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HEIGHTENED PLEADING STANDARD SHOULD BE APPLIED IN NEGLIGENT MISREPRESENTATION CASES

Monday, November 26th, 2012 at 12:00 am, by Ni Qian

How difficult should it be to sue an insurance company for misrepresenting that a patient is pre-authorized for hospitalization stay only to later disclaim his eligibility under the insurance plan? How much specificity does the investor-plaintiff need to allege in order to survive a motion to dismiss in a suit against the owner of a company he invested in for making irresponsible statements of future profitability in order to induce investment? These are the basic questions that are asked when deciding whether negligent misrepresentation claims should be subject to the heightened pleading standard established by [Rule 9\(b\) of the Federal Rules of Civil Procedure](#).

[The Current Debate on the Applicability of Rule 9\(b\) to Negligent Misrepresentation Cases](#)

Rule 9(b) is the heightened pleading standard generally associated with fraud complaints. It requires parties to "state with *particularity* the circumstances constituting fraud or mistake." This is above and beyond what is normally required under [Rule 8\(a\)](#), which only requires a pleading to contain "a short and plain statement of the claim showing that the pleader is entitled to relief." The particularity standard requires complaints to "set forth the time, place and contents of the false representation, the identity of the party making the false statements and the consequences thereof." The purpose of this standard is to ensure that defendants who are subject to accusations of fraud have enough information to be able to adequately prepare for defense.

Recently, the application of 9(b) over negligent misrepresentation claims has divided circuit courts of appeals. The [Second](#) and [Eighth](#) Circuits held that Rule 9(b) complaints do apply to such claims. The [Fourth](#), [Fifth](#) and [Seventh](#) Circuits, however, held that Rule 9(b) complaints do not apply to such claims. District courts in the 10th Circuit are split on whether to apply the rule.

The main question is whether negligent misrepresentation claims lie in negligence or fraud. But not all courts have found a bright line rule necessary when it comes to the application of Rule 9(b) to negligent misrepresentation claims. For example, the Colorado district court in [Denver Health & Hosp. Authority v. Beverage Distributors Co., LLC](#) recognized the circuit as well as district court splits on this issue, and held merely that the rule does not apply to the negligent misrepresentation claim in front of the court because the claim at bar had to do with whether the defendant used

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Should Negligent Misrepresentations Be Treated Like Fraudulent Misrepresentations?

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Generally, the difference between negligent misrepresentation and fraudulent misrepresentation is that the latter requires **proof of state of mind**—that the party must have the intent to induce another act in reliance on the representation that is made knowingly false or without knowing whether it was true or false. To prove negligent misrepresentation, the plaintiff merely needs to show that the false information was given because of a failure to use reasonable care and competence in obtaining or communicating such information.

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Some **courts** have distinguished between negligent misrepresentation claims that contain fraudulent undertones and what is termed “innocent” misrepresentation. In fact, some actions containing negligent misrepresentation claims also contain fraudulent misrepresentation claims based on the same facts. Perhaps they are closer to fraud than other actions only claiming negligent misrepresentation claims. Even so, does this distinction actually warrant different treatment at the pleading stage?

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As stated by Judge Mishler in *Ross v. A.H. Robins*, Rule 9(b) serves three purposes:

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First, it assures the defendant of “fair notice of what the plaintiff’s claim is and the grounds upon which it rests. . . .” Secondly, the specificity requirement grows out of “the desire to protect defendants from the harm that comes to their reputations or to their goodwill when they are charged with serious wrongdoing” [Thirdly,] in the context of securities litigation **Rule 9(b)** serves an additional important purpose. It operates to diminish the possibility that “a plaintiff with a largely groundless claim [will be able] to simply take up the time of a number of other people [by extensive discovery], with the right to do so representing an *in terrorem* increment of the settlement value, rather than a reasonably founded hope that the process will reveal relevant evidence” (citations omitted).

The first purpose—to give fair notice to the defendant of the plaintiff’s claims—surely applies in negligent misrepresentation claims. What is it about claims based in fraud that uniquely require pleading with particularity in order to provide such fair notice? It is clear that one cannot file a suit against another based solely on the vague ground that fraud was committed. But if the claim is based on misrepresentation, fraudulent or negligent, why is the time or place so important if the content and the party making the fraudulent misrepresentation are identified?

The rationale for the heightened pleading standard lies in the second and third stated purposes. It should be harder to plead fraud because it’s more damaging to the defendant’s reputation. The very act of having to defend oneself is already harmful, especially in business where one’s reputation is valuable and sometimes even imperative to the survival of the company. And it is due to this sensitivity that the very threat of lawsuit, even a frivolous one, could drive an otherwise innocent defendant to settle with the plaintiff. The question remains as to whether claims of negligent misrepresentation wreak the same kind of havoc.

Because the difference between fraudulent misrepresentation and negligent misrepresentation claims usually hangs on the state of mind of the party making the representations, the plaintiff may allege negligent misrepresentation only because he or she does not have enough information to allege the state of mind, thus using it as an alternative means of relief. Misrepresentation cases can frequently arise in investment situations—where an investor may have relied on false or misleading information—and in corporate transactions such as mergers and acquisitions. One can imagine that in these sensitive situations, where significant amounts of money are on the line and deals are made based on reputation and goodwill, claims of *negligent* misrepresentation could be just as harmful and debilitating as claims of fraudulent misrepresentation. For example, lack of reasonable care in projecting future financial data may be almost as damaging to a business deal as fraudulently fabricating the numbers.

Because the very scenarios that Rule 9(b) was created to prevent—opportunistic suits that coerce unfair settlements—are also present in negligent misrepresentation cases, Rule 9(b) should be applied in cases of negligent misrepresentation, regardless of whether fraud claims were also alleged based on the same underlying facts. This will help weed out more frivolous cases and lessen the exposure of businesses to unmeritorious claims. Courts should follow the [Second](#) and [Eighth](#) Circuits.

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