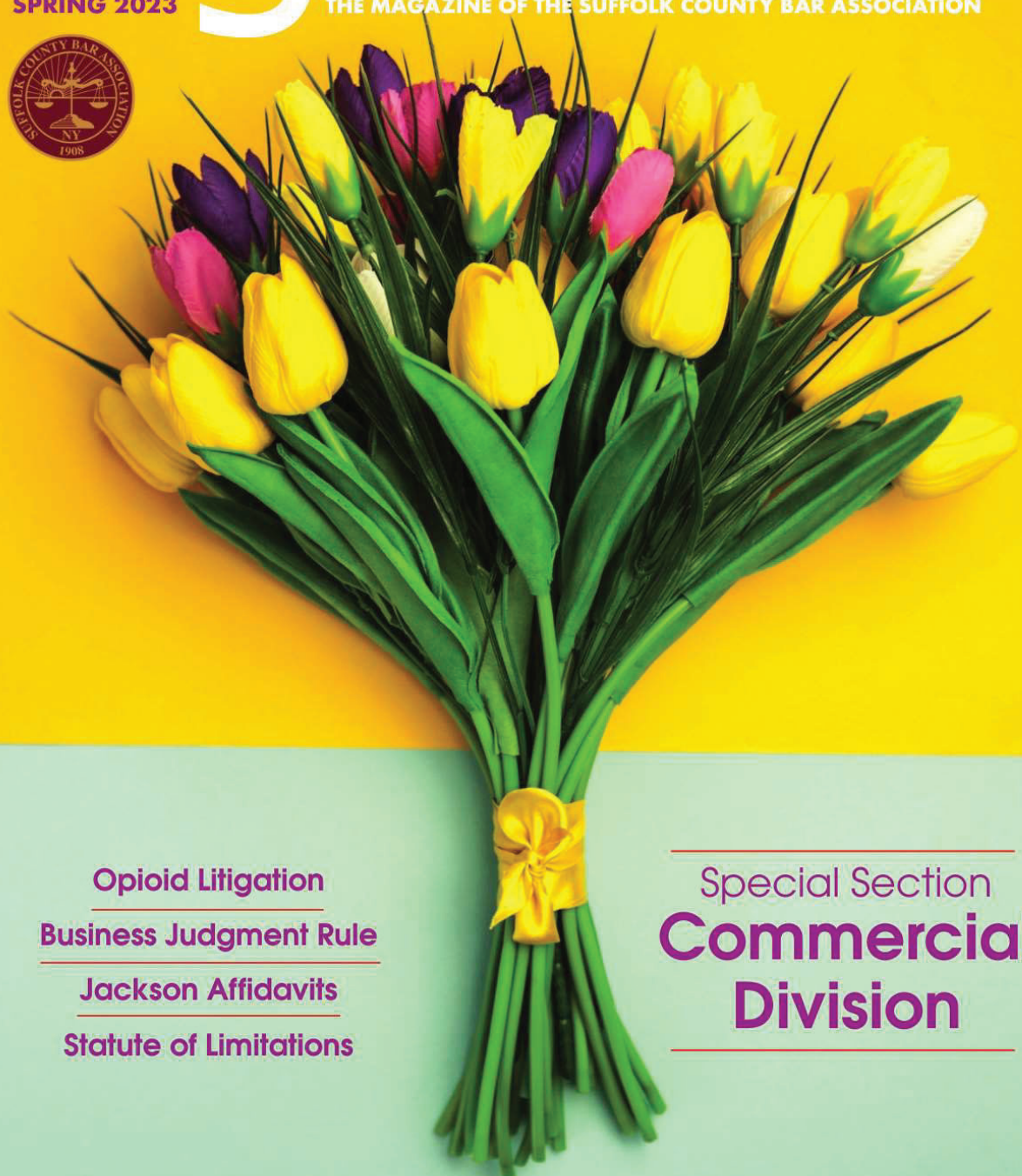


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## Little Known Fraud Fun Facts: The Secret Is Out

By Kevin Schlosser, Esq.

**F**raud claims are ubiquitous in commercial litigation. Indeed, fraud allegations of some sort permeate many Commercial Division cases. This article addresses some relatively little known or acknowledged aspects relating to the cause of action for fraud. Knowledge of these areas could yield great power in litigating fraud claims.

As explained below, while intent to defraud is a commonly-cited element, there is strong authority that intent need not be alleged nor proved if rescission, rather than damages, is sought. Further, while courts often proclaim that fraud claims cannot be based upon mere promises contained in contracts, a free-standing claim of fraud can indeed be based upon representations and warranties contained in a contract. Finally, while fraud enjoys an extended statute of limitations period, claims of negligent misrepresentation or constructive fraud do not benefit from the extended period.

