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The Tort of Giving Negligent Investment Advice
by: Seth E. Lipner* and Lisa A. Catalano**

ABSTRACT:

This article is a novel study of the common-law responsibility of investment advisors to exercise due diligence when providing advice to their clients. The article chronicles the development of the tort of negligent misrepresentation, from its inception in a series of watershed New York cases, through the creation of Restatement (Second) Torts 552, and culminating in analysis of how the courts around the country have applied these concepts to the specifics of securities brokers, investment advisors and others involved in either promoting investments or providing information about them.

The number of cases brought by investors against investment banks and brokerages grows every year. A large percentage of these cases involve allegations of negligence. But despite the spate of cases in this area, there has been no significant scholarship. This article fills the gap.

In researching and writing this piece, the authors have combined their experience as practitioners with their talents as academics and legal scholars. In doing so, they are able to expound authoritatively on the recent developments that have caused the law in this area to coalesce and advance.

The combination of (a) the ubiquity of cases in this area and (B) the paucity of existing legal scholarship will result in an article that will be cited by courts and commentators for years to come.

Introduction

Since the advent of the federal and state securities statutes, the focus of most securities laws has been on preventing fraud and deception.1 The cases decided under these statutes have sometimes varied as to the level of scienter required to prove a

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statutory violation, but some level of scienter is required to be pleaded and proved. But in recent years, a new trend has developed in financial services cases. Today, along with claims sounding in “fraud” (or sometimes instead of them), plaintiffs frame their cases in terms of “negligent misrepresentation.”

The New York Court of Appeals defined succinctly the tort of negligent misrepresentation soon after it first appeared in the legal lexicon. In the famous case *Reno v. Bull*, the Court’s formulation of the tort was simple -- “fraud minus the purpose.” Explaining the difference between fraud and negligent misrepresentation, the Court wrote:

> Negligence and fraud are not synonymous terms; nor in legal effect are they equivalent terms. Fraud presupposes a willful purpose resorted to with intent to deprive another of his legal rights. It is positive in that the purpose concurs with the act, designedly and knowingly committed. Negligence, whatever be its grade, does not include a purpose to do a wrongful act. It may be some evidence of, but is not, fraud. [Citation omitted] Fraud always has its origin in a purpose, but negligence is an omission of duty minus the purpose.

A system of legal responsibility founded upon negligence and due care is, of course, vastly different from one based on fraud, scienter and intent. The existence of a claim for negligent misrepresentation or, more aptly, the negligent provision of

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3 124 N.E. 144 (1919). The case was primarily concerned with the measure of damages for fraud. *Id.* at 146-47.

4 *Id.* at 145.

information, creates the legal responsibility for businesses and professionals to exercise due diligence when giving investment advice, for compensation, to their customers and clients.

Recognition of a tort of providing negligent investment advice is especially important in light of several inter-related facts:

1. The business of giving “investment advice” has grown into an industry made up of a chessboard of broker-dealers, investment managers, financial planners and every variety of adviser, consultant, specialist and the like.\(^6\)

2. The consumers of investment advice constitute an ever-growing population increasingly faced with complex economic decisions that can have crucial effects on people’s lives and well-being.

3. The securities statutes (federal and state) only apply when there has been a false statement “in connection with a purchase or sale of a security,”\(^7\) leaving a gap in the law for a variety of cases, including:

\(^6\) See Karen Hube, Alphabet Soup, The Wall St.J., at R7, Apr. 24, 2006 (documenting the proliferation of titles and roles used by investment professionals). For a breakdown of significant categories of investment professionals, and how the law treats them, see discussion at text and notes accompanying n. 227, infra.

\(^7\) See *Blue Chip Stamps v. Manor Drug Stores*, 423 U.S. 884 (1975)(holding that the federal securities laws are triggered only in connection with a transaction); Unif. Securities Act, § 501, “It is unlawful for a person, in connection with the offer, sale, or purchase of a security, directly or indirectly: (1) to employ a device, scheme, or artifice to defraud; (2) to make an untrue statement of a material fact or to omit to state a material fact necessary in order to make the statement made, in the light of the circumstances under which it is made, not misleading; or (3) to engage in an act, practice, or course of business that operates or would operate as a fraud or deceit upon another person.” § 501, or its equivalent, has been enacted in all the states § 502, “Prohibited Conduct in Providing Investment Advice: Fraud in Providing Investment Advice”, adopted by 14 jurisdictions - Georgia, Hawaii, Idaho, Indiana, Iowa, Kansas, Maine, Minnesota, Missouri, Oklahoma, South Carolina, South Dakota, Vermont, Wisconsin and the Virgin Islands. For a state-by-state compilation of the statutes providing civil remedies for
(a) so-called “holder” cases -- cases where a false statement led an investor to hold a securities position previously acquired;\(^8\)

(b) advice by one investment professional (e.g. a brokerage or pension advisor) to retain another investment firm (e.g. an independent money manager) to make investments for the plaintiff -- an increasingly popular product called a “separately managed account”\(^9\); and

deception in the purchase and sale of securities, see Seth E. Lipner & Joseph Long, SECURITIES ARBITRATION DESK REFERENCE, at 612-714 (2007). The FINRA/NASD “suitability” rule is similarly tied to a transaction. See Rule 2310, discussed infra at n128. See also De Kwiatkowski v. Bear, Stearns & Co., Inc., 306 F.3d 1293 (2d Cir. 2002) (holding that a broker who gave advice to customer regarding securities transactions did not give rise to duty to advise in the future or between transactions, or to monitor all data potentially relevant to customer’s investment)

\(^8\) See text and notes accompanying n.128-141, infra.

(c) advice not related to securities purchases, *(e.g. to retire or change jobs based on careless advice regarding the value of an annuity)*\(^{10}\);

(4) Some states, including New York, do not recognize the existence of a broad fiduciary duty for those providing investment advice on a non-discretionary basis.\(^{11}\)

existence of at least 30 arbitration awards in cases where an investor alleged negligence or misrepresentation in connection with the Merrill Lynch “Consults” program. See Finra.org. There must have been many more such cases which were compromised prior to award. The application of the tort of negligent misrepresentation in to this context is discussed at text and notes accompanying n. 237-245, infra.


\(^{11}\) In a discretionary account, the investment advisor holds power of attorney and makes the investment decisions; in a non-discretionary account, the advisor makes recommendations and provides advice, but the investor makes the final decision on whether to buy, sell or hold a particular security. See *Henricksen v. Henricksen & Smith Barney*, 640 F.2d 880 (7th Cir. 1981); *Leib v. Merrill Lynch*, 461 F. Supp. 951 (E.D. Mich. 1978). See generally, N.POSER, BROKER-DEALER LAW AND REGULATION (3d ed. Supp. 2002), at pp. 2-3. In the former case situation, all states impose a fiduciary duty on the advisor; in the latter, some states do and others do not. See discussion in *Marchese v. Nelson*, 809 F.Supp. 880 (D.Utah1993). For cases holding there is no fiduciary duty, see, *e.g.*, *Press v. Chem. Inv. Servs. Corp.*, 166 F.3d 529, 536 (2d Cir.1999) (broker's fiduciary duty is limited to the “narrow task of consummating the transaction requested”); *Independent Order of Foresters v. Donald, Lufkin & Jenrette, Inc.*, 157 F.3d 933, 940-41 (2d Cir.1998) (in a nondiscretionary account, “the broker's
Recognition of a negligence-based tort regime for investment professionals making investment recommendations requires such professionals to exercise due diligence with regard to any representation or recommendation even when a fiduciary duty is absent.\textsuperscript{12}

Courts around the nation are now recognizing a tort of negligent misrepresentation in the area of advice provided by investment brokers and advisors. This article will demonstrate that the cases applying the “negligent misrepresentation” doctrine in that context have created a sub-species of the tort which this article asserts can be termed the tort of “giving negligent investment advice.”

This article will first review the genesis of the tort of negligent misrepresentation (Part I), particularly by examining the series of cases in the New York Court of Appeals that began with \textit{MacPherson v. Buick}\textsuperscript{13} and ended with \textit{Ultramares v. Touche}.\textsuperscript{14} These

\begin{itemize}
\item See text and notes accompanying n. 219 infra.
\item 111 N.E 1050 (1916).
\item 174 N.E. 441 (1931).
\end{itemize}
two cases, familiar to all lawyers from their law-school class on torts, serve as a useful introduction. They demonstrate how the law addressed and ultimately distinguished cases involving “dangerous” machinery (the car) and cases involving the negligent provision of information. In these early cases, the influence and unique prose of Judge Cardozo provide a colorful background, but they also set the stage for years of controversy.

In Part II, the article examines how the tort created in those New York became the law around the country. In particular, Part II(A) examines the adoption of § 552 of the Restatement of Torts (Second) in 1977, recognizes a tort of “providing negligent information.” In Part II(B), certain cases from around the country by reference to Restatement § 552 are examined, with an emphasis on how Restatement § 552 has been applied to cases involving the provision of financial information and advice.

In Part III, the examination returns to New York, where Restatement § 552 has not been adopted. The focus here is again the way the negligent misrepresentation tort applies to investment advice, but the study reveals a legal rubric that appears to be different from the approach of the Restatement and the other states. Part III thus closely examines New York’s treatment of the subject. That examination is necessary because New York is an important jurisdiction for financial services cases. The center of the financial services community is in New York, so that is where many of these cases occur. In addition, many securities firms employ boilerplate written agreements with that require the application of New York law to their dealings with their clients. There are thus many New York court decisions worthy of study, and the New York cases are instructive as to the establishment of a tort of giving negligent investment advice.
Last, in Part IV, the article compares New York law to that of the Restatement, demonstrating that the differences in approaches are semantic and not substantive, and that the tort of giving negligent investment advice is firmly established in the laws of our 50 states.

In sum, this article will explore how both the nation and New York have adapted the tort of negligent misrepresentation to the context of investment advice, tracing its development from its creation in *MacPherson v. Buick* to its refinement in the Restatement of Torts, to its use today. The article will demonstrate how the tort of negligent misrepresentation has matured into a tort of giving negligent investment advice.

**PART I: Birth of a Tort: How It All Began**

New York’s hesitancy liberally to apply the tort of negligent misrepresentation for information given is, somewhat oddly, rooted in three cases from the days of Judge Cardozo. Four cases, *MacPherson v. Buick*,\(^{15}\) *Glanzer v. Shepard*,\(^{16}\) *International Products v. Erie R Co*,\(^{17}\) and *Ultramares v. Touche*,\(^{18}\) set in motion a chain of events that would ultimately divide New York law from that of the rest of the country.

\(^{15}\) 111 N.E. 1050.

\(^{16}\) 135 N.E. 275 (1922).

\(^{17}\) 155 N.E. 662 (1927).

\(^{18}\) 174 N.E. 441.
Once upon a time, in the days of the 1842 decision in *Winterbottom v. Wright*, privity of contract was the key to a suit for the negligent sale of a defective product. In that case, Wright contracted with the Postmaster-General of England to supply horse-drawn coaches for carrying the mail. Winterbottom, a passenger in one such coach, sued Wright after he was injured when the coach broke down. In this case of apparent first impression, the English Court of Exchequer declined to find liability against Wright. The court held that the defendant could not be held liable because there was no privity of contract between the parties. The court reasoned that to hold otherwise may result in an “infinity of actions,” providing every coach passenger and passerby along the road with a viable claim against the lessor of the vehicle.

A. *MacPherson*

But in 1916, in *MacPherson v. Buick*, Judge Cardozo, writing for the New York Court of Appeals, held the English rule to be inapplicable:

If the nature of a thing is such that it is reasonably certain to place life and limb in peril when negligently made, it is then a thing of danger. Its nature gives warning of the consequences to be expected. If to the element of danger there is added knowledge that the thing will be used by persons other than the purchaser, and used without new tests then, irrespective of contract, the manufacturer of this thing of danger is under a duty to make it carefully. That is as far as we are required to go for the decision of this case. There must be knowledge of a danger, not merely possible, but probable. It is possible to use almost anything in a way that will make it dangerous if defective. That is not enough to charge the manufacturer with a duty independent of his contract. Whether a given thing is dangerous may be sometimes a question for the court and sometimes a question for the jury. There must also be knowledge that in the usual course of events


20 111 N.E. 1050.
the danger will be shared by others than the buyer. Such knowledge may often be inferred from the nature of the transaction. But it is possible that even knowledge of the danger and of the use will not always be enough. The proximity or remoteness of the relation is a factor to be considered. We are dealing now with the liability of the manufacturer of the finished product, who puts it on the market to be used without inspection by his customers. If he is negligent, where danger is to be foreseen, a liability will follow. 21

In this earth-moving paragraph, Judge Cardozo began a series of legal changes that Cardozo termed an “assault on the citadel of privity”. 22 But the inception of a negligence paradigm for “sellers” created policy concerns; if privity provided no limit on the scope of potential plaintiffs, what did? The decisions following MacPherson suggest that Cardozo had several such limits in mind, including the knowledge of the parties, dangerousness of the product, the proximity/remoteness of the relationship between the parties to the suit. But it would, of course, be left to those later cases to define with precision how these limits would be invoked.

Following MacPherson, American product-liability law emerged as its own branch of torts. 23 But the new jurisprudence introduced in MacPherson opened the door to a related issue -- the liability of “sellers” of information, as opposed to sellers of “chattels” like the car involved in MacPherson or the coach in Winterbottom. That issue - - and cases involving the provision of information as distinct from products -- soon reached the New York Court of Appeals.

21 Id. at 1051.

22 Ultramares, 255 N.Y. at 180 (“the assault upon the citadel of privity is proceeding in these days apace.”)

B. *Glanzer*

The first such case to reach the Court was *Glanzer v. Shepard*. The seller of beans requested that a firm of “public weighers” weigh the beans and supply the purchaser with a copy of the certificate. In reliance on the certificate, the purchaser overpaid for the beans. The public weighers were held liable for the overpayment in another opinion by Judge Cardozo:

> The defendants held themselves out to the public as skilled and careful in their calling. They knew that the beans had been sold, and that on the faith of their certificate payment would be made. They sent a copy to the plaintiffs for the very purpose of inducing action. . . .

> There is nothing new here in principle. If there is novelty, it is in the instance only. . . . It is ancient learning that one who assumes to act, even though gratuitously, may thereby become subject to the duty of acting carefully, if he acts at all.[citations omitted] . . . . The controlling circumstance is not the character of the consequence, but its proximity or remoteness in the thought and purpose of the actor.

> . . . We must view the act in its setting, which will include the implications and the promptings of usage and fair dealing. The casual response, made in mere friendliness or courtesy . . . may not stand on the same plane, when we come to consider who is to assume the risk of negligence or error. . . . The line of separation between these diverse liabilities is difficult to draw. It does not lose for that reason its correspondence with realities. Life has relations not capable always of division into inflexible compartments. The molds expand and shrink.

> . . . The defendants, acting, not casually nor as mere servants, but in the pursuit of an independent calling weighed and certified at the order of one with the very end and aim of shaping the conduct of another. Diligence was owing, not only to him who ordered, but to him also who relied.

