

# NEW RULES FOR PROMISSORY FRAUD

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Experience is complex. The job of theory is to simplify and unify, to abstract from the blooming, buzzing confusion and find some basic rules we can use to guide us through it. Contract theory is a prime example. Theorists treat legally binding promises as elemental speech acts, utterances that accomplish one thing: put the promisor under an obligation to perform. This simplification has allowed contract theory to focus on the deep questions that follow: When do speech acts create such an obligation? How should we interpret the scope of the duty undertaken? What should be the legal consequences of its violation? These basic questions, along with a few others, have given rise to volumes of thought on how legal liability should be structured.

But abstraction has its costs. In the case of contract theory, the costs have included a tendency to ignore other aspects of the act of promising.<sup>1</sup> Most notably, theorists have by and large ignored the fact that, in everyday use, a promise is often understood also to *say* something about the promisor's state of mind—namely, that she intends to do the act promised. This representation, like any other, might be true or false, and, if false, the promisor might be held liable for fraud.

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1. While contract theorists have largely ignored the multiple semantic dimensions of a promise, the idea is hardly unusual from the perspective of philosophy of language. Jules Coleman, for instance, uses promises as an example of the semantic complexity:

Suppose, for example, that I say to Smith, “I promise to meet you for lunch today.” Understanding this as a promise means knowing that it warrants a variety of inferences—for example that Smith expects me to show up for lunch; that I predict I will show up for lunch; that I have a duty to show up; that Smith has a right that I show up, and so on. The content of the concept “promise” is revealed in the range of inferences warranted by the belief that a promise has been made; and to grasp the concept of a promise is to be able to project the inferences it warrants.

Jules L. Coleman, *Crimes and Transactions*, 88 CAL. L. REV. 921, 929 (2000).

Courts, on the other hand, awake every morning to find the mess of the world left on their doorstep in a burning paper bag. Plaintiffs have brought to their attention that promises also have a representational dimension, and the courts have crafted the doctrine of promissory fraud to address it. The Restatement (Second) of Torts formulates the rule for promissory fraud as follows: “Since a promise necessarily carries with it the implied assertion of an intention to perform it follows that a promise made without such an intention is fraudulent and actionable in deceit . . . .”<sup>2</sup> That is, a promisor who enters a contract without an intent to perform commits promissory fraud and, consequently, can be held liable in tort as well as contract. Our recent book, *Insincere Promises*, attempts to throw some theoretical light on the well-established action for promissory fraud.<sup>3</sup> The book’s appendix contains a draft “Prestatement” of how we believe the law of promissory fraud should look. This Essay is an expanded version of that Prestatement, tweaking some of the rules and adding extensive comments in the style of the Restatements.

The format of the Restatements has the advantage of permitting a crisp summary of our central recommendations, and we believe our Prestatement can be read without introduction. But the style also has a leveling effect, since every rule or idea is treated as more or less equal. We therefore want to take a few paragraphs to highlight what we see as our most important and immediately realizable recommendations, and to integrate some of the comments we received from conference participants.

The reforms we recommend are by and large independent of one another. That is, they do not need to be implemented all at once, and there is plenty of room for incremental progress. As an initial matter, here are three easy steps courts could take right away that, in our opinion, would result in a significant improvement in the law.

First, courts should drop their insistence that every promise represents an intent to perform, and should instead treat that representation merely as a default (Prestatement § 101). Courts presently assume that every promise says the same thing: The promisor intends to perform. This mandatory rule should be instead a default. A promisor could then disclaim the representation of intent to perform. And even where a defendant–promisor has not explicitly opted out of the default, she should be allowed to offer evidence that, given the context of the agreement, there was no such representation. Such context can include industry norms, local practice or the history of dealings between the parties. Where a promise does not represent an intent to perform, the promisor will not be liable for promissory fraud if she has an undisclosed conditional intent to perform, or an intent to perform or pay damages.

Courts should, however, retain one mandatory rule: While some promises do not represent an intent to perform, every promise represents at least that the promisor does not intend not to perform—that is, she is not entering the contract

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2. RESTATEMENT (SECOND) OF TORTS § 530 cmt. c (1977); *see also* RESTATEMENT (SECOND) OF CONTRACTS § 171 cmt. b (1981).

3. IAN AYRES & GREGORY KLASS, *INSINCERE PROMISES: THE LAW OF MISREPRESENTED INTENT* (2005).

planning breach. The rule here turns on the distinction between not intending to do something and intending not to do it (Prestatement § 105 cmt. a). A promisor who disclaims the default representation of an intent to perform may not intend to perform, but should still be liable for promissory fraud if she intends not to perform.