### **Intent is not Required for Rescission**

The basic elements of a cause of action for fraud are straightforward and often cited: "a material misrepresentation of a fact, knowledge of its falsity, an intent to induce reliance, justifiable reliance by the plaintiff and damages." *Eurycleia Partners, LP v.*

*Seward & Kissel, LLP*, 12 N.Y.3d 553, 559 (2009). It is not commonly known, however, that the element of "intent" is actually not required when the remedy sought is rescission. There is abundant authority for this point.

The New York State court authority for this goes back to a decision rendered in 1874, in which the Court observed: "There can be no doubt that, in this aspect of the case, the defendant obtained the property of the plaintiff through misrepresentations which are material, even though it be assumed that they were made without bad intent on his part." *Hammond v. Pennock*, 61 N.Y. 145, 152 (1874). The remainder of the decision dealt with whether the plaintiff was in fact entitled to rescission when the parties could not be restored to their pre-contract position. Even without establishing an actual intent to defraud, and based upon a mere innocent misrepresentation, the court clearly considered the remedy of rescission. The Court of Appeals continued along this same reasoning in 1928, when it observed "It is not necessary in order that a contract may be rescinded for fraud or misrepresentation that the party making the misrepresentation should have known that it was false. Innocent misrepresentation is sufficient, and this rule applies to actions at law based upon rescission as well

as to actions for rescission in equity." *Seneca Wire & Mfg. Co. v. A.B. Leach & Co.*, 247 N.Y. 1, 7-8 (1928).

Relying upon *Seneca*, the Court bolstered this principle in 1942, holding in *African Metals Corp. v. Bullowa*, 288 N.Y. 78, 85 (1942): "The law is settled that in an action for rescission in equity, or in an action at law based upon an executed rescission, the principal becomes liable to restore the consideration even though the representations made by the agent are innocent." More recently, the First, Second and Fourth Departments joined in the act and ruled similarly. See, e.g., *Bd. of Managers of the Soundings Condominium v. Foerster*,

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**(Fun Facts...** continued from page 29) 138 A.D.3d 160, 164 (1st Dep't 2016) (proof of scienter not required for rescission); *Brodsky v. Nerud*, 68 A.D.2d 876, 877 (2d Dep't 1979) ("the plaintiff correctly argues that even an innocent misrepresentation is a sufficient ground for rescission."); *D'Angelo v. Bob Hastings Oldsmobile, Inc.*, 89 A.D.2d 785, 785 (4th Dep't 1982), *aff'd*, 59 N.Y.2d 773 (1983) ("even an innocent misrepresentation is sufficient ground for rescission"). The Second Circuit has also ruled similarly. See *Stern v. Satra Corp.*, 539 F.2d 1305, 1308 (2d Cir. 1976).

Thus, there is certainly firm authority that intent is not a required element of fraud if rescission is sought.

### **Contract Representations Can Form the Basis of Fraud Claims**

Courts are often challenged when trying to decide whether the breach of contractual promises can also amount to a cause of action for fraud. It is easy to find authority indicating that mere breach of contractual promises does not amount to the tort of fraud. See, e.g., *Michael Davis Constr., Inc. v. 129 Parsonage Lane, LLC*, 194 A.D.3d 805, 807 (2d Dep't 2021) ("[a] cause of action premised upon fraud cannot lie where it is based on the same allegations as the breach of contract claim." (citation omitted)); *JDI Display Am., Inc. v. Jaco Elecs., Inc.*, 2018 NY Slip Op 33949(U) at \*3 (Suf. Co. Sup. Ct. 2018)(*Garguilo, J.*) *aff'd* 188 A.D.3d 844 (2d Dep't 2020); *Fritch v. Bron*, 73 Misc.3d 860, 863 (Suf. Co. Sup. Ct. 2021)(*Emerson, J.*). However, when a contract contains factual representations, or warranties, there can indeed be a basis for an independent fraud claim based upon those contractual provisions.

An instructive and informative decision directly on point was rendered by Commercial Division Justice James Hudson, in *Dulcette Tech. LLC v. MTC Indus., Inc.*, 64 Misc.3d 1231(A) (Sup. Ct. Suffolk Co. 2019), *aff'd*, 210 A.D.3d 1055 (2d Dep't 2022). In *Dul-*

*cette*, the contract was for the sale of goods to plaintiff from the defendant. Plaintiff purchased the artificial sweetener known as "Sucralose" from the defendant for resale to plaintiff's customers. Plaintiff alleged that the products in question did not conform with express contractual warranties. In a non-jury trial, Justice Hudson determined the claims for breach of contract and fraud.