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24 135 N.E. 275 (1922)

25 *Id.* at 276

26 *Id.*

27 *Id.* at 276-77.
C. **International Products**

The law seemed to be heading toward a single paradigm for “negligent misrepresentation” cases. And five years later, the Court seemed only to be refining the area. In *International Products v. Erie RR Co.*, 155 N.E. 626 (1927), the defendant was alleged to have carelessly told the plaintiff that certain of plaintiff’s goods had already reached its warehouse in New Jersey; the plaintiff relied on that information procuring insurance for the goods, but it turned out that the goods had not yet arrived in New Jersey. The incorrect information provided by defendant misdescription resulted in there being no insurance coverage when half the goods were destroyed by a fire.

Writing for the Court, Judge Andrews confronted the issue relating to the negligent provision of information by defendant:

> Confining ourselves to the issues before us, we eliminate any theory of fraud or deceit. . . . We come to the vexed question of liability for negligent language.
>
> In New York, . . . [i]n some cases a negligent statement may be the basis for a recovery of damages. . . .
>
> Obviously, however, the rule we have adopted has its limits. Not every casual response, not every idle word, however damaging the result, gives rise to a cause of action. . . . Liability in such cases arises only where there is a duty, if one speaks at all, to give the correct information. And that involves many considerations. There must be knowledge, or its equivalent, that the information is desired for a serious purpose; that he to whom it is given intends to rely and act upon it; that, if false or erroneous, he will because of it be injured in person or property. Finally, the relationship of the parties, arising out of contract or otherwise, must be such that in morals and good conscience the one has the right to rely upon

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28 155 N.E. 626 (1927).

29 *Id.* at 662-63.
the other for information, and the other giving the information owes a duty to give it with care. [citation omitted]. . . .

When such a relationship as we have referred to exists may not be precisely defined. All that may be stated is the general rule. In view of the complexity of modern business, each case must be decided on the peculiar facts presented. The same thing is true, however, in the usual action for personal injuries. There whether negligence exists depends upon the relations of the parties, the thing done or neglected, its natural consequences, and many other considerations. No hard and fast line may be drawn.\textsuperscript{30}

Despite the analogy to cases of personal injuries, the Court’s decision in fact suggested a limits to the newly-minted tort of negligent misrepresentation of information. The Court identified four conditions for application:

(1) knowledge, or its equivalent, that the information was desired for a “serious,” as opposed to a casual, purpose;\textsuperscript{31}

(2) that the information was given with the intention that it will be relied and acted upon;\textsuperscript{32}

(3) that, if the information was false or erroneous, he will be injured in person or property;\textsuperscript{33} and

(4) that, the relationship of the parties be such that “in morals and good conscience the one has the right to rely upon the other for

\textsuperscript{30} \textit{Id.} at 663-64 (emphasis added).

\textsuperscript{31} \textit{Id.} at 664. The Restatement will adopt an alternate phrase requiring that the speaker have a “pecuniary interest”. See notes and accompanying n. 49, 53-55, \textit{infra}.

\textsuperscript{32} \textit{Id.}

\textsuperscript{33} \textit{Id.} The distinction, or rather the lack thereof, between personal injuries and economic injury in this context was not new; \textit{Glanzer}, of course, involved injury to the plaintiff’s business. See \textit{Glanzer}, 135 N.E. at 276.
information, and the other giving the information owes a duty to give it with care.”34

The elements of the tort as described in *International Products* display a practical blend of contract and tort. It is a claim that sounds in negligence but that also has elements of reliance and deceit. But, as the italicized phrase indicates, embedded in the Court’s refinement of *MacPherson* and *Glanzer* is a new and variable factor -- a reference to “morals and good conscience”, and an invitation to an inquiry as to what types of relationships create a “duty to give [information] with care.”35

Was the Court describing a legal limit of the new tort, or was it simply describing, in other terms, conclusions to be drawn from the elements of “seriousness” and “reliance”? Aside from public weighers and warehousemen, what other types of businesses have a duty to provide information “with care”? The Court does not say, leaving the determination to an examination of facts and circumstances.36

34 155 N.E.2d at 664.

35 *Id.*

36 The creation of this additional requirement has raised a procedural question as to whether the determination is for the court or the jury. The New York Court of Appeals recently described proper the allocation of responsibility for that determination:

> Liability for negligence may result only from the breach of a duty running between a tortfeasor and the injured party. Although the existence of a duty is an issue of law for the courts once the nature of the duty has been determined as a matter of law, whether a particular defendant owes a duty to a particular plaintiff is a question of fact.

D. **Ultramares**

The last decision on the subject from Cardozo’s Court was *Ultramares Corp. v. Touche.* The profession involved was accountancy, so the question raised by International Products was not addressed in detail, since accountancy seems easily to qualify as a profession in which there is a duty generally to impart information with care. But *International Products,* as well as *Glanzer,* were discussed at length, as the Court reviewed the case law in search of a way to limit the zone of potential liability as a result of third-party reliance on a negligently created financial statement.

The decision thus explains:

> If liability for negligence exists, a thoughtless slip or blunder, the failure to detect a theft or forgery beneath the cover of deceptive entries, may expose accountants to a liability in an indeterminate amount for an indeterminate time to an indeterminate class. The hazards of a business conducted on those terms are so extreme as to enkindle doubt whether a flaw may not exist in the implication of a duty that exposes to these consequences. . . .

> [I]f there has been neither reckless misstatement nor insincere profession of an opinion, but only honest blunder, the ensuing liability for negligence is one that is bounded by the contract, and is to be enforced between the parties by whom the contract has been made. We doubt whether the average business man receiving a certificate without paying for it and receiving it merely as one among a multitude of possible investors, would look for anything more.

The decision, penned by the great judge (by then Chief Judge), is a Cardozo classic, blending legal philosophy and flowery language with an innate sense of practical

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37. 174 N.E. 441 (1931).

38. *Id.* at 445-48.

39. *Id.* at 444, 448.
business necessity. It would add an important limit on the new tort, a limit that most courts and legal scholars would ultimately reject.

Acting as a public accountant, Touche had prepared an audited financial statement for its client, the Stern Companies.\footnote{Id. at 442-43.} Stern (Touche’s client) used that financial statement to obtain a loan from Ultramares Corp., who relied on Touche’s accounting work.\footnote{Id. at 443-44.} In dismissing Ultramares’ claim of negligence against Touche, Cardozo wrote:

In the field of the law of torts a manufacturer who is negligent in the manufacture of a chattel in circumstances pointing to an unreasonable risk of serious bodily harm to those using it thereafter may be liable for negligence though privity is lacking between manufacturer and user. [citing MacPherson v. Buick Motor Co. and the recently-promulgated Restatement of Torts] . . . Even so, the question is still open whether the potentialities of danger that will charge with liability are confined to harm to the person, or include injury to property. . . . We are now asked to say that a like liability attaches to the circulation of a thought or a release of the explosive power resident in words. . . .

In Glanzer v. Shepard, the seller of beans requested the defendants, public weighers, to make return of the weight and furnish the buyer with a copy. . . . Here was something more than the rendition of a service in the expectation that the one who ordered the certificate would use it thereafter in the operations of his business as occasion might require. Here was a case where the transmission of the certificate to another was not merely one possibility among many, but the ‘end and aim of the transaction,’ . . . . The bond was so close as to approach that of privity, if not completely one with it. Not so in the case at hand. . . . Foresight . . . may charge with liability for fraud. The conclusion does not follow that it will charge with liability for negligence.

. . . [N]othing in our previous decisions commits us to a holding of liability for negligence in the circumstances of the case at hand, and that such liability, if recognized, will be an extension of the principle of those decisions to different conditions, even if more or less analogous. The question then is whether such an extension shall be made. . . . [N]egligence

\footnote{Id. at 442-43.}

\footnote{Id. at 443-44.}
alone is not a substitute for fraud. . . . A change so revolutionary, if expedient, must be wrought by legislation.  

Legislation, needless to say, was not forthcoming. The newly-born tort of giving negligent information had been quickly circumscribed by a limit based on neither knowledge nor foreseeability of the information’s intended use.

Even as other states would adopt the principles of *MacPherson*, they would decline to adopt the limitation of *Ultramares*. But in New York, when it came to the provision of information, Cardozo left the new tort subject to a requirement of a “bond . . . so close as to approach that of privity, if not completely one with it.” And there it would more-or-less stay.

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42 *Id.* at 444-45. The Court discussed two other cases, *Jaillet v. Cashman*, 139 N. E. 714 (1923), and *Courteen Seed Co. v. Hong Kong & Shanghai Banking Corporation*, 157 N. E. 272, 273 (1927), describing them as the “anitidote” to *Glanzer and International Products*:

In [*Jaillet*] . . . the defendant supplying ticker service to brokers was held not liable in damages to one of the broker's customers for the consequences of reliance upon a report negligently published on the ticker. If liability had been upheld, the step would have been a short one to the declaration of a like liability on the part of proprietors of newspapers. In [*Courteen*], the principle was clearly stated by Pound, J., that ‘negligent words are not actionable unless they are uttered directly, with knowledge or notice that they will be acted on, to one to whom the speaker is bound by some relation of duty, arising out of public calling, contract or otherwise, to act with care if he acts at all.’

*Id.* at 445.

43 See Restatement (Second) of Torts § 552(1) and (2), discussed at note ***, infra.

44 *Id.* at 445.
PART II: The Tort’s Confirmation: § 552 of the Restatement of Torts

A. Restatement § 552

The first Restatement of Torts contained extensive material on negligent misrepresentation in the context of the “bodily harm,” and a single section on the subject of the regarding the negligent provision of information causing economic loss.

§ 552. Information Negligently Supplied for the Guidance Of Others
One who in the course of his business or profession supplies information for the guidance of others in their business transactions is subject to liability for harm caused to them by their reliance upon the information if
(a) he fails to exercise that care and competence in obtaining and communicating the information which its recipient is justified in expecting, and
(b) the harm is suffered
   (i) by the person or one of the class of persons for whose guidance the information was supplied, and
   (ii) because of his justifiable reliance upon it in a transaction in which it was intended to influence his conduct or in a transaction substantially identical therewith.

The third-party beneficiary origins of the tort are plainly evident in subsection (b), but, aside from those limits on the class of potential plaintiffs, the section is broadly worded and simple - care is to be exercised “in obtaining and communicating” information. The only limit on the class of potential defendants is that the information be

45 See Restatement of Torts §§ 304 and 311 (1934).

46 Restatement of Torts § 552 (1938)

47 See Ultramares, 174 N.E. at 445, where Cardozo analogized the tort to the famous third party beneficiary cases Lawrence v. Fox, 20 N. Y. 268 (1859) and Seaver v. Ransom, 120 N. E. 639 (1918).
provided “in the course of his business or profession supplies information for the
guidance of others in their business transactions.” 48

In 1977, when the American Law Institute promulgated the Restatement (Second)
of Torts, they adopted a slightly-revised §552. Again titled “Information Negligently
Supplied for the Guidance of Others”, the Restatement (Second) Torts § 552 provides:

(1) One who, in the course of his business, profession or
employment, or in any other transaction in which he has a
pecuniary interest, supplies false information for the guidance of
others in their business transactions, is subject to liability for
pecuniary loss caused to them by their justifiable reliance upon the
information, if he fails to exercise reasonable care or competence
in obtaining or communicating the information.

(2) Except as stated in Subsection (3), the liability stated in
Subsection (1) is limited to loss suffered by the person or one of a
limited group of persons for whose benefit and guidance he intends
to supply the information or knows that the recipient intends to
supply it; and through reliance upon it in a transaction that he
intends the information to influence or knows that the recipient so
intends or in a substantially similar transaction.

(3) The liability of one who is under a public duty to give the
information extends to loss suffered by any of the class of persons
for whose benefit the duty is created, in any of the transactions in
which it is intended to protect them.

Restatement § 552 contains many elements present in the Cardozo-era New York
cases and in the Restatement (First) of Torts. 49 The only real divergence between the two
Restatements lies in the formulation of the class of potential plaintiffs - the Second

48 Id. at § 552.

49 There are some subtle changes, however. See, e.g. insertion of the “pecuniary
interest” language. See discussion at text and n. accompanying n. 53 to 55, infra.
Restatement rejects the *Ultramares* passion for “privity” in favor of a more-expansive approach. But the scope of potential defendants was largely unchanged.

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50 See Restatement (Second) of Torts § 552(2). Indeed, subsection (3) goes further, stating a special, expanded class of potential plaintiffs where the information provider is under a “public duty to give the information.” An even broader view of the tort of negligent misrepresentation than that contained in the Restatement is to employ a foreseeability test like that used in ordinary negligence cases and that articulated in *MacPherson v. Buick Motor Corp.* 217 N.Y. at 390 (“[T]he presence of a known danger, attendant upon a known use, makes vigilance a duty. We have put aside the notion that the duty to safeguard life and limb, when the consequences of negligence may be foreseen, grows out of contract and nothing else. We have put the source of the obligation where it ought to be. We have put its source in the law.” *Id.* The judicial debate concerning the applicability of either the strict privity, foreseeability or Restatement of Torts (Second) § 552 approach in the context of negligent misrepresentation claims generally occur most often in the context of accountant liability to non-client third parties. Although the foreseeability approach has not gained much momentum in the context of the provision of negligent information, a small minority of jurisdictions have adopted the approach in that context, explaining that they see no reason to differentiate between different suppliers of products or services to the public. *See e.g., Rosenblum Inc. v. Adler*, 461 A.2d 138 (N.J. 1983) (adopting the foreseeability approach in the accountant context); *Citizens State Bank v. Timm, Schmidt & Co.*, 335 N.W.2d 361 (Wis. 1987) (same); *Touche Ross v. Commercial Union Ins.*, 514 So. 2d 315 (Miss. 1987) (same in dicta). Generally, these courts have articulated public policy arguments, such as risk-spreading and deterrence, in support of the foreseeability test. *See Rosenblum Inc. v. Adler*, 461 A.2d at 152 and *Citizens State Bank v. Timm, Schmidt & Co.*, 335 N.W.2d at 366-367. Obviously, this approach casts a much broader net than the privity or near privity approach, providing potential recovery to a much larger group of parties injured by negligently made statements. Thus, many courts have criticized the foreseeability test because of its potential for unlimited and indeterminate liability and chilling effect on the flow of commercial information. *See e.g., Credit Alliance Corp. v. Arthur Andersen & Co.*, 65 N.Y.2d 536, 548, 493 N.Y.S.2d 436, 441 (explaining that there should be privity in the accountant context because otherwise the accountant would be exposed to unlimited and uncertain liability for a negligently prepared report); *Raritan River Steel Co. v. Cherry, Bekaert & Holland*, 367 S.E.2d 609, 615 (N.C. 1988) (expressing concern that the “reasonably foreseeable” test could result in liability much more expansive than an accountant could bear); *Haberman v. Wash. Pub. Power Supply Sys.*, 109 Wn.2d 107 (Wash. 1987), appeal dismissed 488 U.S. 805 (1988) (Applying the Restatement (Second) of Torts § 552, the court set forth the following scenarios where liability may be imposed for negligent misrepresentation beyond the intended recipient of the information: where “(1) the defendant has knowledge of the specific injured party’s reliance; or (2) the plaintiff is a member of a group that the defendant seeks to influence; or (3) the defendant has special reason to know that some member of a limited group will rely on the information.” *Id.* at 162-63).
The elements of the tort, as laid out in the Restatement, are:

(a) that the provider act either in the course of the provider’s business, profession or employment or otherwise have a pecuniary interest in the information supplied;

(b) that he provides “information for the guidance of others in their business transactions”;

(c) that the recipient of the information justifiably rely on it;

(d) that the provider fails to exercise due care regarding the information provided; and

(e) that the recipient suffers pecuniary loss as result of the falsity of the information.