Second, courts faced with claims of promissory fraud should pay more attention to scienter (Prestatement §§ 103 cmt. b & 104 cmt. b). Today courts generally assume that because the promisor must have known her own intent, any misrepresentation of that intent was necessarily a knowing, or intentional, misrepresentation. As we explain, this inference is unwarranted, from which follow two recommendations. The first is defendant-friendly: Courts considering promissory fraud claims should insist on sufficient evidence of scienter—that the misrepresentation in question was knowing or reckless—and should readily grant motions for summary judgment when such evidence has not been submitted (Prestatement § 104(b)). The second is plaintiff-friendly: The possibility of non-knowing promissory misrepresentations opens the door for claims of nonfraudulent or negligent promissory misrepresentation, a cause of action that courts have until now failed to recognize (Prestatement § 103).

The third quick improvement would be to recognize that promissory representations of intent are material only because they say something about the objective probability of performance, and to interpret a representation of intent to perform as saying, absent evidence to the contrary, that there is at least a fifty-percent chance that the promisor will perform (Prestatement §§ 100 cmt. a, 101(b) & 107). Our point about the importance of the objective probability of performance is a corollary of Karl Llewellyn's objection to the Holmesian heresy: "[T]he essential purpose of a contract between commercial men is actual performance and they do not bargain merely for a promise, or for a promise plus the right to win a lawsuit . . ."<sup>4</sup> A promisee cares about whether or not the promisor *intends* to perform because he wants to know whether or not she *will* perform. Because representations of intent are in this context also representations about the objective probability of performance, a plaintiff should be permitted to show that the representation was false by showing that the actual probability of performance was in fact lower than the representation of intent suggested.

In order to simplify the factfinding task here, courts should adopt the following interpretive default: Absent evidence to the contrary, a representation of intent to perform also represents that there is at least a fifty-percent chance that the promisor will perform. That is, a promise presumptively represents not only an intent to perform but thereby also that performance is more likely than not. This is only a default. It is a familiar fact that some intentions are more likely to succeed than others, and the parties should be free to argue that the promissory representation at issue suggested a higher or lower probability of performance. Where the parties do not make such arguments (whether by choice or necessity), our fifty-percent default allows courts to address the objective probability of performance by posing a simple question to the jury: "Was it more likely than not

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4. U.C.C. § 2-609 cmt. 1 (2004).

that the promisor would perform?" If the answer is "No," then the representation of intent misrepresented the objective probability of performance.<sup>5</sup>

This last recommended reform brings us to a larger point that bears additional emphasis: The single act of promising can, and often does, say and do many things at once. We have focused on a cluster of representations relevant to the objective probability of performance, which include representations of intent, warranting representations that the promisor is so likely to perform it is in the promisee's interest to rely, and express statements about the probability of performance. But a promise might say other things as well. For example, especially where a contractual promise does not represent an intent to perform, it might represent that the promisor intends to pay damages in the case of breach and spare the promisee the expense of a lawsuit. Even promises that represent an intent to perform might also say something about the promisor's intent should she breach, since breach is always a possibility. The promise might represent, for instance, that the promisor does not plan to hide any breaches or otherwise to obstruct the promisee's ability to recover. Perhaps the law should also recognize these representations as interpretive defaults backed by the law of promissory fraud. Our Prestatement should not be read as the last word on the subject.<sup>6</sup>

We should also say a few words about our recommended measures of damages. It is no doubt true that the formula for optimal damage multipliers is "simpler to state than to apply,"<sup>7</sup> and we received several thoughtful questions at the conference about its practicability. Multipliers appear in two places in our Prestatement. First, in determining the appropriate compensatory award for nonfraudulent promissory misrepresentation, we recommend multiplying actual damages by the reciprocal of the probability of enforcement (Prestatement § 108(a)(1)). Here we adopt a solution for the problem of underenforcement that has wide currency in the economic literature and which is in no way specific to promissory fraud.<sup>8</sup> It is a reasonable question whether juries are equipped to assess

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5. Our fifty-percent default does something to specify what is, in extra-legal practice, the relatively imprecise representation of an intent to perform (imprecise in terms of what it says about the objective probability of performance). Richard Craswell has recently suggested that the common law should go further and take a regulatory approach that attempts to incentivize disclosure of information that is optimal both in terms of quantity and format. Richard Craswell, *Taking Information Seriously: Misrepresentation and Nondisclosure in Contract Law and Elsewhere*, 92 VA. L. REV. 565 (2006). We wonder whether in most contract contexts (excluding examples like consumer contracts), this matter cannot be left to the parties themselves, who have a reason to insist on optimal information. Whether or not this is so, however, we would also observe that so long as a cheap, vague representation—such as "I intend to perform"—does the job, it would be wrong to push for more precision or to require the parties to say much more.