Justice Hudson rejected defendant's argument that the fraud claim should be dismissed because they were merely duplicative of the breach of contract claims. In particular, Justice Hudson distinguished between contractual promises of future performance and misrepresentations of present fact contained in the contract and, quoting other decisions, observed: "If a plaintiff alleges that it was induced to enter into a transaction because a defendant misrepresented a material fact, the plaintiff has stated a claim for fraud even though the same circumstances also give rise to the plaintiff's breach of contract claim." *Dulcette*, 64 Misc.3d 1231(A) at \*9 (citations omitted). In applying the law to the facts, Justice Hudson concluded: "The fraud allegation is not based on mere failure to perform promises of future acts, but on misrepresentations of the analysis already performed on the Sucralose. This is a misrepresentation of a presently-existing fact, and is not duplicative of the breach of contract." *Id.*

Justice Hudson's decision was affirmed in its entirety by the Second Department in *Dulcette Tech., LLC v. MTC Indus., Inc.*, 210 AD3d 1055 (2d Dep't 2022). (The Second Department did not specifically address the legal reasoning of Justice Hudson's decision, but did affirm by deferring to the court's credibility determinations. As such, the Second Department did not disagree with the conclusions of law relied upon by Justice Hudson.)

Thus, there is firm authority supporting an independent cause of action for fraud based upon contractual

representations and/or warranties.

### **Statutes of Limitations for Negligent Misrepresentation**

When dealing with statutes of limitation for fraud, CPLR 213(8) is often cited ("an action based upon fraud; the time within which the action must be commenced shall be the greater of six years from the date the cause of action accrued or two years from the time the plaintiff or the person under whom the plaintiff claims discovered the fraud, or could with reasonable diligence have discovered it."). This more generous time period, however, should not be relied on to apply to claims that do not actually involve intentional fraud, such as negligent misrepresentation or constructive fraud. Moreover, courts are not entirely consistent in applying the time period to such other claims.

In *Berman v. Holland & Knight, LLP*, 156 A.D.3d 429, 429-430 (1st Dep't 2017), the Court observed that while the extended two-year discovery rule of CPLR 213(8) "does apply to actual fraud," (emphasis in original), the Court applied a six year statute of limitations to the claim of constructive fraud. If the claim is denominated or alleged as "negligent misrepresentation" the court may apply a different analysis. So, for example, because of the reference to "negligence" courts have applied a three-year statute of limitations to such claims. See, e.g., *Remis v. Fried*, 31 Misc.3d 1203(A) at \*3 (N.Y. Co. Sup. Ct. 2011); *Enzinna v. D'Youville College*, 34 Misc.3d 1223(A) at \*2 (N.Y. Co. Sup. Ct. 2010) ("plaintiff's claim for damages for negligent misrepresentation ... is governed by a three-year limitations period"); *U.S. Fire Ins. Co. v. North Shore Risk Management*, 114 A.D.3d 408, 410 (1st Dep't 2014) ("negligent misrepresentation claims, to which a three-year statute of limitations applied").

Other courts, however, have recognized that if the claim involves allegations of fraud of some sort, the  
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**(Fun Facts...** continued from page 34) six-year statute applies. See *Fandy Corp. v. Lung-Fong Chen*, 262 A.D.2d 352 (2d Dep't 1999) ("[t]he plaintiff's causes of action based on constructive fraud and negligent misrepresentation are covered by the six-year Statute of Limitations governing equitable actions in general"); *Colon v. Banco Popular North America*, 59 A.D.3d 300, 301 (1st Dep't 2009) ("[c]ontrary to plaintiffs' contention, the action is not governed by a six-year limitations period (CPLR 213), since they neither al-

leged fraud nor constructive fraud against defendant.").

Yet, there are decisions that serve to throw this entire area of law into confusion, such as the Third Department's decision in *Krog Corp. v. Vaner Group, Inc.*, 158 A.D.3d 914 (3d Dep't 2018). In *Krog*, the Third Department addressed claims for aiding and abetting fraud and negligent misrepresentation, and assumed not only that the six-year statute of limitations applied to such claims but also the extended two-year period under CPLR

213(8) for actual fraud. Although the Third Department cited case law for this proposition, the decisions it relied upon did not address negligent misrepresentation claims at all.

### Conclusion

While general pronouncements relating to claims of fraud are abundant and easily found, the more obscure principles are not as widely known or applied.

The secret is thus out.

Knowledge is power. 🧠