§ 552 of the Restatement (Second) of Torts has been adopted or endorsed by courts in nearly every state other than New York. How this tort would be applied in the financial services arena is addressed in the next Section. New York’s unique approach is considered in Part III.


See n.52, infra.
B. State Law Applying Restatement (Second) § 552 in Investment Cases

Applying Restatement (Second) § 552, most states have recognized a tort based on negligently providing false information, commonly termed “negligent misrepresentation,” and sometimes called “innocent misrepresentation.” The tort has been recognized and applied in cases involving a variety of investment cases.52 This

section analyzes a sample of those cases, demonstrating how courts have applied the elements of Restatement § 552 in that context.

1. “Pecuniary Interest”

Incorporating elements of Glanzer and International Products, the Restatement requires that the supplier of information have a pecuniary interest in the transaction in

order for liability to attach. Where the information is not provided in connection with one’s own business or profession, Comment (d) explains that the pecuniary interest in supplying information can still be found. The Restatement Comment further explains that there are situations where the supplier of information receives no direct remuneration, but nevertheless stands to benefit, giving as one example an officer of a corporation who supplies information about the company.”

In *Private Mortgage Investment Services, Inc. v. Hotel and Club Associates, Inc.*, a case involving a real estate appraiser. The Fourth Circuit explained the rationale for imposing a duty of care on all those who provide information for pecuniary gain:

> [A]s with accountants, the Restatement (Second) of Torts' approach represents the soundest method of determining the scope of a professional real estate appraiser's duty to third persons for negligent misrepresentation because it balances the need to hold professional real estate appraisers to a standard that accounts for their contemporary role in the financial world with the need to protect them from liability that unreasonably exceeds the bounds of their real undertaking.

2. **“In the Business of Supplying Information for the Guidance of Others”**

Importantly, for Restatement § 552 to apply, the supplier must be the “in the business of supplying information for the guidance of others”, and that element has led to

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Comment (d). The comment offers, at the other extreme, an attorney giving a casual opinion to a friend, or in cases involving what is referred to as “curbside opinion”, the duty of diligence does not attach. See generally *International Products*, 155 N.E. at 664 (“Not every casual response, not every idle word, however damaging the result, gives rise to a cause of action.”)

296 F.3d 308 (4th Cir. 2002).

*Id.* at 314.
litigation in the context of investment advice.\(^{56}\) For example, in *Penrod v. Merrill Lynch*,\(^{57}\) a customer of a brokerage firm sued to recover losses allegedly incurred after

following negligently-given advice from a broker. The defendant challenged the attempt to impose a duty based upon the giving of investment advice. While the court did not find that the broker in that case had breached his duty of care, it did hold that the broker and brokerage firm were in the business of supplying information, and that Restatement §522 was thus applicable. In so ruling, the court found it notable that the brokerage firm in *Penrod* not only provided its customers with information, but also provided a service of holding securities for its customers, and transferring the securities upon instructions from clients.

By comparison, in *National Union Fire Insurance Co. of Pittsburgh v. Continental Illinois Corp.*, information given by a bank to an insurance company as part of its application for insurance policies was alleged to have been false, and that the bank was negligent in imparting it. The court held that even though banks are generally in the “information” business, the bank was not generally in the business of supplying

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58 *Id.* at 377-379

59 *Id.* at 380

60 *Id.* at 381

61 *Id.* At 381-82. See also *Zurad v. Lehman Bros. Kuhn Loeb*, 757 F.2d 129 (7th Cir. 1985) (omission by investment firm of the high degree of risk was a breach of “the duty to exercise reasonable care in obtaining and relaying information to guide Zurad in her investment decisions.”)


63 *Id.* at 317.
information to insurance companies like the one involved here, and that the bank thus did not meet the “business of supplying information” test in that case.64

In *Rankow v. First Chicago Corp.*,65 the plaintiff was a participant in a Dividend Reinvestment and Stock Purchase Plan (the “Plan”) provided to its shareholders by First Chicago Corp. The Plan permitted First Chicago's common stockholders to reinvest their dividends and make optional cash payments toward the purchase of more shares of common stock at five percent below the prevailing market price, without paying service charges or brokerage commissions. The plaintiff participated in the Plan; his investment strategy (which he alleged was known to First Chicago) involved acquiring shares at discount prices and immediately selling those shares on the open market. It was critical to plaintiffs’ profit/risk calculation that he have reliable information from First Chicago about the day and method on which the discounts would be calculated.66

The rules and methods governing the determination of the method and day the discount would be determined were set forth in the Plan prospectus, which First Chicago amended from time-to-time. But contrary to the method disclosed in the then-current Prospectus, First Chicago used a different date-setting methodology without advising Plan participants, a difference that resulted in a higher price being charged to the plaintiff. Ignorant of the change and relying First Chicago’s representation as to how it would compute the discount, plaintiff sold more shares of stock then he had obtained. The plaintiff wound up having to later buy additional shares at even higher prices to cover

64 Id. at 317-18.

65 870 F.2d 356 (7th Cir. 1989).

66 Id. at 357-58
their sales, and he alleged damage as a result of First Chicago’s negligently false representation about its computation method.\(^67\)

The district court dismissed the negligent misrepresentation claim on the ground that Illinois law only permits recovery for purely economic loss under a negligence theory when the defendant is “in the business of supplying information for the guidance of others in their business transaction,” holding that First Chicago did not meet this requirement.\(^68\)

But the Seventh Circuit disagreed and found that First Chicago was “in the business of supplying information” under Restatement § 552.\(^69\) The court described the two poles from which the analysis should proceed. First, there are those who deal only in tangible products or non-informational services - who are deemed not to be in the business of supplying information.\(^70\) Even though such businesses are tangentially involved in supplying information, they are not within the class of businesses governed by § 552. The court explained:

> Obviously, a great many businesses involve an exchange of information as well as of tangible products - manufacturers provide operating or assembly instructions, and sellers provide warranty information of various kinds. But if we ask what the product is in each of these cases, it becomes clear that the product (a building, precipitator, roofing material, computer or

\(^67\) Id.


\(^69\) 870 F.2d at 365.

\(^70\) Id. at 363-64.
software) is not itself information, and that the information provided is merely incidental.\footnote{Id. at 364. Cf. Ultramares, where Cardozo compared two of the seminal New York cases:}

At the other extreme, are those who are clearly in the business of supplying information:

Real estate brokers and termite inspectors would seem to fall fairly clearly into a category at the opposite end of a continuum beginning with manufacturers dealing only in tangible goods; brokers and inspectors arguably provide information only. If we ask what the product is in these cases, the answer is obviously “information,” whether about the housing market or about termite infestations.\footnote{Rankow, 870 F. 2d at 364. Arguably, the greatest extension of the doctrine was in Sain v. Cedar Rapids Community School District, 626 N.W.2d 115 (Iowa 2001). In that case, the Iowa Supreme Court ruled that a high school guidance counselor was involved in the business of proving information, and thus subject to potential liability for negligently advising a student about the courses that would qualify for college athletic eligibility.}

In a footnote, the court continued:

\footnote{Id. at 364. Cf. Ultramares, where Cardozo compared two of the seminal New York cases: In one respect the decision in International Products Co. v. Erie R. R. Co. is in advance of anything decided in Glanzer v. Shepard. The latter case suggests that the liability there enforced was not one for the mere utterance of words without due consideration, but for a negligent service, the act of weighing, which happened to find in the words of the certificate its culmination and its summary. This was said in the endeavor to emphasize the character of the certificate as a business transaction, an act in the law, and not a mere casual response to a request for information. The ruling in the case of the Erie Railroad shows that the rendition of a service is at most a mere circumstance and not an indispensable condition. The Erie was not held for negligence in the rendition of a service. It was held for words and nothing more. So in the case at hand. If liability for the consequences of a negligent certificate may be enforced by any member of an indeterminate class of creditors, present and prospective, known and unknown, the existence or nonexistence of a preliminary act of service will not affect the cause of action. The service may have been rendered as carefully as you please, and its quality will count for nothing if there was negligence thereafter in distributing the summary. 174 N.E. 444 [emphasis added].}{71}
The issue is obviously whether or not the product is information, not whether or not it is tangible. We use businesses dealing in tangible goods as an example here for two reasons: first, they provide the clearest case of non-informational products (because the transfer of intangible products and services more often depends heavily upon an exchange of information); and second, they are the only examples we have from the Illinois courts of businesses that have been held not to be in the business of providing information.\textsuperscript{73}

But, the court wrote:

[b]etween these two extremes lies . . . more difficult cases, involving defendants whose business it is to provide both tangible (or other non-informational goods or services) and information. Financial services such as those provided by banks and stockbrokers present a particularly difficult problem, because there is a very thin line between an exchange of information about finances and actual financial transactions . . . [citation omitted] That is why, as noted at the outset, it is particularly important in these settings to examine the particular information and transactions involved case by case.”\textsuperscript{74}

The court then considered such “mixed” cases, where both goods (or services) and information were exchanged.\textsuperscript{75} In one such case reviewed by the court, a seller of paintings prepared detailed “provenances” for the artwork it sold. The court stated “these provenances were an important part of the product provided by the seller, and because they were provided in that case with full knowledge that the buyer would use them in future resale transactions, the ‘business of supplying information’ test was met.”\textsuperscript{76} The

\textsuperscript{73} \textit{Id.}

\textsuperscript{74} \textit{Id.} (emphasis in original). \textit{See also Continental Leavitt Communications, Ltd. v. PaineWebber, Inc.}, 857 F. Supp. 1266, 1271 (N.D. Ill. 1994) (brokerage firms are not always acting in the capacity of providers of information.)

\textsuperscript{75} \textit{Rankow}, 870 F. 2d at 364

\textsuperscript{76} \textit{Id.}, citing \textit{Duchossois Indus. v. Stelloh}, 1988 WL 2794 (N.D. Ill. 1988).
court also cited *Penrod*, noting that “for the purposes of the “business of providing information” test, there is little difference between this combined exchange of financial services and information and that provided by First Chicago (except that securities may be more obviously the principal business of a stockbroker than of a bank).”

With respect to First Chicago, the court held that it was indeed in the business of supplying information because:

> Information provided to Plan participants regarding pricing dates . . . [was] clearly part of the product provided by First Chicago . . . [T]he information about pricing dates provided to the plaintiffs by First Chicago . . . was an important part of the product if offered – a financial service. Further, the information in this case . . . was provided with full knowledge that it would be used in guiding the plaintiffs in their business transactions with third parties. . . . [A]lthough the information in this case was provided by First Chicago to its stockholders rather than its customers, these differences are not sufficiently decisive to relieve First Chicago of liability.”

Not all financial service providers, however, are necessarily within the category defined by the Restatement. For example, at least one court has found that insurance salesman are not in the business of supplying information. In *Gerdes v. John Hancock Mutual Life Insurance Co.*, the court held that plaintiffs did not satisfy this element merely by alleging that the agent was an “insurance producer” who sold Hancock insurance policies to them. The court, however, also stated that it was unable to determine based on these allegations whether the nature of the agent’s business was to supply information and whether he was engaging in the business when he made the

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77 *Id.*

78 *Id.*

alleged misrepresentations to the plaintiffs.\textsuperscript{80} The court explained that the agent could have been acting in his insurance agent capacity selling insurance policies only, in which case the nature of his business was to provide a non-informational product and any information he may have provided would have been incidental to the sale of the product. It was, however, also plausible that the agent was an independent insurance broker who sold policies for numerous insurance companies, in which case the nature of the agent’s business may have been to provide information as well as a non-informational product. “[T]he issue would be whether the information provided was a significant aspect or ‘important part’ of the product offered.”\textsuperscript{81} These were questions within the province of the jury.

But in the ordinary case involving securities sales and investment professionals, the Restatement’s threshold requirement would seem to be satisfied. For example, in\textit{ Zurad v. Lehman Bros. Kuhn Loeb},\textsuperscript{82} the complaint alleged an omission by an investment firm concerning the recent market price, a quick rise due to merger speculation, and the fact that trading had been twice suspended. The court wrote:

\begin{quotation}
\textsuperscript{80} \textit{Id.} at 700.
\end{quotation}

\begin{quotation}
\textsuperscript{81} \textit{Id.} The court suggested that if the agent was paid and controlled directly by Hancock, he would be classified as an insurance agent and plaintiffs could not maintain a negligent misrepresentation claim against him because Hancock would have been the agent’s principal during the exchange negating the possibility that Hancock was a third party. \textit{Id.} By contrast, if the agent was acting as a broker independent of Hancock, Hancock would have been a third party with whom plaintiffs transacted business while guided by the agent’s representations. The court noted that the fact that the agent received commissions from Hancock would not alone preclude his being classified as an insurance broker. \textit{Id.}
\end{quotation}

\begin{quotation}
\textsuperscript{82} 757 F.2d 129 (7th Cir.1985).
\end{quotation}
[T]he failure to supply that highly significant information while advising Zurad to purchase the stock was a breach of . . . duty to exercise reasonable care in obtaining and relaying information to guide Zurad in her investment decisions. The omission of this information, coupled with the information [defendant] did give Zurad, amounted to a misrepresentation of the material facts relating to the degree of speculation involved in the purchase of the Heller stock. Merely advising Zurad against investing all her funds in Heller, without more, did not fulfill his duty.

Considering the difference in their positions and familiarity with the market, we cannot escape the conclusion that it was [defendant’s] duty to give her . . . information. She was entitled to consider that [information] in evaluating the risk undertaken, . . . [Defendant’s] Office Manager admitted at trial that the purchase . . . was not suitable for a person of Zurad's income and net worth.  

_Zahorik v. Smith Barney Harris Upham Co., Inc._  

concerned the sale to the plaintiff of a limited partnership interest in Alpha Energy 1981-A Drilling Program (“Alpha-1981”), an oil and gas drilling program. Zahorik alleged that Smith Barney employees advised him of Alpha-1981 and solicited his investment. Smith Barney provided Zahorik with a “private placement memorandum” which Smith Barney had played a significant role in authoring, reviewing and editing. After reviewing the memorandum, Zahorik decided to invest $75,000 to purchase one-half of a unit of Alpha-1981.  

Zahorik claimed that Smith Barney negligently made numerous misrepresentations or omitted material facts in its representations to him about the financial prospects of Alpha-1981, thus overstating the value of the program.