6. For a framework for thinking about promissory representations of an intent to cooperate in recovery, see Gregory Klass, *Contracting for the Case of Breach: Second-Order Duties and Extracompany Remedies* (Sept. 28, 2006) (unpublished manuscript), available at <http://ssrn.com/abstract=933648>.

7. *Ciraolo v. City of New York*, 216 F.3d 236, 244 (2000) (Calabresi, J., concurring).

8. The canonical statement of the idea can be found in A. Mitchell Polinsky & Steven Shavell, *Punitive Damages: An Economic Analysis*, 111 HARV. L. REV. 869 (1998).

the probability of enforcement, or whether they will put aside their biases when determining the appropriate multiplier.<sup>9</sup> We believe that allowing for multipliers in those cases where detection is particularly unlikely would probably do more good than harm. But the point is not central to our project, and our proposal that courts recognize a new tort of nonfraudulent promissory misrepresentation does not depend on using a multiplier.

Multipliers also appear in our proposed calculation of punitive damages for promissory fraud, which we suggest be the dollar-value of the defendant's gain multiplied by the reciprocal of the probability of enforcement (Prestatement § 109(a)(2)). Again one might raise doubts about jury competence. Here, however, we are even more sanguine. Punitive damages are designed to fully deter bad behavior. Since there is no such thing as too much deterrence here, a jury can be instructed that, in the case of uncertainty, it should err on the side of awarding more rather than less. Of course, awards that are too high by orders of magnitude violate norms of fairness and threaten to deter otherwise valuable behavior. While this is a good argument for careful judicial policing of punitive damage awards here as elsewhere, we doubt that the measure we propose—which is calibrated to award the minimum necessary to deter bad behavior—will result in unreasonably high awards.

Finally, we can locate a few of our recommendations in relation to other papers that were presented at this conference. Andrew Klein suggests using comparative fault to replace or weaken the traditional requirement that the plaintiff's reliance on a fraudulent representation was *justified*.<sup>10</sup> That reform could easily be applied to promissory fraud as well and provides a nice supplement to our theory. Where a promisee knows more about the probability of performance than does the promisor, she cannot show justifiable reliance on the promissory representation, and should not be able to recover for promissory fraud (Prestatement § 104(a)(5)). Thus, for instance, a credit card company that is aware that an applicant is a terrible credit risk and charges an accordingly higher interest rate might have difficulty showing reasonable reliance on the cardholder's representation of intent. Under Klein's proposal, it might nonetheless be entitled to partial recovery through the apportionment of fault.

Deborah DeMott recommends a new test, based on justifiable expectations of loyalty, for when one party owes a fiduciary duty to another.<sup>11</sup> The reasonable expectation of loyalty provides a nice gloss on what we have termed "unidirectional or unbalanced relationships of trust" (Prestatement § 102 cmt. d). But while DeMott is interested in the way fiduciary relationships give rise to

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9. See, e.g., Cass R. Sunstein et al., *Assessing Punitive Damages (with Notes on Cognition and Valuation in Law)*, 107 YALE L.J. 2071, 2111–12 (1998); W. Kip Viscusi, *The Social Costs of Punitive Damages Against Corporations in Environmental and Safety Torts*, 87 GEO. L.J. 285, 327–32 (1998); Daniel Kahneman et al., *Shared Outrage and Erratic Awards: The Psychology of Punitive Damages*, 16 J. RISK & UNCERTAINTY 49 (1998).

10. Andrew R. Klein, *Comparative Fault and Fraud*, 48 ARIZ. L. REV. 983, 999 (2006).

11. Deborah A. DeMott, *Breach of Fiduciary Duty: On Justifiable Expectations of Loyalty and Their Consequences*, 48 ARIZ. L. REV. 925 (2006).

special duties, we are interested in another use courts might make of them. The existence of a fiduciary or quasi-fiduciary relationship can serve as evidence of what a promise represented. A reasonable expectation of loyalty can be evidence that the act of promising represented that the probability of performance was so high, that the promisee could reasonably rely on it. Not only do fiduciary relationships give rise to fiduciary duties, but they can also serve as evidence of the performance or nonperformance of other, more broadly applicable duties.

