed and constitutes fraud.[13]

In most jurisdictions, if fraud is alleged as the basis for rescission and at trial only innocent misrepresentations are proved, the court will nevertheless grant the requested relief.[14] North Carolina in *Ebbs v. St. Louis Union Trust Co.* adopted a different view: in order to obtain rescission on the ground of fraud, all the essential elements of fraud must be proved.[15] In other words, whether the relief of damages or the

Seip, 158 N. C. 363, 74 S. E. 3 (1912); Hodges v. Smith, 158 N. C. 256, 73 S. E. 807 (1912); Case Threshing Machine Co. v. Feezer, 152 N. C. 516, 67 S. E. 1004 (1910).

[8] Harper v. Oak Ridge Supply Co., 184 N. C. 204, 144 S. E. 173 (1922); Houston v. Thornton, 122 N. C. 365, 295 S. E. 827 (1898); Solomon v. Bates, 118 N. C. 311, 24 S. E. 478 (1896); Tate v. Bates, 118 N. C. 287, 24 S. E. 482 (1896).

[9] Palomino Mills, Inc. v. Davidson Mills Corp., 230 N. C. 286, 52 S. E. 2d 915 (1949).

[10] Unitype Company v. Ashcroft Bros., 155 N. C. 63, 71 S. E. 61 (1911) (type setting machine).

[11] Peebles v. Patapsco Guano Co., 77 N. C. 233 (1877) (commercial fertilizer).

[12] *See* Corley Co. v. Griggs, 192 N. C. 171, 174, 134 S. E. 406, 407 (1926); citing Lehigh Zinc & Iron Co. v. Bamford, 150 U. S. 665, 673 (1893).

[13] Vail v. Vail, 233 N. C. 109, 63 S. E. 2d 202 (1951) (Evidence showed a 72 year-old mother to have been induced by son to sign a deed conveying to him a tract of land other than one agreed upon. On appeal from non-suit the court held that the fiduciary relationship, added to this evidence, constituted a prima facie case of fraud.).

[14] 5 WILLISTON, CONTRACTS §1500 (Rev. ed. 1937).

[15] 199 N. C. 242, 153 S. E. 858 (1930). There was also some indication in this case that rescission might be granted on a unilateral mistake relying on a dictum in Long v. Fidelity and Guaranty Co., 178 N. C. 503, 101 S. E. 11 (1919).

relief of rescission is sought on the ground of fraud, the elements of fraud which must be proved are identical. This includes of course the necessity of proving scienter in an action for either relief.

Although the court in the principal case chose to ignore *Ebbs v. St. Louis Union Trust Co.*, the two cases are almost identical on their facts.[16] The *Ebbs* case was an action for rescission and damages on the basis of fraud, and the principal case was an action for damages based on fraud. It is rather evident from the two cases, that the misrepresentations were either made with knowledge of their falsity, or in conscious ignorance as to their truth or falsity. The one making the false representation in each case was a real estate agent, who was or should have been experienced in the fundamentals of house construction. Since the facts of both cases show only a lack of knowledge of truth or falsity, with relief being granted in one and denied in the other, the necessary conclusion follows that the two cases are in substance inconsistent.

It would seem that the court in the *Ebbs* case completely overlooked the long line of decisions in North Carolina which support the holding of the principal case that actual knowledge of the falsity of a misrepresentation is not necessary to a finding of fraud. On the basis of the instant case as supported by the chain of decisions, the *Ebbs* case (which was never sound law) is no longer the law in North Carolina, in spite of the failure of the court in the principal case expressly to overrule the decision there.

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Wills—Caveat by Proponent

One B died, apparently intestate. His heirs at law and next of kin recovered all of his personal papers and turned them over to the Clerk

But in Cheek v. Southern R.R., 214 N. C. 152, 156, 198 S. E. 626, 628 (1938) the court said, "The court has not adopted the doctrine that an unilateral mistake—or mistake alone of the party seeking to avoid the contract—unaccompanied by fraud, imposition, undue influence, or like circumstance of oppression, is sufficient to avoid a contract." It was indicated in this latter case, however, that it would be difficult to imagine a case, in which there were innocent misrepresentations on the one side and a mistake on the other induced by such innocent misrepresentations, that could not be resolved into mutual mistake. *E.g.*, Vail v. Vail, 233 N. C. 109, 63 S. E. 2d 202 (1951); Breece v. Standard Oil Co. of N. J., 209 N. C. 527, 184 S. E. 86 (1936); Hinsdale v. W. I. Phillips Co., 199 N. C. 563, 155 S. E. 238 (1930); Bell v. Harrison, 179 N. C. 190, 102 S. E. 200 (1920); Oltman v. Williams, 167 N. C. 312, 83 S. E. 348 (1914).

[16] 199 N. C. 242, 153 S. E. 858 (1930); Note, 9 N. C. L. REV. 86 (1930) (real estate broker represented house to be perfectly constructed and made of stone, when in fact, it was stone veneer; *held*, representations made without knowledge of their falsity, and consequently without intent to deceive). This case was cited in the Brief for Appellees, pp. 4, 11, Atkinson v. Charlotte Builders, Inc., 232 N. C. 67, 59 S. E. 2d 1 (1950).