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83 _Id._ at 134.


85 _Id._ at 310
Smith Barney sought dismissal on the basis that Illinois law requires that a negligent misrepresentation claim must include an allegation that the defendant is in the “business of supplying information” for the guidance of others in their business transactions. The district court wrote:

we observe that securities brokers may be in an apparent hybrid situation with respect to whether their status is that of a seller of information or a seller of a tangible item. In some circumstances, a securities dealer may purely sell information regarding a potential investor's purchase of an interest in a particular company. Negligent misrepresentations made to the investor in the context of those types of transactions would be a legitimate basis for a negligent misrepresentation action under Illinois law. See, e.g., *Zurad v. Lehman Brothers Kuhn Loeb, Inc.*, [citation omitted] On the other hand, where the dealer simply acts as a selling agent for another party, a sort of informational conduit, and never purports to independently offer “information” regarding the investment potential, it may avoid liability for a negligent misrepresentation action.

The court in *Zahorik* ordered the plaintiff to amend the Complaint making allegations addressing the described requirements.

These cases, all from the Seventh Circuit and addressing Illinois law and Restatement §552 are exemplary of the path followed by most other states. Taken together, they establish that those who provide financial advice and guidance as to how to invest qualify for negligence-based liability.

3. **Opinion**

87 *Id.* at 313-14.

88 *Id.* at 314.

89 *Id.* at 314

90 See n. 52, supra.
The Restatement’s Official Comment (b) states that the rule “applies not only to information given as to the existence of facts but also to an opinion given upon facts equally known to both the supplier and the recipient.” Applying the Comment, in *Lawyers Title Ins. Corp. v. Baik*, the Washington Supreme Court explained that a negligent “opinion” can give rise to a claim:

> The respondents' approach to the “false information” element of a negligent misrepresentation claim would immunize all communications that were explicitly (or even arguably) presented as opinions. Every defendant would claim that he or she had accurately and truthfully stated his or her opinion, and the content of even the most negligently obtained opinion would go unexamined: whether the opinion had been derived by tossing a coin or consulting an astrologer would be of no consequence, so long as the letter accurately stated the opinions that those methods had yielded.

Courts have thus found justifiable reliance on an expression of opinion in such cases, but often these cases are associated with a finding that the defendant had specialized knowledge and access to information not available to the plaintiff. In

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91 Restatement (Second) Torts § 552, at cmt. b.

92 55 P.3d 619 (Wash. 2002).

93 *Id.* at 547. See also *Private Mortgage. Inv. Services, Inc. v. Hotel and Club Associates, Inc.*, 296 F.3d 308 (4th Cir. 2002) (opining that South Carolina would adopt Restatement § 552 Comment (b) as to opinions to a valuation be a real estate appraiser); *Memorial Hosp. of Laramie County v. Healthcare Realty Trust Inc.*, 509 F.3d 1225 (10th Cir. 2007) (applying Wyoming law, the court held that negligently-rendered opinions were actionable, although “promises and predictions” are not); *Milwaukee Partners v. Collins Engineers, Inc.*, 485 N.W.2d 274 (Wis.1992). But see *Repucci v. Lake Champagne Campground, Inc.*, 251 F.Supp.2d 1235 (D.Vt. 2002) (applying Vermont law that opinions are not actionable); *VNA Plus, Inc. v. Apria Healthcare Group, Inc.*, 29 F.Supp.2d 1253, 1265 (D. Kan.1998)(same, applying Missouri law); *Omega Eng’g, Inc. v. Eastman Kodak Co.*, 908 F.Supp. 1084, 1097 (D. Conn.1995) (same, applying Connecticut law).
Dowling v. Narragansett Capital Corp., 94 for instance, plaintiffs, former shareholders of defendant corporation, brought an action against the corporation, its directors and officers and certain stockholders for the sale of the corporation’s assets at what was alleged to be a grossly inadequate price. Plaintiffs alleged that the defendants orchestrated the sale for their own benefit and solicited the approval of the remaining shareholders without adequately informing them about the nature of the transaction. 95 Prior to the sale, a special meeting of the corporation’s shareholders was scheduled. The notice of the meeting was accompanied by a proxy statement in which the corporation’s board of directors recommended the sale as “fair” and in the “best interest of the stockholders.” 96 The recommendation was bolstered by an opinion from Salomon Brothers, Inc. (Salomon), an investment banking firm hired by the corporation, indicating that the proposed price fairly reflected the value of the corporation’s stock. 97

In addition to the claims asserted against the corporation and the individual defendants, plaintiffs also asserted a claim against Salomon for its alleged negligent misrepresentation of the adequacy of the sale price in its fairness opinion. 98

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95 Id. at 1109-11.
96 Id. at 1110.
97 Id.
98 Id. at 1111.
sought dismissal in part on the ground that plaintiffs could not justifiably rely on an expression of opinion versus an assertion of fact.\textsuperscript{99} The court disagreed explaining that:

\textit{[w]hile that argument may be valid in other situations, it is not when the opinion is expressed by an expert under circumstances implying that the speaker has unique access to facts which support the opinion. In such cases, the combination of specialized knowledge not possessed by the listener and apparent access to facts not available to the listener may turn what would otherwise be an opinion into an assertion upon which the listener may reasonably rely.}\textsuperscript{100}

The court found that, in that case, Salomon held itself out as an expert in valuing stock.\textsuperscript{101} Thus, plaintiffs’ reliance on Salomon’s opinion concerning the value of the corporation’s stock was reasonable.\textsuperscript{102}

4. \textbf{Reasonable Care and Competence}

Comment (e) to § 552 begins by stating the obvious -- that the speaker’s duty is to act with reasonable care in obtain and communicate the information, and that what is reasonable depends on the circumstances. The Comment explains that not only is that the speaker’s duty, but it is what the recipient is entitled to expect. Exactly what that is is subject to “a good many factors.”\textsuperscript{103}

\begin{flushright}
\textsuperscript{99} \textit{Id.} at 1124.
\textsuperscript{100} \textit{Id.} at 1124 [citation omitted].
\textsuperscript{101} \textit{Id.}
\textsuperscript{102} \textit{Id.} at 1125.
\textsuperscript{103} Restatement (Second) Torts § 552 cmt. (e).
\end{flushright}
First discussed is the character of the informant. If the recipient does not know the fact and the speaker has held himself out as having special competence, the Comment explains, the recipient has the right to expect care from the speaker, including that a careful investigation will be made, and that the speaker has “normal business or professional competence to form an intelligent judgment upon the data obtained.” That is true both as to facts, and to inferences and opinions drawn and expressed based on such facts. But if no special pretense is made, the standard is one of the “care and competence that the nonprofessional character of his informant entitles him to expect.” “Reasonable conversance with the language employed . . . and reasonable care in its use” is also normally expected. So is communicating the information in a way that it may be understood by the recipient, and in a way that is not misleading.

In *Stephenson v. Deutsche Bank AG*, the Minnesota district court held that the plaintiffs, who had sued a bank and securities broker-dealers alleging that they perpetrated market manipulation scheme resulting in the failure of a major brokerage firm, could not succeed. The court held that the plaintiff’s sophistication was determinative of whether they were owed a duty by the defendants. Applying the

104 *Id.*

105 *Id.*

106 *Id.*

107 *Id.*


109 *Id. at 1062*
Restatement (Second) of Torts § 552, the court stated that “[a] required element of this claim is that the alleged misrepresenter owes a duty of care to the person to whom they are providing information.” 110 The court dismissed the negligent misrepresentation claim explaining that, “[i]n negligent misrepresentation, as opposed to common law fraud, no duty of care exists between sophisticated equals negotiating an arm’s length business transaction . . . Where sophisticated equals negotiate, ‘the injured party’s remedy is to sue either in contract or to sue for intentional misrepresentation.’” 111

Where the plaintiffs were unsophisticated, however, courts have held that the defendant clearly owed plaintiffs a duty to supply information with care and diligence. For example, in Marchese v. Nelson, 112 investors sued a broker and his broker-dealer employers with respect to their losses in speculative over-the-counter stocks. 113 While the court did not explicitly state that the investors lack of sophistication was dispositive as to the duty issue, the court did note that the investors were unsophisticated 114 and held that the broker owed the investors a duty because he was in a superior position to obtain information with respect to the value of the investors’ accounts. 115

110 Id. at 106 [citation omitted].

111 Id. at 1061-62 (citation omitted).


113 Id. at 883.

114 Id. at 894.

115 Id. at 890.
5. **Justifiable Reliance**

Reliance is of course tied to expectation, and, as demonstrated in the previous section, definition of the precise level of care is also tied to expectations. It is thus not surprising that the cases get a bit tangled, but the themes of the cases are nonetheless consistent with the Restatement, even if they are not consistent with each other. The requirement of reliance is, like the rest, often described as another fact specific element, because § 552 requires that the recipient show “justifiable” reliance.

The courts differ in their interpretation of this element. Some courts hold that so long as the investor is provided with written materials disclosing the risk, the investor has no claim for negligent misrepresentation. In *Alton v. Wyland*,\(^{116}\) for example, an investor made investments in an oil and gas shelter investment and a real estate company investment recommended by his investment advisors. The investor brought an action against the investment advisors (employees of a financial planning firm) alleging that they were negligent by failing to disclose the nature and extent of the risks associated with the investments\(^{117}\). The investor, however, had signed an affidavit with respect to the real estate investment and had received a private placement memorandum, both of which indicated that the investment involved a high degree of risk.\(^{118}\)

The investor indicated that he had not read the affidavit or the private placement memorandum, but instead, relied upon the advice of his investment advisors.\(^ {119}\)

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\(^{117}\) *Id.* at 994.

\(^{118}\) *Id.* at 993-94.

\(^{119}\) *Id.* at 995.
held that, under those facts, the defendants were entitled to assume that the investor read the documents disclosing the risks of the investments and that the investor thus could not maintain a claim for negligent misrepresentation.\footnote{Id at 996.}

By contrast, other courts have held that even if written disclosure about the investment is made, it will not preclude an investor’s negligent misrepresentation claim where the investor had no prior experience with the investment and the written materials were difficult to comprehend. In \textit{Continental Leavitt Communications, Ltd. v. PaineWebber, Inc.},\footnote{857 F. Supp. 1266 (N.D. Ill. 1994).} Continental Leavitt Communications, Ltd. (CLC) sued PaineWebber, Inc. (PWI) and one of its brokers for negligent misrepresentation with respect to their opinion that bearer bonds held by CLC as collateral for a deal that CLC was doing with a customer were “good, genuine and authentic.”\footnote{Continental Leavitt, 857 F.Supp. at 1268-69.} The fact was, however, that the bonds were nonnegotiable without their certificate of authentication, a fact that was disclosed, but undiscovered by both parties, in the bond’s terms and conditions.\footnote{Id at 1269.}

PWI contended that CLC failed to demonstrate justifiable reliance because the terms and conditions printed on the back of the bonds contained information about the terms of their negotiability. The court wrote:

This debate reflects the clash of two common law principles. Defendants rely upon the principle that: “A person may not enter into a transaction
with his eyes closed to available information and then charge that he has been deceived by another.” Plaintiff counters with the proposition that: “one should not be allowed to hold oneself out as an expert whose statements or advice is to be relied upon and then after someone else has relied on that advice to his detriment, say, ‘You should not have believed me.”

The court stated that, in its opinion, the latter of these propositions governed the case:

Defendant correctly states the general rule as to reliance: a plaintiff may not be deemed to have reasonably relied on a defendant's misrepresentation when the plaintiff has the opportunity and resources to inquire into the information. This rule is excepted, however, where the plaintiff lacks the information necessary to evaluate the representation and the plaintiff has placed some form of trust in the defendant.

In short, there was “sufficient evidence for the finder of fact to conclude that [plaintiff] lacked the expertise to evaluate the bonds and that his trust in PWI was justified.” Significantly, the court observed that the Terms and Conditions were written in minuscule type and were crammed into a single back page. . . . [Since Plaintiff] had no experience with bearer bonds, such was not an unreasonable course of action. . . . PWI had held itself out to him as having expertise with securities.” The court denied summary judgment to the defendants.

6. “Holder” Cases - Advice to Refrain from Selling

124 Id. at 1272 [citations omitted].

125 Id. [citations omitted].

126 Id.

127 The court called it “challenging reading material.” Id. at 1273 n.2
An important consequence of the growth of the tort of giving negligent information is the way it can be applied to advice that an investor “hold” (rather than sell) a particular security. Such cases are, as a matter of statutory application, not governed by either the federal or state securities statutes, because those statutes all provide that the information imparted must have been “in connection with a purchase or sale.” When the investor’s grievance that the advisor “negligently” advised the investor to “hold”, common-law claims are crucial to a litigant’s success.

California appears to be the first state to decide a major case employing negligent misrepresentation involving advice to “hold” a security. In Small v. Fritz Companies,

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128 See Blue Chip Stamps v. Manor Drug Stores, 423 U.S. 884 (1975). See also NASD [FINRA] Rule 2310(a) - the so-called and frequently-invoked “suitability rule” (“In recommending to a customer the purchase, sale or exchange of any security. . . .”). See, e.g. Zurad, 757 F.2d at 134 (investment was “unsuitable”). See also Jill Gross & Ronald Filante, Developing a Law / Business Collaboration Through Pace's Securities Arbitration Clinic, 11 Fordham J. Corp. & Fin. L. 57, 60 (2005) (writing that:
a common customer complaint is misrepresentation, in violation of both federal and state securities laws, and the common law. Here, clients claim that brokers induced them to buy securities by misrepresenting the level of risk incurred by the purchase, by claiming to have information that was not yet priced into the stock, or by promising a specified rate of return. Alternatively, not listing the drawbacks of investments such as illiquidity, deferred contingent sales charges, or unusual political and economic risks, can constitute actionable behavior on the broker’s part. . . . Because the statute of limitations for violations of [SEA] § 10(b) is relatively short, the clinic often alleges negligent and/or fraudulent misrepresentation causes of action under applicable state law.)

129 Indeed, from the perspective of an advocate, because proof of intent to deceive, required for common law fraud, is often the most difficult element to establish, judicial recognition of a claim for negligent misrepresentation makes establishing liability simpler for those seeking recovery for innocent, i.e. negligent - falsehoods. Common law concepts can also be crucial, e.g., where there is some other defense to statutory liability (e.g. where a shorter statute of limitations has run).
Inc., a shareholder brought a class action alleging negligent misrepresentation against the corporation and three of its officers and directors. The suit alleged that the negligent mis-reporting of financial results caused the shareholder to refrain from selling. The Court, citing fraud cases from California and several other states, explained first that “forbearance from selling stock is sufficient reliance to support a cause of action . . . for negligent misrepresentation.”