Lastly, several papers in this conference addressed the scope and reasons for the economic loss doctrine.<sup>12</sup> The economic loss doctrine is, among other things, a tool for patrolling the border between tort and contract. Our argument, on the other hand, is that some forms of tort liability can play a beneficial role in the contracting context. One explanation of the difference is that the economic loss doctrine has traditionally applied only to negligence and strict liability. But in recent years, several jurisdictions have expanded the doctrine to bar some fraud claims as well.<sup>13</sup> The doctrine is developing, and it is not clear that these courts would apply the rule to bar promissory fraud claims as well, which fall into the category of fraud in the inducement.<sup>14</sup> Be that as it may, we doubt whether these holdings make sense under any coherent reading of the economic loss doctrine. For the present, however, we leave the question for those who have proposed coherent readings of the doctrine.

## A DRAFT PRESTATEMENT OF THE LAW OF INSINCERE PROMISING

### 100. Promissory misrepresentation

(a) A *promissory representation* is a representation made, implicitly or explicitly, by the promisor at the time of promising that concerns the probability that the

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12. See Anita Bernstein, *Keep It Simple: An Explanation of the Rule of No Recovery for Pure Economic Loss*, 48 ARIZ. L. REV. 773 (2006); Dan B. Dobbs, *An Introduction to Non-Statutory Economic Loss Claims*, 48 ARIZ. L. REV. 713 (2006); Jay M. Feinman, *The Economic Loss Rule and Private Ordering*, 48 ARIZ. L. REV. 813 (2006); Mark P. Gergen, *The Ambit of Negligence Liability for Pure Economic Loss*, 48 ARIZ. L. REV. 749 (2006); Oscar S. Gray, *Some Thoughts on "The Economic Loss Rule" and Apportionment*, 48 ARIZ. L. REV. 897 (2006); Helmut Koziol, *Recovery for Economic Loss in the European Union*, 48 ARIZ. L. REV. 871 (2006); Richard A. Posner, *Common-Law Economic Torts: An Economic and Legal Analysis*, 48 ARIZ. L. REV. 735 (2006); Ellen S. Pryor, *The Economic Loss Rule and Liability Insurance*, 48 ARIZ. L. REV. 905 (2006); Travis M. Wheeler, Note, *Negligent Injury to Reputation: Defamation Priority and the Economic Loss Rule*, 48 ARIZ. L. REV. 1103 (2006).

13. See generally R. Joseph Barton, Note, *Drowning in a Sea of Contract: Application of the Economic Loss Rule to Fraud and Negligent Misrepresentation Claims*, 41 WM. & MARY L. REV. 1789 (2000); Steven C. Tourek et al., *Bucking the "Trend": The Uniform Commercial Code, the Economic Loss Doctrine, and Common Law Causes of Action for Fraud and Misrepresentation*, 84 IOWA L. REV. 875 (1999).

14. But New York courts, many of which take an even stricter approach to the line between contract and tort, have rejected promissory fraud claims as not far enough removed from contractual duties. See Ian Ayres & Gregory Klass, *Promissory Fraud*, N.Y. ST. B.J., May 2006.

promise will be performed. Representations of intention concern the probability of performance.

- (b) A *promissory misrepresentation* is a promissory representation that is false at the time it is made.

**Comment:**

*a. Probability of performance.* The action for promissory fraud has addressed traditionally only misrepresentations of promisor intent at the time of promising. The promisor's initial intent, however, is material only as an indicator of the probability that she will perform. A promisor who intends to perform is more likely to do so than a promisor who does not intend to perform, which is why the promisee, who is faced with the decision whether or not to enter into a contract or otherwise rely, cares about promisor intent. A promisor might, however, represent information about the probability of her performance in other ways. Such representations can give rise to the same harm as misrepresentation of intent and, in appropriate cases, should give rise to similar legal liability.

*b. Implicit and explicit representations.* A promise is primarily not a representation about how the world is, but an act that puts the promisor under a new obligation. But a single speech act, such as a promise, often has multiple meanings. In most cases, a promise also *implicitly* represents that the promisor intends to perform, and perhaps other things about the probability of performance as well. A promisor might, instead of or in addition to any implicit representations, *explicitly* make such representations, using words like "I fully intend to perform," "There is a ninety-percent chance of performance," or "You can safely rely on my performing."

*c. At the time of promising.* A promissory representation is not a prediction but concerns the present probability of performance. That is, it represents the state of the world at the time of promising, and is therefore true or false when it is made. Consequently, the truth or falsity of a promissory representation does not depend on whether or not the promisor performs her promise.

### 101. Promissory representations of intention

- (a) Absent contrary circumstances, a promise represents that the promisor intends to perform. Contrary circumstances can include a party's explicit disavowal of such a representation, the relationship between the parties, local practice, and the promisor's statement to the promisee of what the probability of her performance is.
- (b) Absent evidence to the contrary, a court should interpret a representation of intent to perform to mean that there is at least a fifty-percent chance that the promisor will perform.
- (c) Every promise necessarily represents that the promisor does not intend not to perform.