Nevertheless, the thrust of the Court’s decision was reminiscent of the policies, although not the conclusions, seen in Ultramares. The Defendants argued that allowing such broad claims by a class plaintiff who refrained from selling based on a public disclosure would invite “strike suits” and other potentially frivolous and vexatious


131 Id. at 1256.

132 Id. at 1259 (citing, inter alia, Carlson v. Richardson, 267 Cal.App.2d 204, 206-208, 72 Cal.Rptr. 769 (1968); Halagan v. Ohanesian, 257 Cal.App.2d 14, 17-19, 64 Cal.Rptr. 792 (1967); David v. Belmont, 291 Mass. 450, 197 N.E. 83 (1935); Duffy v. Smith, 57 N.J.L. 679, 32 A. 371 (1895); Continental Insurance Co. v. Mercadante, 222 A.D. 181, 225 N.Y.S. 488 (1927); Rothmiller v. Stein, 38 N.E. 718 (1894); and Gutman v. Howard Sav. Bank (D.N.J.1990) 748 F.Supp. 254, 264 (upholding a holder's action based on forbearance under New York and New Jersey law, saying: “Lies which deceive and injure do not become innocent merely because the deceived continue to do something rather than begin to do something else. Inducement is the substance of reliance; the form of reliance-action or inaction-is not critical to the actionability of fraud.”)

133 Defendants first asserted that in the context of stock sold on a national exchange, a corporation cannot, as a matter of law, be found to have knowingly intended to defraud “an anonymous shareholder like plaintiff Greenfield,” because no corporate officer or director had a face-to-face or personal communication with him. Id. at 1259-60. The Court rejected the argument: “Nevertheless, although many fraud cases involve personal communications, that has never been an element of the cause of action. [citation omitted] Fraud can be perpetrated by any means of communication intended to reach and influence the recipient”. Id. at 1260.
The Court, examining federal and state law precedents in detail, stated that while it “recognize[d] the importance of the policy considerations defendants advance, [and] although those considerations may justify placing limitations on a holder's cause of action, they do not justify a categorical denial of that cause of action.”

The Court then looked at the Complaint filed in the case. It was a class action. It made nothing but conclusory allegations of reliance. While California had never before considered the pleading requirement for negligent misrepresentation cases, the Court imposed the same specificity requirement that applies in fraud cases. The Court thus stated, as many other courts have, that conclusory allegations of reliance, insufficient in the context of fraud, are equally insufficient in the context of negligent misrepresentation claims. The Court wrote:

134 Id.
135 Id.
136 The California Supreme Court decision requiring specific pleading for negligent misrepresentation claims is opposite that applied in the Ninth Circuit under Federal Rules of Civil Procedure Rule 9(b), where the regular pleading requirements of Rule 8 are applied for pleading negligent misrepresentation. See In re Daou Systems, Inc., 411 F.3d 1006 (9th Cir. 2005). See also Tricontinental Indus., Ltd. v. PricewaterhouseCoopers, LLP, 475 F.3d 824, 833 (7th Cir. 2007); Gen. Elec. Capital Corp. v. Posey, 415 F.3d 391, 395-96 (5th Cir. 2005); Washtenaw County Employees' Retirement System v. Wells Real Estate Inv. Trust, Inc., 2008 WL 2302679 (N.D.Ga. 2008) (holding that heightened pleading requirements of the Private Securities Law Reform Act (PSLRA) and FRCP 9(b) do not apply to negligent misrepresentation claims); Higgins v. Spence & Spence, P.A., 2008 WL 506187 (E.D.N.C. 2008).

The district courts in the Second Circuit, however, usually apply Rule 9(b) to any cause of action that bears a close legal relationship to fraud or mistake. See, e.g., Matsumura v. Benihana Nat. Corp., 542 F.Supp.2d 245 (S.D.N.Y. 2008) (“where ‘the wording and imputations of the complaint are classically associated with fraud,’ Rule 9(b) governs any non-fraud claim that the plaintiffs have made “little, if any, effort to differentiate” from the fraud allegations upon which the action is predicated.”) Cf. Biliouris v. Sundance Resources, Inc., 559 F.Supp.2d 733 (N. D. Tex. 2008) (“Dismissal of negligent misrepresentation claim was warranted, where the claim was based upon
in view of the danger of nonmeritorious suits, such conclusory language does not satisfy the specificity requirement. In a holder's action a plaintiff must allege specific reliance on the defendants' representations: for example, that if the plaintiff had read a truthful account of the corporation's financial status the plaintiff would have sold the stock, how many shares the plaintiff would have sold, and when the sale would have taken place. The plaintiff must allege actions, as distinguished from unspoken and unrecorded thoughts and decisions that would indicate that the plaintiff actually relied on the misrepresentations.  

The Court also observed, however, that the class-action context of Small separated it from other “holder” cases in which, for example, cases where an investor was induced to refrain from selling his stock by a face-to-face conversation or direct communication with a corporate officer or director. But in the class context, the Court noted: “plaintiffs who cannot plead with sufficient specificity to show a bona fide claim operative facts that also formed basis of fraud claims that did not satisfy heightened pleading requirements . . . , and there was no distinct focus in the complaint on negligent misrepresentation, separate from those allegations otherwise directed at pleading fraud claims, as would allow court to redact fraud claims and leave behind the negligent misrepresentation claim”).

Fed.R.Civ.P. 9(b) requires that “[i]n all averments of fraud or mistake, the circumstances constituting fraud or mistake shall be stated with particularity.” Where Rule 9(b) applies, the complaint must “(1) specify the statements that the plaintiff contends were fraudulent, (2) identify the speaker, (3) state where and when the statements were made, and (4) explain why the statements were fraudulent.” Mills v. Polar Molecular Corp., 12 F.3d 1170, 1175 (2d Cir.1993). The Second Circuit is more stringent than the others, applying these heightened pleading requirements to any claims that “sound[] in fraud,” regardless of whether fraud is an element of the claim. See, e.g., Rombach v. Chang, 355 F.3d 164, 166, 170 (2d Cir.2004)(federal securities claims). Cf. Suez Equity Investors, L.P. Associates v. The Toronto-Dominion Bank, 250 F.3d 87, 103 (2d Cir. 2001)(applying New York law, “to the extent that a ‘special relationship of trust’ is sparsely pled”, the complaint was nevertheless deemed sufficient). See also Caprer v. Nussbaum, 36 A.D.3d 176, 825 N.Y.S.2d 55 (N.Y. App. Div. 2006) (placing the burden of establishing “privity” on the plaintiff ).

137 65 P.3d at 1265.

138 Id. at 1259-60.
of actual reliance do not stand out from the mass of stockholders who rely on the market.’’

The concerns raised by the defendants in Small v. Fritz were thus validated (to some extent) by the California Supreme Court. As previously observed, those concerns are reminiscent of Ultramares, and Cardozo’s discussion of over-extended third-party liability, although they manifest themselves in a different way, through a different solution.

The California Supreme Court, in ruling that a “holder” could sue for negligent misrepresentation, did not truly break new ground in the negligent misrepresentation field. Rather, the Court’s decision is best seen as a careful and logical application of the existing tort. Thus, in Rogers v. Cisco Systems Inc, a federal court opined that Florida law would follow California, both as to existence of a claim for holders who relied on negligent misrepresentations, as well as the specificity requirement for pleading.

In the end, the decision in Small v. Fritz demonstrates the maturity of the tort of providing negligent information, even as judicial concerns about the extent of third-party liability.

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139 Id. at 1266.


141 One should note, however, that it has been in several cases that if the price at which the victim decided not to sell was “inflated” by a fraud on the market, then the plaintiff’s damages do not flow from the misrepresentation. See e.g. In re WorldCom, Inc. Securities Litigation, 336 F.Supp.2d 310 (S.D.N.Y. 2004); Lee v. Marsh & McLellan Companies, Inc.,17 Misc.3d 1138(A), 856 N.Y.S.2d 24 (Sup.Ct.Nassau Cty. 2007). That limitation would seem not to be a defense, in, for example, a case involving a negligent misrepresentation as to risk. See, e.g. Zurad v. Lehman, 757 F. 29 at 131-32; Zaborik v. Smith Barney, 664 F. Supp. at 311-312.
liability remain. But that case and the others discussed here make clear that a broad claim for negligent misrepresentation by information-providers is fully established in law.

Part III: The Tort Comes Home: New York and the “Special Relationship” Test

The New York courts have not adopted Restatement (Second) Torts § 552. Due in large part to Cardozo’s legacy, the restrictive “privity or approaching privity” rule of *Ultramares* has dominated the scene. There were just few high court decisions after Cardozo, a situation that is not unusual in areas where the Judge treaded heavily. But beginning in the late 1980s, the New York Court of Appeals gave new life to the tort of negligent misrepresentation in the context of service and information providers.

A. The New York Court of Appeals Takes a New Look

*Ossining Union Free School Dist. v. Anderson LaRocca Anderson*\(^{142}\) was one such case. The case involved a school district that hired an architectural firm to evaluate the safety of their buildings. The architect, in turn, hired two consulting firms to provide reports; these consultants had no contract with the school district, but they knew the district would receive and rely on the reports. The school district received and relied on the reports. Later, after a third consultant reported that the initial reports were incorrect,

\(^{142}\) 539 N.E. 2d 91 (1989).
the school district sued the first consultants alleging that the original consultants failed to exercise due care.\footnote{Id. at 92-93.}

Judge Kaye’s opinion contains a frank discussion of the development of the tort in New York and the divergence of the law of other states. She began:

At issue is a question that has long been a subject of litigation: in negligent misrepresentation cases, which produce only economic injury, is privity of contract required in order for plaintiff to state a cause of action? Whether defendants are accountants (as in several recent cases) or not (as here), our answer continues to be that such a cause of action requires that the underlying relationship between the parties be one of contract or the bond between them so close as to be the functional equivalent of contractual privity. . . .

Courts have long struggled to define the ambit of duty or limits of liability for negligence, which in theory could be endless. While much of this struggle has been couched in the rhetoric of foreseeability of harm, under some circumstances foreseeability has appeared particularly inadequate for defining the scope of potential liability. In negligent misrepresentation cases especially, what is objectively foreseeable injury may be vast and unbounded, wholly disproportionate to a defendant's undertaking or wrongdoing. In reaching the policy judgment called “duty”, courts have therefore invoked a concept of privity of contract as a means of fixing fair, manageable bounds of liability in such cases. . . . The long-standing rule is that recovery may be had for pecuniary loss arising from negligent representations where there is actual privity of contract between the parties or a relationship so close as to approach that of privity.\footnote{Id. at 91, 94. Judge Kaye noted that New York’s privity rule is less expansive than that of other states. Id. at 95.}

Judge Kaye’s decision also makes an important point about the businesses involved which in the different Judge Kaye’s decision cases:

Nor does the rule apply only to accountants. We have never drawn that categorical distinction, and see no basis for establishing such an arbitrary limitation now. It is true that in many of the cases involving claims for negligent misrepresentation, the defendants are accountants. Indeed, in
attempting to fashion a rule that does not expose accountants to crippling liability, we have noted the central role played by that profession in the world of commercial credit. But while the rule has been developed in the context of cases involving accountants, it reflects our concern for fixing an appropriate ambit of duty, and there is no reason for excepting from it defendants other than accountants who fall within the narrow circumstances we have delineated. Notably, Glanzer itself did not involve a suit against accountants.\textsuperscript{145}

Applying the law to the facts, she upheld the complaint found liability, observing that:

\textit{[p]laintiff alleges that through direct contact with defendants, information transmitted by Anderson, and the nature of the work, defendants were aware—indeed, could not possibly have failed to be aware—that the substance of the reports they furnished would be transmitted to and relied upon by the school district. Plaintiff asserts that that was the very purpose of defendants’ engagement.}\textsuperscript{146}

The Court’s decision in Ossining was, however, not sufficient to “spell out” completely the outer boundaries of the tort as it would apply to the investment advisory business. But in 1996, the Court filled the hole.

In \textit{Kimmell v. Schaefer},\textsuperscript{147} the New York Court of Appeals addressed that issue head on. The case involved an investment-gone-bad, and a suit against an officer-promoter for failing to exercise diligence when describing the investment to investors.\textsuperscript{148} The Court wrote:

\textit{ Liability for negligence may result only from the breach of a duty running between a tortfeasor and the injured party. . . .}

\textsuperscript{145} \textit{Id.} at 94.

\textsuperscript{146} \textit{Id.} At 95.

\textsuperscript{147} 675 N.E.2d 450 (1996).

\textsuperscript{148} \textit{Id.} at 452-53.
In the commercial context, a duty to speak with care exists when “the relationship of the parties, arising out of contract or otherwise, [is] such that in morals and good conscience the one has the right to rely upon the other for information” [citing International Products] This reliance must be justifiable, as a “casual response given informally does not stand on the same legal footing as a deliberate representation for purposes of determining whether an action in negligence has been established.”

Since a vast majority of commercial transactions are comprised of such “casual” statements and contacts, we have recognized that not all representations made by a seller of goods or provider of services will give rise to a duty to speak with care. Rather, liability for negligent misrepresentation has been imposed only on those persons who possess unique or specialized expertise, or who are in a special position of confidence and trust with the injured party such that reliance on the negligent misrepresentation is justified. Professionals, such as lawyers and engineers, by virtue of their training and expertise, may have special relationships of confidence and trust with their clients, and in certain situations we have imposed liability for negligent misrepresentation when they have failed to speak with care.

The analysis in a commercial case such as this one is necessarily different from those cases because of the absence of obligations arising from the speaker’s professional status. In order to impose tort liability here, there must be some identifiable source of a special duty of care. The existence of such a special relationship may give rise to an exceptional duty regarding commercial speech and justifiable reliance on such speech.

Whether the nature and caliber of the relationship between the parties is such that the injured party’s reliance on a negligent misrepresentation is justified, generally raises an issue of fact. In determining whether justifiable reliance exists in a particular case, a fact finder should consider whether the person making the representation held or appeared to hold unique or special expertise; whether a special relationship of trust or confidence existed between the parties; and, whether the speaker was aware of the use to which the information would be put and supplied it for that purpose.\(^\text{149}\)

In *Kimmell*, the defendant was promoting investments in a limited partnership called the Cogenic Embarcadero Limited Partnership. This partnership involved several projects developed by a company called Cogenic Energy Systems, Inc. (CESI) for the

\(^{149}\) *Id.* at 454 [citations omitted]
purpose of providing heat and electricity to industrial and commercial energy users through on-site gas-powered “cogeneration” units. The New York Court of Appeals found that the plaintiffs “justifiably assumed that defendant possessed expertise in this area and relied on his apparently unique knowledge of CESI and its operations.” ¹⁵⁰ The Court wrote:

Defendants efforts sought to induce plaintiffs to invest in the project. The record indicates that the Embarcadero projections were generated for the express purpose of providing investors with current information about potential returns on the project. As the CESI representative responsible for marketing the Embarcadero limited partnership, defendant provided Gross with projections to distribute to potential investors generally, and the plaintiffs in particular. ¹⁵¹

*Kimmell* would become a watershed case under New York law. It was the first negligent misrepresentation case decided by the Court of Appeals since the time of Cardozo that dealt with an information provider other than an accountant, attorney or engineer – i.e. it was the first such case in 70 years with a non-professional as the defendant. And equally important, instead of couching the decision in terms of “privity or near-privity”, the duty to speak with care is said to flow from a “special relationship.” ¹⁵²

¹⁵⁰ *Id.* at 452-53.

¹⁵¹ *Id.* at 454.

¹⁵² *Id.* at 454. The phrase “special relationship” in the context of negligent misrepresentation first appears in the (published) lexicon in *Dorsey Products Corp. v. U.S. Rubber Co.*, 21 A.D.2d 866, 867, 251 N.Y.S.2d 311 (N.Y. App. Div. 1964) (“A cause of action can therefore only be supported by some special relationship between the parties (*International Products Co. v. Erie R.R. Co.*).”) Unfortunately, we do not know who actually coined it - the decision was “Per Curium”. Thereafter, although the concept traces itself back to *International Products*, the term only began to be used frequently in the 1990s. See *Mathis v. Yondata Corp.*, 125 Misc.2d 383, 480 N.Y.S.2d 173 (Sup.Ct.Monroe Cty 1984) (computer hard-ware/software manufacturer; complaint alleging special relationship survived summary judgment); *United Safety of America, Inc. v. Consolidated Edison Co. of New York, Inc.*, 213 A.D.2d 283, 623 N.Y.S.2d 591 (N.Y.
And even though the words “trust and confidence” appear in the formulation, it is clear that no fiduciary duty existed between the litigants.\textsuperscript{153}

Soon after \textit{Kimmell}, however, the Court seemed to retreat from its holding. \textit{Murphy v. Kuhn}\textsuperscript{154} raised the question whether an insurance agent should be liable to a former customer for tortious misrepresentation based upon the failure of the defendant insurance agent to advise plaintiff about deficiencies in his insurance coverage. In addressing the issue, the Court acknowledged that “the asserted duty is a special level of advisory responsibility.”\textsuperscript{155}

The New York Appellate Division in \textit{Murphy} had affirmed an order of the New York Supreme Court (a lower court), granting defendants’ motion for summary judgment.\textsuperscript{156} The Court of Appeals affirmed the Appellate Division’s decision on the ground that no special relationship was established, and a claim for negligent

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\textsuperscript{153} See text and notes accompanying n. 12, \textit{supra}.  
\textsuperscript{154} 682 N.E.2d 972 (1997). \textsuperscript{155} \textit{Id.} at .  
misrepresentation could not lie.\textsuperscript{157} In doing so, The Court of Appeals described its decision in \textit{Kimmell} as a case where it had recognized a special relationship in a commercial controversy, involving no generally recognized professional relationship.\textsuperscript{158}

But the Court found \textit{Kimmell} “significantly distinguishable” because “the instant case … involves an insurance agent - insured relationship and an alleged failure to speak. We … disclaim any implication of a direct, precedential applicability [of that case] in the insurance relationships context.”\textsuperscript{159} The Court wrote:

As a matter of law, this record does not rise to the high level required to recognize the special relationship threshold that might superimpose on defendants the initiatory advisement duty, beyond the ordinary placement of requested insurance responsibilities. Rather, the record in the instant case presents only the standard consumer-agent insurance placement relationship, albeit over an extended period of time. Plaintiffs’ plight does not warrant transforming his difficulty into a new, expanded tort opportunity for peripheral redress. The record does not support plaintiffs’ effort in this manner to shift to defendant insurance agent the customer’s personal responsibility for initiating, seeking and obtaining appropriate coverage, without something more than is presented here.\textsuperscript{160}

\textsuperscript{157} 682 N.E.2d at 974.

\textsuperscript{158} \textit{Id}. at 974.

\textsuperscript{159} \textit{Id}. at 974.

\textsuperscript{160} \textit{Id}. at 975. The Court compared its ruling to the law in several other states:

[O]ther jurisdictions have recognized such an additional duty of advisement in exceptional situations where, for example, (1) the agent receives compensation for consultation apart from payment of the premiums;(2) there was some interaction regarding a question of coverage, with the insured relying on the expertise of the agent; or (3) there is a course of dealing over an extended period of time which would have put objectively reasonable insurance agents on notice that their advice was being sought and specially relied on. In these circumstances, insureds bear the burden of proving the specific undertaking. The relationship established in the instant case does not rise to the level of these exceptional situations and we refrain from determining when the special relationship analysis may apply in the insurance context.
The defendant in *Murphy* was a “standard” insurance agent - and while the Court does not examine the *Kimmell* factors, but instead proceeds directly to the conclusion that “[t]he record does not support plaintiffs’ effort in this manner to shift to defendant insurance agent the customer’s personal responsibility for initiating, seeking and obtaining appropriate coverage. . . .”

The Court of Appeals’ only other foray into the area was in *J.A.O. Acquisition Corp. v. Stavitsky.* The case arose out of a stock purchase transaction after which the purchaser sued the sellers and their bank for negligent misrepresentation. Before the transaction was consummated, the buyer undertook a due diligence review of the

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*Id.* at 272 [citations omitted]. See also *People Express Airlines v. Consol. Rail Corp.*, 495 A.2d 107 (1985) (“The special relationship, in reality, is an expression of the courts’ satisfaction that a duty of care existed because the plaintiffs were particularly foreseeable and the injury was proximately caused by the defendant's negligence.”); *Sewell v. Great Northern Ins. Co.*, --- F.3d ----, 2008 WL 2926226 (10th Cir. 2008); *Swartz v. Deutsche Bank*, 2008 WL 1968948 (W.D.Wash.) (“Normally the duty to disclose unknown material facts exists only when there is a fiduciary relationship between the parties, but can arise when there is a ‘quasi-fiduciary’ relationship; i.e., where a special relationship of trust and confidence exists and one party is privy to material facts ‘not easily discoverable’ by the other, or when one party relies on the specialized knowledge of the other.”)

161 *Id.* at 976. The Court of Appeals wrote: “Insureds are in a better position to know their personal assets and abilities to protect themselves more so than general insurance agents or brokers, unless the latter are informed and asked to advise and act. Furthermore, permitting insureds to add such parties to the liability chain might well open flood gates to even more complicated and undesirable litigation.” *Id.* See generally Note, *Murphy V. Kuhn: Defining the Insurance Broker's Exposure to Professional Liability Lawsuits in New York*, 43 N.Y.L. Sch. L. Rev. 633 (1999).


163 *Id.* at 585-86.
company to be purchased, and certain adjustments in the price were made.\textsuperscript{164} At the closing, the buyer received a “pay-off letter” from the sellers’ bank stating the balance due to them under the company’s revolving-credit operating account; adjustments at the closing were then based on the amount stated in the letter.\textsuperscript{165}

It was later revealed that the payoff letter incorrectly failed to include a $1.3 million debit in the company’s operating account, resulting in pecuniary loss to the buyer.\textsuperscript{166} The bank moved for summary judgment, and the trial court granted the motion, holding that neither a special relationship nor privity existed, and that reliance had not been demonstrated. The Appellate Division affirmed on both grounds.\textsuperscript{167}

The Court of Appeals affirmed.\textsuperscript{168} It recited three elements of the tort of negligent misrepresentation:

(1) the existence of a special or privity-like relationship imposing a duty on the defendant to impart correct information to the plaintiff;

(2) that the information was incorrect; and

(3) reasonable reliance on the information.\textsuperscript{169}

\textsuperscript{164} \textit{Id.} at 588.

\textsuperscript{165} \textit{Id.} at 586.

\textsuperscript{166} \textit{Id.}


\textsuperscript{168} 863 N.E.2d at 587.

\textsuperscript{169} \textit{Id.} The recitation does not include the negligence element, and must thus be read as a kind of shorthand. The Court clearly did not intend to impose a strict liability standard.
The Court’s decision assumed arguendo that the first two elements had been met, and thus the Court did not explore whether in fact a special relationship existed. Implicit the Court’s use of the alternative terms “special or privity-like relationship”, however, is an understanding that these concepts speak to different situations, but that both are addressed to the same jurisprudence - determining whether, in the words of International Products, “that in morals and good conscience the one has the right to rely upon the other for information.”

The difference between these two concepts - the “special relationship” and “privity-or-near-privity” is not made clear. But it must be observed that neither Kimmell, Murphy and J.A.O. are cases about privity - they are about determining whether the defendant fits the mold of the weigher in Glanzer or warehouseman in International Products – whether this defendant is within the class of enterprises that can be a potential defendant in a negligent misrepresentation case. Privity cases are about whether the plaintiff is in the class of plaintiffs who may sue.

The Court in J.A.O. Acquisition, however, rested its decision exclusively on a determination that there was no reliance, finding that the buyer would have gone through with the transaction anyway; the financial shortfall, apparently, was thus really a dispute between the seller and the buyer about whether the adjustments were correctly made at

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170 Id. The case is not mentioned. Only Murphy and one other case are cited in the short opinion. Neither Kimmel nor Ossining, nor any of the old classics, are discussed at all.

171 The Court of Appeals left undisturbed the Appellate Division’s conclusion that seller’s bank (which presented the “pay-off letter”) was not in a special relationship with the buyer, chose not to tie itself on that issue.
the closing.\textsuperscript{172} The case serves as an important reminder that “but-for” reliance is an element of the tort of negligent misrepresentation.\textsuperscript{173}

\textit{Kimmell} thus remains the last detailed word from the New York Court of Appeals on the subject of “special relationship”. The three-factor analysis articulated in that case provides a firm framework from which to analyze numerous situations, including whether a stockbroker or financial advisor\textsuperscript{174} qualifies for “special relationship” that gives rise to a claim for the negligent misrepresentation of information. The next section is a study of the New York cases on the subject.

\textbf{B. Applying the “Special Relationship” Requirement to Investment Cases}

A study of the cases following \textit{Kimmell} support the existence of a negligent misrepresentation claim against brokers, investment advisors and financial planners under New York law.\textsuperscript{175} Although there are only few direct cases on point (in no small part
\textsuperscript{172} 863 N.E.2d at 587.
\textsuperscript{173} The CFO of the buyer testified that his company wanted to acquire the stock, and had decided to do so regardless of the amount of adjustments to be made at the closing. \textit{Id.} at 149. \textit{Cf. Continental Leavitt v. PaineWebber}, 1994 WL 710745 (N.D.Ill.), at *9-10 (discussing “but for” and “proximate causation” standards).
\textsuperscript{174} The defendant in \textit{Kimmell} was not an NASD-licensed securities broker.
because of the almost-universal reference of such cases to contractual arbitration),\textsuperscript{176} the cases applying \textit{Kimmell} are informative, and they exhibit no trend toward immunizing brokers and investment advisors in the manner that insurance agents are immunized under \textit{Murphy}.\textsuperscript{177} Indeed, the cases since \textit{Kimmell} establish almost beyond doubt, that the advice contemplated by such professions creates the “special relationship” that New York law requires. Even though such individuals are not generally deemed to be fiduciaries, they nevertheless owe a duty of reasonable care (\textit{i.e.} “due diligence”) in the representations they make to clients.

The Court of Appeals in \textit{Kimmell} listed three factors to consider in determining whether a “special relationship” exists:

\begin{enumerate}
\item whether the person making the representation held or appeared to hold unique or special expertise;
\item whether a special relationship of trust or confidence existed between the parties; and,
\end{enumerate}

\textsuperscript{176} The phenomenon was noted, \textit{e.g.} in \textit{Estate of Ives v. Ramsden}, 174 P.3d 1231 (Wash. App. Div. 2008)(“The lack of new cases that would further develop a standard for unsuitable recommendation liability is because almost all unsuitability claims are heard in arbitration.”)

\textsuperscript{177} As the New York Court of Appeals wrote in \textit{Murphy v. Kuhn}:
Insurance agents or brokers are not personal financial counselors and risk managers, . . . . Insureds are in a better position to know their personal assets and abilities to protect themselves more so than general insurance agents or brokers, unless the latter are informed and asked to advise and act. Furthermore, permitting insureds to add such parties to the liability chain might well open flood gates to even more complicated and undesirable litigation. 682 N.E.2d at 976. See also \textit{Hoffend & Sons, Inc. v. Rose & Kiernan, Inc.}, 851 N.E.2d 1149 (2006).
whether the speaker was aware of the use to which the information would be put and supplied it for that purpose.\textsuperscript{178}

A significant number of cases since that decision have employed these factors to analyze whether a sufficient relationship exists to justify imposition of duty to speak with care. For example, in \textit{Actrade Financial Technologies Ltd. v. HLC Industries, Inc.},\textsuperscript{179} the \textit{Kimmell} factors were employed to conclude that no special relationship existed between seller and buyer of Trade-Acceptance Drafts, \textit{i.e.} short term unconditional promises to pay.\textsuperscript{180} The complaint alleged that the seller had special expertise, but that allegation alone was insufficient to withstand a dismissal motion because it alone did not satisfy \textit{Kimmell}.\textsuperscript{181} In \textit{Henneberry v. Sumitomo Corp. Of America},\textsuperscript{182} a special relationship was found in a case involving false representation about investment by corporate promoter, where the fact was in the exclusive knowledge of the speaker and the speaker knew there would be reliance.\textsuperscript{183}

\textsuperscript{178} 675 N.E.2d at 453.
\textsuperscript{179} 2007 WL433358 (Bkrtcy. S.D.N.Y. 2007).
\textsuperscript{180} \textit{Id.} at *1
\textsuperscript{181} \textit{Id.} at *5-6. In addition to the \textit{Kimmell} factors, the court noted that whether the speaker was an “educated professional” is another relevant consideration. \textit{Id.} at *5 [citation omitted].
\textsuperscript{182} 532 F.Supp.2d 523 (S.D.N.Y. 2007).
Suez Equity Investors, L.P. Associates v. The Toronto-Dominion Bank

concerned an investment in a health care financing venture named SAM Group. The plaintiffs alleged that the defendants discouraged them from inquiring into the background of SAM Group's principal, J. Christopher Mallick, and instead provided them with what was purportedly the report of an independent investigator who had performed a background check on Mallick, but was in fact a modified version of that report with adverse information deleted. Plaintiffs thereafter invested in SAM Group in reliance on the modified report. When SAM Group subsequently failed financially, securities litigation ensued.

The district court dismissed plaintiffs’ negligent misrepresentation action when it found that plaintiffs had not sufficiently alleged the existence of a “special relationship” between the investors and the defendant. The Second Circuit reversed, noting the following important factors leading to a conclusion that a relationship of trust and confidence had been pled:

[P]laintiff’s complaint implies a relationship between the parties that extended beyond the typical arm’s length business transaction: defendants initiated contact with plaintiffs, induced them to forebear from performing their own due diligence, and repeatedly vouched for the veracity of the allegedly deceptive information. [citation to record omitted] Moreover, …


250 F.3d 87, 103 (2d Cir. 2001).

Id. at 93.

Id. at 92-93.