**Comment:**

*a. Default representation of intent.* Absent contrary evidence, the law should interpret a promise to represent that the promisor intends to perform. This default

is majoritarian, as most promisors intend to perform and want to share that information with promisees. The default is also information-forcing, since it gives a promisor who does not intend to perform a new reason to expressly tell the promisee that she does not, for by doing so she avoids potential liability for promissory misrepresentation.

*b. Permissible conditional intentions.* The possibility of breach is part of the background understanding of the parties, and it would be unreasonable to expect either promisor or promisee to anticipate performance come what may. Thus a promisor's default representation of an intent to perform is not a representation to perform under all possible future states of the world—an intent to perform “no matter what.” As an initial matter, the doctrine of excuses recognizes that certain changed circumstances (e.g., impracticability, frustration) may excuse performance. A promisor's initial intent to perform may therefore be conditioned on the non-occurrence of such changed circumstances without misrepresentation. Second, a representation of an intent to perform might not be false even if the promisor believes she will likely breach in some circumstances that would not excuse performance. Such a conditional intention is permissible so long as the promisor does not have a special reason to believe that such circumstances are likely to occur, and such eventualities are not particularly salient to the transaction. In addition, an intent to perform that is conditioned on the non-occurrence of an undesirable event, such as increased production costs, is more permissible than one conditioned on the nonoccurrence of a desired event, such as a better offer from a third party.

*c. Comparison to present doctrine.* Courts and commentators presently assume that every promise represents an intent to perform. That is, the current doctrine imposes on promisors a mandatory representation of intent. Yet there are situations in which a promisor wants to undertake a legal obligation to perform, though she is unsure whether she will actually do so. So long as such a promisor does not misrepresent her intent—that is, so long as the promisee is on notice that the promisor may not intend to perform—there is no reason to deter such a promisor from entering into the transaction.

*d. Contracting around the default.* The clearest way a promisor can opt out of the default representation of an intent to perform is to inform the promisee that she makes no such representation. There are, however, contexts where this is already clear to both parties—because of an industry norm, local practice, or the course of dealings between the parties. Finally, if the promisor represents precisely what the probability of her performance is (e.g., “There is a seventy-five-percent chance I will perform”), any representation of intent is of little added use to the promisee, and the promise should be interpreted as making no representation as to promisor intent.

*e. The fifty-percent default.* As a representation of intent, a promise also says something about the objective probability of performance—namely, that performance is at least as likely as the chances of the promisor realizing an intention of that sort. What any given expression of intent says about the future



varies depending on context and on the sort of act intended. The habitual opium smoker's statement that she intends to quit suggests a lower probability that she will realize her intention than the dutiful roommate's report that she intends to do the dishes. Evidence of context and the parties' background understanding can indicate that the expression of intent represented a higher or lower objective probability of performance.

Where the parties do not introduce such evidence—whether because it does not exist or because they have chosen not to—the court should interpret a representation of intent to perform to mean that there is at least a fifty-percent chance that the promisor will perform. That is, if performance was more likely than not, then the representation of an intent to perform did not misrepresent the objective probability of performance.

*f. Mandatory representation of no intent not to perform.* A promisor may not intend to perform a promise because she is unsure whether or not she will perform (e.g., she intends to perform only under certain undisclosed conditions), or because she intends not to perform (under any probable future state of the world). In the latter case, if the promisee is aware of the promisor's intent—that is, if the promisee has not been misled—then the promisee is contracting for damages rather than performance. Such transactions create no value that could not be realized by an express contract for the anticipated damage amount. And they impose significant costs, which include both the residual possibility of promisee mistake and publicly provided adjudication and enforcement. Consequently, there is nothing to be gained by permitting a promisor to enter into a transaction she intends not to perform. Such promisors are deterred by a mandatory minimum representation: every promise represents that the promisor does *not* intend *not* to perform. As noted in the first sentence of this comment, this minimum representation does not entail that the promisor intends to perform.

## 102. Warranting promissory representations

- (a) Unless a promisor warns the promisee that she does not believe that it is in the promisee's interest to rely on her performance or states to the promisee what the probability of her performance is, her promise represents that she does not believe that the probability of her performance is so low that it is not in the promisee's interest to rely on her performing.
- (b) Circumstances indicating that a promise represents that the probability of performance is so great that it is in the promisee's objective interest to rely on that performance can include explicit statements, local practice and the relationship between the parties.

### Comment:

*a. Warranting promissory representations.* In addition to representations of intent, a promisor can say something about the probability of performance by comparing it to the promisee's participation constraint, that is, to the minimum probability of performance that would make entering into the transaction a good bet for the promisee. Thus a promisor might assure the promisee that the probability of performance is so high that it is in the promisee's interests to undertake significant

reliance costs, though those costs will provide no return in the case of nonperformance.

*b. The default warranting representation.* Most promisors do not want to warrant that the transaction is in the promisee's best interest. First, a promisor may not know enough about the promisee's participation constraint to make such a representation. Second, other information about the probability of performance (e.g., the promisor's intent to perform) may suffice to assure the promisee that it is in the promisee's interest to rely. Courts can and should, however, adopt a more modest default: that the promisor does not *believe* that it is not in the promisee's interest to rely. A promisor who cannot estimate the promisee's participation constraint should have no belief as to whether or not it is in the promisee's interest to rely. Such a promisor accords with the default representation. But a promisor who believes that the probability of performance is so low that it is not in the promisee's interest to rely is given a new reason to share that information with the promisee, else face liability for a promissory misrepresentation. *Cf.* Restatement (Second) of Contracts § 151 (unilateral mistake); *id.* § 161(c) (non-disclosure as equivalent to assertion when disclosure would correct a mistake); UCC 2-315 (implied warranty of fitness).

*c. Contracting around the default.* A promisor who believes that it is not in the promisee's interest to rely can avoid the default representation by informing the promisee of that fact. Alternatively, a promisor who informs the promisee of just what the probability of performance is has, in the normal case, provided the promisee with enough information to determine for herself whether the transaction is in her interest. Consequently, such a representation also suffices to opt out of the default.

*d. Fully warranting representations.* While most promisors would not wish to warrant that the probability of performance is so high that it is in the promisee's interest to rely, as described in comment *a*, some promisors do wish to make such representations. An express statement such as "You can count on me," is such a representation and, if false, can give rise to liability for promissory misrepresentation or fraud. Alternatively, where there exists a unidirectional or unbalanced relationship of trust between promisor and promisee, such as in a fiduciary relationship, the promise should be interpreted as implicitly making such a warranting representation.

### **103. Nonfraudulent promissory misrepresentation**

A plaintiff who claims promissory misrepresentation must show that: (1) the defendant made a promissory representation; (2) that representation was, at the time it was made, false; (3) it was foreseeable that someone in the claimant's position would act or refrain from acting in reliance on the representation; (4) the claimant justifiably relied on the representation, which is to say that, because of the representation, the claimant reasonably expected that the promise would be performed and relied on that expectation; and (5) the claimant suffered damages as a proximate result of his reliance.

**Comment:**

*a. The elements of promissory misrepresentation.* The above elements of (nonfraudulent) promissory misrepresentation are no different from the elements of the generic action for (nonfraudulent) misrepresentation, the only difference being that the action is limited to promissory misrepresentations.

*b. Comparison to present doctrine.* Because a promisor cannot be mistaken as to her own intent, most courts assume that every misrepresentation of intent is perforce an intentional misrepresentation, and therefore that all promissory misrepresentations are fraudulent. That assumption overlooks four significant cases. First, where a promise is made by an agent representing a principal, that agent can be mistaken as to the principal's intent. Second, a promisor might be mistaken as to the meaning of her promise, and therefore unwittingly intend to do something other than what the promise obliges her to do. Third, while a promisor cannot be mistaken as to her intent, she may be mistaken as to the objective probability of her performance. The representation of an intent to perform is also a representation about the objective probability of performance, and the latter representation may be false even if the former is not. Fourth, some promissory representations are not representations of intent, but say something about the probability of performance by communicating other facts. The assumption about the transparency of intent says nothing about these representations, which concern facts about which the promisor might simply be mistaken.

In any of these four cases, if the promisor's mistake was reasonable, or a matter of mere negligence, there should be no liability for promissory fraud. The plaintiff's case may, however, satisfy the elements of nonfraudulent or negligent misrepresentation—a possibility courts presently fail to recognize.

*c. Proximate harm and breach.* In all but the most unusual case, the only possible proximate harm of a promissory misrepresentation is the harm stemming from the defendant's failure to perform. In the normal case, therefore, nonperformance or breach is an element of promissory misrepresentation and promissory fraud.