Id. at 94-5.
the complaint emphatically alleges the other two factors enunciated in *Kimmell*. First, [defendants] appeared to possess - and held themselves out as possessing - special knowledge about the SAM Group generally, and Mallick in particular. Second, these defendants knew that plaintiffs sought information about Mallick to aid their investment decision and defendants supplied it for that purpose, while dissuading plaintiffs from conducting their own investigation. Given that a determination of whether a special relationship exists is essentially a factual inquiry, these allegations are sufficient to overcome a motion to dismiss. 188

Similarly, in *Fleet Bank v. Pine Knoll Corporation*, 189 the court imposed a duty of care on a bank for imparting information about a complex financial transaction:

> [W]e are persuaded that defendants have tendered sufficient admissible proof to raise a question of fact as to the existence of a special relationship with plaintiff …[T]he various financial transactions undertaken by [defendant] on behalf of the corporation following the September 1993 closing, i.e., the execution of the series of short-term notes and the management and alleged depletion of her personal assets, were done in response to information and/or advice that she received from [the individuals] who acted as the relationship managers for the underlying loan. In this regard, one of the plaintiff’s senior vice presidents candidly acknowledged at his examination before trial that “a lot of small business customers are not financiers. They are good at whatever they happen to do, but they don’t know finance. They rely heavily upon their relationship managers to provide them with financial solutions. By providing a customer with inaccurate information, you could put them in a very bad position. We need to be very careful in how we advise these people.” Such testimony, coupled with the other proof contained in the record, including [defendant’s] averments that she repeatedly was assured that the phase II financing, without which the entire project could not succeed, would be forthcoming, persuades us that defendants have raised a question of fact as to whether, under the particular circumstances presented here, a special relationship existed between plaintiff and defendants and, if so, whether defendants’ reliance upon the information conveyed was reasonable. 190

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188 *Id.* at 103-04.


190 *Id.* at 796.
Even in the insurance context, there has been an apparent expansion of the concept of “trust and confidence” to bring within its ambit even some insurance situations. In *Shultz v. Sunlife Assur. Co. of Canada*, the court wrote:

Plaintiffs were the owners of a life insurance policy issued by Defendants. . . . A jury could reasonably find that Defendants’ agent, Mock, had unique or special expertise regarding the life insurance policy, that there was a relationship of trust or confidence between Plaintiffs and Mock and/or Defendants, and that Mock (who acted on behalf of Defendants) was aware of the use to which the information would be put and supplied it for that purpose. Although, ordinarily, insurance agents have been held not to have a special relationship with the insured, that line of cases involves the situation where the agent is sued for failing to obtain, or advise the insured to obtain sufficient coverage, but are sued for factual statements made by their agent, Mock, concerning the policy at issue here (i.e., whether the policy was paid in full and whether future bills could be disregarded).

The court found that triable issues of fact remain on whether there was a special relationship sufficient to sustain a claim for negligent misrepresentation. The court noted that the defendants were not being sued for failure to advise the plaintiffs to obtain sufficient coverage, but were sued “for factual statements made by their agent Mock, concerning the policy at issue.”

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193 *Id.*

The case is also noteworthy because the court highlighted an important aspect of the speaker’s duty in a negligent misrepresentation case - an obligation “to investigate the true facts”, and held there were triable issues of fact with regard thereto.\textsuperscript{195} The essence of that duty was described in greater detail by the Second Circuit in \textit{Hanley v. SEC}.\textsuperscript{196}

Brokers . . . are “under a duty to investigate, . . . Thus, a [broker] cannot deliberately ignore that which he has a duty to know and recklessly state facts about matters of which he is ignorant. He must analyze sales literature and must not blindly accept recommendations made therein. The fact that his customers may be sophisticated and knowledgeable does not warrant a less stringent standard.\textsuperscript{197}

Most significantly, in \textit{Lynch v. McQueen},\textsuperscript{198} an investor brought suit alleging that her stockbroker and insurance agent improperly liquidated some of her securities to meet monthly premiums on whole life insurance policies.\textsuperscript{199} In finding the existence of the requisite relationship of trust and confidence involving the investor and an NASD member, the court found significant the allegations that:

\begin{quote}
Guardian’s insurance agent, McQueen, initiated their relationship, convinced [plaintiff] to buy certain insurance policies which she otherwise would not have bought, and encouraged her to rely on him to take care of all her insurance needs.\textsuperscript{200}
\end{quote}

\textsuperscript{195} See Restatement § 552 and Comment (f) thereto, discussed at text and notes accompanying n. 103 - 115, \textit{supra}.

\textsuperscript{196} 415 F.2d 589 (2d Cir. 1969) (finding a “special relationship” under the Securities Exchange Act between a broker and its clients).

\textsuperscript{197} \textit{Id.} at 596.


\textsuperscript{199} \textit{Id.} at 791-92.

\textsuperscript{200} \textit{Id.} at 792
In another case involving an NASD-licensed securities broker, *Knight Securities L.P. v. Fiduciary Trust Co.*,\(^{201}\) the Appellate Division First Department declined to dismiss a claim that the firm had misrepresented certain aspects of transaction in which it played a dual role of agent for the buyer-defendant and facilitator of the transaction.\(^{202}\)

In *J.P. Morgan Chase Bank v. Winnick*,\(^{203}\) the federal court examined in detail whether a lender could establish a “special relationship” in order to maintain a suit against its borrower (and the officers and directors thereof) for negligent misrepresentation of the financial status of its business. The court reviewed the legal landscape, highlighting *Kimmell*, but characterizing the case as neither “abolish[ing] . . . nor loosen[ing]” the special relationship requirement.\(^{204}\) Analyzing several post-*Kimmell* cases,\(^{205}\) the court explained that the type of relationship that meets the test is one which


\(^{202}\) The case thus is analogous to *Zahorik v. Smith Barney*, 664 F. Supp. 309 discussed *supra* at n. 84 - 89 and accompanying text.


\(^{204}\) *Id.* at 402.

\(^{205}\) Among the cases cited and analyzed were *Suez Equity Investors v. Toronto-Dominion Bank*, 250 F.3d 87 (2d Cir. 2001) (discussed at text accompanying n.184-188, *supra*); *Wells Fargo Bank Northwest, N.A. v. Taca Int’l Airlines, S.A.*, 247 F.Supp.2d 352 (S.D.N.Y.2002) (dispute between the lessee and lessor of a aircraft, where the complaint alleged that several of the defendant’s agents “made expert representations about maintenance costs,” “had unique expertise in the intended conversion of Airbus 300 aircraft from passenger to cargo use,” and “misrepresented the historical maintenance costs and the good mechanical condition of the planes.”); *LaSalle Bank v. Citicorp Real Estate*, No. 02 Civ. 7868 (HB), 2003 WL 1461483 (S.D.N.Y. 2003); and *Doehla v. Wathne Limited, Inc.*, No. 98 Civ. 6087 (CSH), 1999 WL 566311 (S.D.N.Y. 1999).
exists “distinct from the defendants’ obligations under the terms of the [contract] itself.” The court then held that the facts presented established nothing more than a “plain vanilla” lending relationship that did not meet the standard.

The movement under New York law holding a securities broker-dealer or non-fiduciary investment advisor liable brings New York into the mainstream, not only with respect to states adopting Restatement § 552, but also with the Securities & Exchange Commission. Indeed, the SEC has long held brokers to this higher standard. In *Hanly v.*

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206 *J.P. Morgan v. Winnick*, 350 F.Supp.2d at 404. (emphasis added). The court characterized the argument that the defendant had greater knowledge of the industry in which it operated as:

nothing more than knowledge of the particulars of the company's business-and of the true situation underlying the misrepresentations pertaining to that business, . . . not constitut[ing] the type of ‘specialized knowledge’ that is required in order to impose a duty of care in the commercial context. If it were, every bank would have a claim against every borrower who failed to exercise due care in the context of commercial bank loans. [citation omitted]. Borrowers will almost always have “specialized” knowledge of the particulars of their businesses, and indeed, of the facts underlying any misrepresentations made in support of desired loans. That is why banks, which are in the business of assessing lending risks posed by potential borrowers, have sophisticated means of assessing those risks that cut across industries and areas of technical expertise. The relationship between a bank and a borrower is the very epitome of an arm's length commercial transaction: the borrower must comply with the negotiated terms of its contract, and may not defraud the lender by deliberate falsehood, but it is not liable in tort for mere carelessness about its representations.

*Id.* at 402.

Securities and Exchange Commission, the Second Circuit upheld the SEC’s views on the subject:

A securities dealer occupies a special relationship to a buyer of securities in that by his position he implicitly represents he has an adequate basis for the opinions he renders. While this implied warranty may not be as rigidly enforced in a civil action where an investor seeks damages for losses allegedly caused by reliance upon his unfounded representations, its applicability in the instant proceedings cannot be questioned.

Sonics was an over the counter stock. Those who purchased through petitioners could not readily confirm the information given them. In Charles Hughes & Co., Inc. v. SEC, 139 F.2d 434 (2d Cir. 1943), cert.denied, 321 U.S. 786 (1944), this Court recognized the difficulties involved in over the counter stocks and the special duty imposed upon those who sell such stocks not to take advantage of customers in whom confidence has been instilled.

The statement “[w]hile this implied warranty may not be as rigidly enforced in a civil action where an investor seeks damages for losses allegedly caused by reliance upon his unfounded representations” may have been true in New York in 1969, when Hanly was decided. It is true no more.

An good summary of the law of negligent misrepresentation in New York is found in Fraternity Fund Ltd. v. Beacon Hill Asset. The court described the tort as consisting of five interconnected elements:

(1) carelessness in imparting words;
(2) upon which others were expected to rely;
(3) and upon which they did act or failed to act;

 Former SEC Chair Harvey Pitt was the last attorney listed on the brief for the SEC.

Id. at 596-597.

(4) to their damage; and
(5) that the declarant express the words directly, with knowledge or notice that they will be acted upon, to one to whom the declarant is bound by some relation or duty of care.211

In Fraternity Fund, the court separated the plaintiffs into two groups – those who relied upon the misrepresentations prior to their first investment in the Funds and those who were shareholders and/or limited partners at the time they relied upon the misrepresentations. The court found the allegations are “more than sufficient to show justifiable reliance with respect to both groups,”212 but it did so on different theories:

The first-time investors justifiably relied on the Beacon Hill Defendants to publish accurate information about the Funds they managed. These defendants, after all, allegedly managed and determined the composition of the Funds and therefore were uniquely positioned to know their overall value. The Individual Defendants were particularly situated to know the values of the Funds because they were sole principals and directors of Beacon Hill. Moreover, the Beacon Hill Defendants allegedly sent MPRs to prospective investors in order to induce them to invest and therefore should have known that plaintiffs would rely upon this information in deciding whether to invest. Plaintiffs who held investments in the funds when inaccurate statements were made also justifiably relied upon statements for these reasons, but for another as well. As shareholders and/or limited partner, their relationships with the Individual Defendants were fiduciary in nature.213

Fraternity Fund’s description of the tort, and how it was applied there, is coextensive with the way Restatement § 552 has been applied in cases involving

211 Id. at 410-411 (citing Dallas Aero Inc. v. CIS Air Corp. 352 F. 3d 775, 788 (2d Cir. 2003), which relies upon White v. Guarente, 478, 372 N.E. 2d 315 (1977)).

212 376 F.Supp.2d at 410.

213 Id. at 411.
securities broker-dealers, investment advisors, financial planners and other investment professionals. But notably, the Court also relied on Kimmell, finding a sufficiently-pled “special relationship.”

All these cases recognize that those in the business of offering investment advice - as opposed to those selling purely investment or insurance “products” -- are in a “special relationship” with their clients. The resulting adoption of a negligence standard for information and advice provided by them, shows that New York has indeed joined the nation, and in at least in this limited respect, and that the tort has finally come home.

214 In Hatleberg v. Norwest Bank Wisconsin, 700 N.W.2d 15 (Wis. 2005), a case involving, inter alia, a claim of negligent misrepresentation, the defendant disputed the plaintiffs’ characterization of its services as involving “financial planning.” The Court was not moved by the debate over the proper characterization, stating that whether the defendant “styles itself as an ‘investment planner,’ ‘financial planner,’ or ‘financial advisor,’” it bears responsibility for its actions” under Restatement §552. Id. at 25. In Maliner v. Wachovia Bank, N.A., 2005 WL 670293 (S.D.Fla. 2005) the court applied Restatement §552 to the activities of a Wachovia team that included a “Wachovia Client Relationship Manager” and an “investment specialist.” Explaining the nature of the information provided, this team “prepared a comprehensive financial analysis, which included evaluations of [plaintiff’s] investment portfolio, his net worth, debt management, retirement finances, estate planning, and insurance coverage,” Id at *3, i.e. a financial plan. See also Neikirk v. Resource Management, Inc., 983 So.2d 106 (La.App. 2008) (plaintiffs sued financial planning company and its insurer for, inter alia, negligent misrepresentation, alleging that client switched employment positions based on financial planner's mistaken representations that retirement account could be rolled over into a new plan and remain tax deferred); Ferola v. Allstate Life Ins. Co., 23 Mass.L.Rptr. 60 (Mass.Super. 2007) (summary for defendant denied in case alleging misrepresentation by financial planner as to advisability of annuity options); Zarrella v. Minnesota Mut. Life Ins. Co., 824 A.2d 1249 (R.I. 2003); Benson v. Richardson, 1990 WL 290144 (N.D.Iowa) (describing the defendant as “a smooth-talk ing, fast-operating, self-proclaimed ‘certified financial planner,’ a latter-day Charles Ponzi, whose intelligence, charm, and apparent sophistication in matters financial made dupes out of the plaintiffs. . .”). Cf. Mason v. Burkett, 756 F.Supp. 679 (Conn. 1991) (applying Restatement §552 to a financial planner, but finding that no false statement was made). See generally, John A. Gray, Personal Liability Exposure of Financial Planners: Private Enforcement, 36 St. Louis U. L.J. 623 (1992)

215 Id.
PART IV. **The Tort of Giving Negligent Investment Advice**

New York’s many contributions to the modernization of tort law of course include the concept of negligent misrepresentation. It thus seems anomalous that the state that brought down the “Citadel of Privity” in *MacPherson* erected the barrier of *Ultramares* in cases where negligent misrepresentation of information was involved, and thereby split the nation. But the question who is a potential plaintiff - the *Ultramares* question - is a different question from who is a potential defendant.

As Part III demonstrated, professionals like accountants, lawyers and engineers have long bee in the category of defendants whose negligent falsities may be actionable in New York. In such circumstances, diligence in investigation and in the communication of information is required under New York law.

*Kimmell*, however, reminded us that the diligence obligation is not limited to those who can be labeled “professionals”, or even those whom the law treats as

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216 New York continues to express its concerns about the potential for over-extended liability by rigorous application of the *Ultramares* doctrine. See, *e.g.*, *Eurycleia Partners L.P. v. Seward & Kissel, L.L.P.*, 46 A.D.2d 400, 849 N.Y.S.2d 510 (N.Y.App.Div. 2007) (case brought by hedge fund investors against the fund’s outside law firm and auditor dismissed for lack of privity or near-privity). *Cf. Caprer v. Nussbaum*, 36 A.D.3d 176, 825 N.Y.S.2d 55 (N.Y.App.Div. 2006) (finding a near-privity relationship where an accountant was sued for negligently providing information about tax deductions for common charges to condominium-unit owners. The engagement was with the condominium association, not the individual unit owners, but the court denied the accountant summary judgment by analogizing the case to a third party beneficiary situation, and showing that the condo-owners met that standard. *Id.* at 196-98.)
The defendant in Kimmell, a corporate officer and investment promoter, was not an attorney or accountant. He held no professional license, his educational credentials were not examined by the Court, and the Court cited no cases distinguishing businesses from professions. He was clearly not a fiduciary. Still, the Court of Appeals found the existence of a “special relationship” sufficient to impose a duty of care.

This study of the cases decided after Kimmell reveals that, in a large sense, the New York requirement of a “special relationship” functions in much the same way as the “pecuniary interest” and “in the business of supplying information for the guidance of others” predicates of Restatement § 552. They screen out the cases of “casual advice”,

Indeed, in Murphy v. Kuhn, the Court noted specifically that Kimmell involved a defendant with “no generally recognized professional relationship” with the plaintiff. 682 N.E.2d at 974. See also Marchese v. Nelson, 809 F.Supp. at 892-895.

Cf. AG Capital Funding Partners L.P. v. State Street Bank & Trust Co., 842 N.E.2d 471 (2005) (comparing a claim for attorney malpractice with one for negligent misrepresentation, and noting that both require a privity-like relationship. Id. at 479).

As stated at the outset at n.11, supra. the lack of a fiduciary duty leaves a gap in duty; the negligent misrepresentation tort is important in states that, like New York, do not impose a fiduciary duty in investment-advice situations..

Like New York, Oregon’s courts have used their own “special relationship” rubric to limit the tort of providing negligent information. But although Oregon may use the same term, they define it differently from New York. For example, in addressing the requirement in the Oregon Supreme Court, in Conway v. Pacific University, 924 P.2d 818 (Ore. 1996) explained:

Another way to characterize the types of relationships in which a heightened duty of care exists is that the party who owes the duty has a special responsibility toward the other party. This is so because the party who is owed the duty effectively has authorized the party who owes the duty to exercise independent judgment in the former party's behalf and in the former party's interests. In doing so, the party who is owed the duty is placed in a position of reliance upon the party who owes the duty; that is, because the former has given responsibility and control over the situation
and then focus on the nature of the defendant’s business and the plaintiff’s expectations.221

To appreciate the equation of New York’s requirement of a “special relationship” with the Restatement’s requirement that the defendant be “in the business of supplying information for the guidance of others”, one need only recall, for example, the Seventh

Id. at 824. Oregon’s rule, while using the term “special relationship,” is different from the 3-part Kimmell test. The thrust is nonetheless the same - the emphasis is on “trust and confidence”. See Conway, id. at 825n.5 and Kimmell, 675 N.E.2d at 455. The decision in Conway preceded Kimmell by one month.

Oregon’s test of relinquished decision-making is applied whenever the defendant is “to exercise independent judgment”. Conway at . Oregon in essence uses its “special relationship” concept in a negligent misrepresentation case to describe the Restatement’s “in the business of supplying information” language, and thereby distinguish those who are “at arm’s length or adversarial” to the plaintiff.”. Id. Cf. National Mulch & Seed, Inc. v. Rexius Forest By-Products, Inc., 2007 WL 894833 (S.D.Ohio 2007)(holding that Ohio law does not require any “special relationship” beyond that required in Restatement § 552).

221 The modern English is apparently similar. See Recent Case, Negligent Misrepresentation – in General–Action Lies for Negligent Misrepresentation Causing Financial Loss but Disclaimer Is a Defense; Hedley Byrne & Co. v. Heller & Partners (H.L. 1963), 77 Harv.L.Rev. 773 (1964) (“To limit liability for lightly given advice, the House of Lords would impose a duty of care only when the defendant has given the impression of deliberately inviting reliance on his use of care. Like many American decisions, Hedley Byrne emphasized the importance of the defendant's possession of special skill or superior access to facts in generating reasonable reliance from which a duty of care would arise. That the events occurred in a business context also favors liability, both because of defendant's notice of the seriousness of the inquiry and because of the desirability of assuring businessmen that they can rely on accurate information.” Id. at 774).
Circuit’s decision in *Rankow*, and that Circuit’s journey through the brokerage cases. Those cases explained that, excluded from liability under Restatement § 552, are those who deal only in tangible products or non-informational services. Such businesses are deemed not to be “in the business of supplying information,” even though they are tangentially involved in supplying information.

That same concept is the jumping off point for Cardozo’s decision in *Glanzer v. Shepard*, where the Court made the leap from the dangerous product involved in *MacPherson* to the provision of a weighing certificate by a firm of public weighers:

> The defendants held themselves out to the public as skilled and careful in their calling. They knew that the beans had been sold, and that on the faith of their certificate payment would be made. They sent a copy to the plaintiffs for the very purpose of inducing action. . . . In such circumstances, assumption of the task of weighing was the assumption of a duty to weigh carefully for the benefit of all whose conduct was to be governed.

Moving ahead to *Kimmell*, we again see a case that has embedded in it Restatement’s conception of being “in the business of supplying information to others for guidance,” but it does so in terms of the “special relationship.” Put differently, a seller of goods, or a service provider who gives information but who does not meet the *Kimmell* factors, is not “in the business of supplying information.” And, conversely, those who

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222 See text accompanying n. 65-78, *supra*.

223 See text accompanying n.73, *supra*.

224 135 N.E. at 276-77. See also *International Products*, 155 N.E. at 664.

225 *Murphy v. Kuhn* is New York’s example. The Court of Appeals concluded: “The record does not support plaintiffs’ effort in this manner to shift to defendant insurance agent the customer’s personal responsibility for initiating, seeking and obtaining appropriate coverage, without something more than is presented here.” 682 N.E. at 975.
hold themselves out as having “information”, including financial or investment expertise, and who stand to benefit economically from a client’s reliance on that information, certainly qualify under *Kimmell*. In these respects, the two “tests” are the same - and neither is about privity.

Securities broker-dealers and their registered representatives even more certainly qualify both as being “in the business of supplying information for the guidance of others” or being in a “special relationship” with respect to their clients. These firms and the representatives must be licensed; they must pass an examination, and they must meet continuing education requirements. Their conduct is subject to exacting regulation, and they are subject to direct regulation by government and industry self-regulatory organizations. The nature of their business, when they offer advice, is rooted in the client reposing trust and confident in them. Their entire raison d’etre, the value they add to investors making complex investment choices, provides the pecuniary interest

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226 Note that in such cases, “privity” is not, and had never been the issue. There is direct contact, knowledge, etc. See *Small v. Fritz*, 65 P.3rd at 1259-60, 1266, discussed at text and notes accompanying n. 128-141, *supra*.

227 NASD Manual Rule 1031 (Registration Requirements). “Financial planners” need not be registered (*i.e.* licensed), unless they also earn commissions or fees for the purchase or sale of securities. Many if not most financial planners have that dual role. “Investment advisors”, *i.e.* money managers, typically acting under a Power of Attorney, make investment decisions for their clients for a fee, need not be licensed if the do not also earn commissions or fees for the purchase or sale of securities, but they must register under either the Investment Advisor Act of 1949 or the law of the state(s) in which they operate. When it comes to determining whether a “special relationship” exists under New York law, these different permutations ought not effect the outcome because each meets the *Kimmell* test - all qualify as being in a “special relationship” with their clients.

228 NASD Manual, Rule 1120 (Continuing Education Requirements)
that justifies the law imposing a diligence requirement. Where reliance on that supposed added-value leads to loss because of negligent representations of fact, liability ought to attach - and it does, in the Restatement states, and in New York as well.

Investment brokers, consultants and advisors’ business is to provide “investment advice”, i.e. they make recommendations to their clients. Webster’s defines “advice” as a “recommendation regarding a decision or course of conduct.” Neither the New York cases nor the Restatement of Torts refers directly to providing “advice” - they refer to “words” and “information”. But “advice,” by its nature, ought to be based on information, and those whose business is to give investment advice ought to act with reasonable care in giving that advice.

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229 Thus, in Continental Leavitt v. PaineWebber, 857 F.Supp. 1256, 1270-71 (N.D.Ill. 1994), the court, in finding that a duty of care existed in the context of brokerages, wrote:

unlike a discount brokerage house, PWI provides information and advice to its clients regarding investment opportunities. . . . At his deposition, [the broker] testified that PWI often supplied information and advice which did not generate commissions. . . . This advice is given in hopes of building relationships which later lead to commissions. . . . This evidence supports Plaintiff's allegation, at paragraph 4 of its First Amended Complaint, that PWI is “in the business of supplying information and rendering advice” to its customers.


230 In the process of doing so, they may make “representations of fact”, e.g. providing statistics about past performance. But the nature of their business is to use those facts as a basis of recommendations and advice. See generally, FINRA Rule 2310.


232 In Marchese v. Nelson, 800 F.Supp. at 891, the court explained the standard thusly:

The negligent representer need not be shown to have any intent to deceive the victim, and he generally does not demonstrably know that what he says is false. The law imposes on him the duty to reasonably assure the
Attorneys, of course, are held liable for malpractice if they give substandard advice to their clients. But non-attorney negligent misrepresentation claims are also often couched in terms of giving “negligent advice.” Indeed, the liability of other professionals, including physicians, accountants, engineers, insurers as well as the “commercial” entities covered by Kimmell, is frequently characterized by courts as involving giving “negligent advice.”

The extension of the concept of giving negligent advice explicitly to the recommendations of securities brokers and investment consultants and advisors is much

accuracy of what he represents, because of his superior position to obtain the needed knowledge and his pecuniary interest in the transaction.”

*Id.*


235 See, e.g., Morisaki v. Wallace, 2008 WL 2690055, at *2 (Cal.App. 4 Dist. 2008)(describing the tort of negligent misrepresentation as applying to “a professional who offers an opinion, information, or advice.”)

more recent, but very important. For example, *Toledo Blade Newspaper Unions Blad Pension Plan v. Investment Performance Services, LLC*, 237 was a case like that described in the Introduction of this article.238 A pension consultant advised its client, the Board of Trustees of a union pension plan to hire a particular (outside) investment manager that the consultant recommended.239 The defendants merely recommended the manager; they did not make the actual investment; they did not exercise discretionary authority or control with respect to management of the Plan or the disposition of Plan’s assets; and they did not advise the Plan as to the advisability of purchasing or selling any specific securities.240 Nevertheless, the defendants had played an active role in the selection of the manager, and they were contractually compensated for, *inter alia*, manager-search services.241

The court found that “the Trustees paid for and looked to [defendants] for investment expertise as to the Plan and its assets . . . . Defendants recommended, and vouched for [the investment manager]”242


See text and notes accompanying n.9, *supra*.

*Id.* at *1.

*Id.* at *8.

*Id.* at *9.

*Id.* at *8. See also *Engle v. Dinehart*, 2000 WL 554942 (5th Cir. 2000) (involving allegations of negligent failure to discover that an individual who was chosen by defendant to advise plaintiff and who defendant represented was a “certified financial planner” in fact was not certified).
The court then found that the manager who was hired pursued “an overly risky” and strategy with which defendants “went along. . . . cost[ing] the Plan millions of dollars.”\(^{243}\) Granting summary judgment to plaintiff, the Court explained:

> in spite of their duty to diversify to minimize the risk of large losses, Defendants admit to recommending [a manager] whose strategy . . . was apparently highly volatile. . . . Defendants breached their . . . duty of care either by allowing the large investment in . . . light of the high volatility or by being completely ignorant of the high risk . . . . [T]here is no reason to think [defendant’s] advice under these circumstances was . . . prudent. The Trustees relied on [the defendants] for [their] expertise and recommendations. . . .”\(^{244}\)

As the \textit{Toledo Blade} case demonstrates, when a careless investigation or careless speech, leads to damaging investment advice, the result is that a common-law tort has occurred, even as federal and state securities laws are not implicated (because there was

\(^{243}\) \textit{Id.} at *11.

\(^{244}\) \textit{Id.} at *12 [emphasis added]. The case alleged a breach of fiduciary duty under ERISA in addition to negligence, and the court’s discussion takes place in the context of a fiduciary’s duty to exercise care. There is, however, no significant difference between that scenario and the \textit{prima facie} elements of a negligent misrepresentation claim. ERISA, a statute directed at investments, provides for a prudent person standard with regard to the execution of fiduciary duties by a plan's fiduciary. It provides, inter alia that the plan’s fiduciaries act “with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims; and . . . diversify[] the investments of the plan so as to minimize the risk of large losses, . . . .” 29 U.S.C. §1104(a) (2008). Because the court herein found that defendants were fiduciaries and breached their fiduciary duty, “the Court need not address the alternative negligence claim, except to note that it carries a lower standard than the breach of fiduciary duty claim and would likely reach a similar conclusion.” The same thing can be said about New York law; cases such as \textit{Glanzer, International Products} and \textit{Kimmell} make clear that the duty to use reasonable care in giving advice exists even when there is no fiduciary duty.
neither a “purchase” nor a “sale”. ) The tort of giving negligent investment advice fills the gap.  

CONCLUSION

As this study demonstrates, the law recognizes a tort of “giving negligent investment advice.” In 1916, a tort was created for negligent misrepresentation in the sale of a machine. Society, and the law, had, at that time, begun to perceive cars as dangerous and a potential source of injury, and the law was adapting. Nearly 100 years later, we can say that society and courts have recognized that information about investments and finance have the same potential to cause damage as do cars. Thus the

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245 See text and notes accompanying n.10, supra., discussing financial advice, e.g. to retire, and the discussion of “holder” cases, text and notes accompanying n. 128-143, supra.

246 Ohio appears to be the only state whose courts have repeatedly referred to a tort of giving “negligent investment advice”, albeit they usually do so in the context of analyzing cases under the statute of limitations. See e.g. Avery B. Klein & Co. v. Joslyn, 1993 WL 106948 (Ohio App. 1993). These Ohio cases, however never question the existence of the tort, thereby implicitly validating it. Other state and federal courts have also used the term, again, usually in the context of describing (and implicitly, rather than explicitly, validating) such a claim. See e.g. Baff v. Redfield Blonsky & Co., 1995 WL 242107, at *1 (S.D.N.Y. 1995). Cf. Mosko v. Defilippo, 1991 WL 191211, at *3 (D.Mass. 1991) (stating, with regard to a separate “negligent investment advice” count: [i]t is unclear whether this is a claim under state tort law, or under the NASD rules themselves. To the extent that the plaintiff meant to set out a conventional negligence claim, she has already done so in her claims for negligent misrepresentation and breach of fiduciary duty. She cites no authority supporting a separate cause of action for negligent advice.”) The phrase “negligent investment advice” first appears in Starr v. O'Rourke, 5 Misc.2d 646, 159 N.Y.S.2d 60 (N.Y. Sup.Ct. 1957), a suit by a customer against a brokerage firm. The phrase is used by the court to describe the case; it is neither an explicit or implicit validation. It would take 50 more years for that to occur, but the time has come.
law now provider that brokers, and investment consultants and advisors, must always exercise diligence in the advice and recommendations they make to their clients.