**104. Promissory fraud**

- (a) The action for promissory fraud is a species of the action for deceit. In order to prove promissory fraud, a claimant must show that: (1) the defendant made a promissory representation; (2) the representation was, at the time it was made, false; (3) the defendant knew that the representation was false or acted with reckless disregard of its truth; (4) it was foreseeable that someone in the claimant's position would act or refrain from acting in reliance on the representation; (5) the claimant justifiably relied on the representation, which is to say that, because of the representation, the claimant reasonably expected that the promise would be performed and relied on that expectation; and (6) the claimant suffered damages as a proximate result of his reliance.
- (b) Proof that a promisor did not intend to perform or that a promisor intended not to perform, which can satisfy (2), might not be sufficient to show that a

promissory misrepresentation was made knowingly or recklessly, *i.e.*, might not satisfy (3).

**Comment:**

*a. The elements of promissory fraud.* The above elements of promissory fraud are the same as the elements for the generic action of deceit, the only difference being that the action is limited to promissory misrepresentations.

*b. Comparison to present doctrine.* As noted above, *supra* § 103 cmt. b, courts wrongly assume that a promissory misrepresentation is necessarily an intentional misrepresentation. As a result, when faced with a claim of promissory fraud, courts generally fail to insist on separate proof of scienter—that the misrepresentation was made knowingly or with reckless disregard of its truth. This is an error and courts should require evidence of scienter.

### 105. The crime of false promise

A defendant may be found guilty of the crime of false promise only if there is proof that at the time of promising that the defendant intended not to perform and the evidence excludes all other hypotheses to a moral certainty. Consequently, a promisor who had an undisclosed conditional intention to perform (an intention to perform if C), who has an undisclosed disjunctive intention to perform (an intention to perform or to X), or who had no intention with respect to performance is not guilty of false promise.

**Comment:**

*a. Intent not to perform vs. no intent to perform.* A promisor might neither intend to perform nor intend not to perform—for example, if she intends to perform or pay damages, or intends to perform only under certain undisclosed conditions. Under the default interpretation of a promise, such a promisor may well be liable for promissory fraud, since she has represented an intent she does not have. But because such a promisor does not *intend* not to perform, she is not guilty of the crime of false promise. Criminal liability is reserved only for cases where the promisor enters into the transaction intending not to perform. Such cases are both more egregious, and subject to more reliable proof.

*b. Moral certainty.* Proof of the crime of false promise turns primarily on proof of the promisor's initial intent. Evidence of such intent can be equivocal. In order to avoid chilling promissory transactions, the evidentiary bar should be higher than the beyond-a-reasonable-doubt standard. Instead, the prosecution should be required to prove bad initial intent to a moral certainty.

### 106. Proof of intent

- (a) The nonperformance of a promise, while probative as to the defendant's intent at the time of promising, is never dispositive as to that intent.
- (b) Other evidence of an initial intent not to perform can include: (1) a short time or lack of changed circumstances between the last promissory representation and nonperformance; (2) the fact that the defendant made no preparations or

attempts to perform; (3) evidence that the defendant knew at the time of promising that she would be unable or unwilling to perform; (4) other deceptions by, or actions of, the defendant that suggest a scheme to defraud; and (5) similar broken promises by the defendant without excuse or explanation.

- (c) Motive evidence that the defendant believed at the time of promising that it would be in her best interest to perform strongly suggests that she did intend to perform.

**Comment:**

*a. The relevance of nonperformance.* The mere fact of breach is never sufficient to show bad intent at the time of promising, since the defendant may have changed her mind. Nor is it enough to show a low probability of performance at the time of promising. It is, however, relevant to both.

*b. Circumstantial evidence of intent.* The only direct evidence of a promisor's initial intent are her own statements. Because such statements are rarely forthcoming, most cases turn on circumstantial evidence. While it is impossible to draw up a definitive list of the forms of such circumstantial evidence, subsections (b) and (c) describe several categories of commonly salient evidence. It is to be observed that the relevance of any type of evidence is often highly context sensitive. For example, in one case a defendant's partial performance might be strong evidence of an initial intent to perform, while in another, minimal initial steps in performing might indicate that the defendant was stringing the promisee along, hoping to delay a suit for breach of contract.

### 107. Proof of the probability of performance

Evidence that the probability of performance was lower than represented can include: (1) the promisor's intent at the time of promising; (2) circumstances at the time of promising suggesting that the promisor would likely not be able or would choose not to perform; and (3) empirical evidence of the promisor's past performance record.

**Comment:**

*a. The relevance of the probability of performance.* Not every promissory representation is a representation of intent, for it is possible to say something about the probability of performance by representing other facts. *See supra* § 100 cmt. a. Moreover, a promisor who intends to perform may nonetheless misrepresent the objective probability of her performance at the time of promising. *See supra* § 103 cmt. b. In either case, a plaintiff can show misrepresentation without showing bad initial intent. While the objective probability of performance turns in part on promisor intent, it also depends on whether the promisor will be able to perform and whether it is likely that the promisor will choose to change her mind about performance. Proof of a low probability of performance may also be had by way of scientific induction, from past similar breaches.

### 108. Remedies for nonfraudulent promissory misrepresentation

- (a) A claimant who has proven by a preponderance of the evidence that the defendant made a promissory misrepresentation is entitled:
- (1) to recover all of the costs that he has reasonably incurred in reliance on the promissory representation, as well as his litigation costs, all of which, where there is proof that the type of promissory misrepresentation in question is particularly likely to go unnoticed or to evade legal sanction, may be multiplied by the reciprocal of the probability of enforcement; and
  - (2) to rescind the contract.
- (b) A contractual agreement that one or more parties shall not be liable for nonfraudulent promissory misrepresentation is enforceable. A contractual agreement that nonfraudulent promissory misrepresentation shall entitle the deceived party to any or all of the remedies for promissory fraud is enforceable.

#### Comment:

*a. The general measure of damages.* The default measure of damages for nonfraudulent promissory misrepresentation is the plaintiff's reliance costs. Because recovery is in tort, certain contractual limits on damages do not apply, and a plaintiff may be able to recover, *inter alia*, emotional or other nonpecuniary damages and nonforeseeable consequential damages. Suspending the otherwise applicable limits on breach-of-contract damages does not threaten their general effectiveness, since liability for promissory misrepresentation is the exception rather than the rule.

*b. Damage multiplier.* A promissory representation is made to convince the promisee to rely on performance. Liability for promissory misrepresentation promotes that purpose by assuring the promisee that she will be able to recover her reliance costs if the promissory representation is false. The proper functioning of this mechanism, however, depends on the probability of enforcement—which may be particularly low in the case of promissory misrepresentation, given difficulties of proof. This difficulty is addressed by the use of a damage multiplier.

*c. Avoiding or increasing liability.* An agreement may exclude one or more parties from liability for promissory misrepresentation, so as to protect the promisor against her reasonable or negligent mistake as to the probability of performance. Alternatively, a party who wishes to provide additional assurances as to the veracity of her promissory representations may choose to undertake greater liability for any nonfraudulent representation, including the remedies for promissory fraud.

### 109. Remedies for promissory fraud

- (a) A claimant who has proven by a preponderance of the evidence that the defendant has committed promissory fraud has the option either:

- (1) to recover her reliance costs as described in § 108(a)(1);
  - (2) to recover punitive damages in the amount of the defendant's gain from the misrepresentation multiplied by the reciprocal of the probability of enforcement; or
  - (3) to demand specific performance.
- (b) Where a contract is enforceable on its face, an agreement that one or more parties shall not be liable for promissory fraud shall not be enforced. A contractual stipulation that, in the case of promissory fraud, punitive damages shall be assessed in a certain amount or that the remedy will be specific performance is enforceable.

**Comment:**

*a. Damages.* So long as the probable damage amount is equal to or greater than the defendant's anticipated gain from the misrepresentation, the threat of legal liability should serve to deter promissory fraud. This can be accomplished by giving the successful plaintiff a choice between various monetary damage measures, as well as specific performance. As between multiplied reliance damages (§ 109(a)(1)) and the multiplied amount of the defendant's gain (§ 109(a)(2)), a promissory fraud plaintiff will always choose the higher amount. Similarly, a plaintiff will request specific performance (§ 109(a)(3)) only where that remedy is worth more to her than either measure of money damages. This choice of damage measures therefore ensures adequate deterrence and full compensation.

*b. Attempts to limit liability.* Plaintiffs should not be permitted to contract out of liability for promissory fraud. The promisor who is worried about such liability can instead expressly disclaim any representations as to her intent or the probability of performance, except for the mandatory representation that she does not intend not to perform.

### **110. Relationship to damages for breach of contract**

An award of monetary damages for promissory misrepresentation or promissory fraud does not forestall separate recovery for breach of contract. But a claimant's reliance interest may be recovered only once. Consequently, a finding of breach of contract will only allow additional recovery of the difference between the claimant's expectation and reliance interests. An award of rescission for promissory misrepresentation or specific performance for promissory fraud precludes recovery of damages for breach of contract.

### **111. Pleading requirements for promissory fraud**

In all averments of promissory fraud, the circumstances constituting fraud must be stated with particularity. A complaint must also state facts sufficient to create a prima facie case of a promissory misrepresentation and that the promisor made that misrepresentation knowingly or recklessly. Where a plaintiff fails to plead promissory fraud with particularity, the claim should be dismissed without prejudice.

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