PROMISSORY FRAUD
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The protracted dispute between Michael Ovitz and Michael Eisner raised one issue that no one paid much attention to: Ovitz's implicit claim that Disney defrauded him when he was hired. Ovitz maintained that Eisner, as the CEO of Disney, promised to give him extensive powers at the company, but that Ovitz was shut out, virtually from day one. Eisner countered that he only made a conditional promise – Ovitz would get the powers only if he showed that he could handle them. Where's the suggestion of fraud?

In Eisner’s misrepresentation of intent. According to Ovitz’s reading of Eisner’s promise, Eisner represented that he intended to give Ovitz full CEO powers from day one. But those powers did not appear on day one, or after. And according to Eisner’s testimony, he didn’t intend to grant them unless Ovitz’s performance was up to snuff. On Ovitz’s version of events, then, Eisner may not only have breached his contract, he may also have committed promissory fraud: he made a promise he did not intend to perform.

This is the kind of issue that a litigator can easily overlook. The reason is no mystery: Promissory fraud is almost never taught in law school, and the cause of action flies under the canonical radar. Yet our research shows that in a majority of U.S. jurisdictions, there are more promissory fraud cases than cases involving more familiar doctrines like mistake and impossibility. And promissory fraud can be a powerful weapon. It permits the recovery of punitive damages for events surrounding a breach of
contract; it can allow a plaintiff to avoid procedural bars like the Statute of Frauds and parole evidence rule; and promissory fraud can even give rise to criminal liability.

While there are plenty of promissory fraud cases out there, we have found that promissory fraud claims are often mislitigated, with both plaintiffs and defendants missing significant opportunities. This article provides an introduction to the cause of action, outlines a number of practice tips for litigators, and suggests a few reforms. While we don’t think there should be more promissory fraud cases – and in fact recommend new ways for limiting promissory fraud liability – we do think that a good deal more attention should be paid to the details of the doctrine.

**The curious doctrine of promissory fraud**

Promissory fraud happens when a party enters into a contract with no intention to perform. The basic thought is that a promise implicitly represents an intent to perform, and this representation can be true or false like any other. In the words of one of the first decisions to recognize the cause of action, “the state of a man’s mind is as much a fact as the state of his digestion.”¹

While at first blush the doctrine can appear odd – a broken promise is not the same thing as a lie – in fact, a successful promissory fraud claim satisfies all of the traditional elements of deceit: representation of a material existing fact, falsity, scienter, deception and injury.² There is a misrepresentation: A promise represents a present intent to perform; where that intent is not present, the representation is false. The misrepresentation is almost always material: What party entering into a contract

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¹ Edgington v. Fitzmaurice, 29 Ch. D. 459, 483 (Ch. App. 1885).
wouldn’t want to know that the other side doesn’t intend to perform? The
misrepresentation is knowing (scienter), since the promisor must know his or her intent.
The promisee has reasonably relied by entering into and performing his or her side of the
agreement. And if the promisor then breaches, we have proximate harm: the whole point
of the representation of an intent to perform was to assure the promisee that he or she
could rely on performance happening.

While the above summary overlooks a few complexities, it shows that promissory
fraud is not really all that odd. Breach of contract is not fraud. But when the breaching
party never intended to perform in the first place, the promise is fraudulent, plain and
simple. Promisees have a right to think that they are bargaining for performance, not an
action for breach of contract.

Promissory fraud in New York

Until the mid-1990s, there was some confusion as to whether New York
recognized the action for promissory fraud. As early as 1957, the Court of Appeals, in
Sabo v. Delman, articulated and affirmed the basic idea behind the action:

While mere promissory statements as to what will be done in the future are not
actionable, it is settled that, if a promise was actually made with a preconceived
and undisclosed intention of not performing it, it constitutes a misrepresentation
of a material existing fact upon which an action for rescission may be predicated. 3

The next year, in Channel Master Corp. v. Aluminium Ltd. Sales, Inc., the Court extended
this rule to actions for damages, writing that ‘one who fraudulently misrepresents himself

3 3 N.Y.2d 155, 160 (1957) (citations and quotation marks omitted).
as intending to perform an agreement is subject to liability in tort whether the agreement is enforceable or not.\textsuperscript{4}

Despite their apparently clear language, \textit{Sabo} and \textit{Channel Master} did not put an end to the question of whether or not promissory fraud was actionable in New York. Lower courts found it difficult to reconcile them with dicta in a 1910 case, \textit{Adams v. Gillig}, which considered a claim that a real property purchaser falsely represented an intent to develop property for residential purposes. While \textit{Gillig} held the misrepresentation to be actionable, the Court emphasized that the representations at issue were collateral to the contract and suggested that “statements promissory in their nature and relating to future actions must be enforced if at all by an action upon the contract.”\textsuperscript{5}

Even after the Court of Appeals’ subsequent contrary statements in \textit{Sabo} and \textit{Channel Master}, lower New York courts, and especially the First Department, read \textit{Gillig} to entail that “a cause of action for fraud does not arise when the only alleged fraud relates to a breach of contract,”\textsuperscript{6} and that “[a] contract action may not be converted into one for fraud by the mere additional allegation that the contracting party did not intend to meet his contractual obligation.”\textsuperscript{7}

To our minds, these cases were misguided, since promissory fraud is a separate wrong, even if embedded in the contracting process. We believe the Court of Appeals cleared up this confusion in 1995, with its decision in \textit{Graubard Mollen Dannett &

\textsuperscript{4}4 N.Y.2d 403, 408 (1958).
\textsuperscript{5}199 N.Y. 314, 318 (1910). That this was dicta is shown by the next sentence in the opinion: “It is unnecessary to decide or discuss the question whether under some possible circumstances the courts will not in equity lay hold of false statements that are contractual in their nature to prevent the consummation of a fraud.” \textit{Id.}
Horowitz v. Moskovitz. Graubard once again affirmed that “[a] false statement of intention is sufficient to support an action for fraud, even where that statement relates to an agreement between the parties.”8 While this would seem to have decided the issue as far as New York law goes,9 federal courts applying New York law occasionally still rely on the earlier line of cases to dismiss promissory fraud claims.10 Attorneys litigating promissory fraud cases under New York law should take special care navigating these waters.

Evidentiary issues

To say that we can make sense of promissory fraud using the traditional definition of deceit is not to say that the cause of action doesn’t raise special issues. The most significant is proof of intent. Direct evidence of a bad initial intent – a defendant’s admission of his or her insincerity – is hard to come by. Absent such evidence, how can a plaintiff prove something as private and fleeting as the defendant’s intent at the time of formation?

Worries about proof of promisor intent once caused many jurisdictions to reject the action for promissory fraud. The thought seems to have been that, in order to allow proof of intent by circumstantial evidence, evidentiary standards would have to be so

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relaxed that every action for breach of contract would be transformed into a fraud case. And one still finds thinking along these lines in jurisdictions like Illinois, Michigan and Tennessee, where courts set an especially high evidentiary bar for promissory fraud claims.  

But once you start to look at actual cases, you quickly see that there are numerous situations in which there is more than enough independent evidence of a bad initial intent. Think about the Georgia crematorium owner, who had over the course of many years failed to perform hundreds of promises to cremate remains, leaving them instead to decompose in a field. Or the itinerant roofing contractor, who takes a down payment on the job and then immediately moves on to the next town to make similar broken promises. 

Proper judicial policing of the sufficiency of pleadings and evidence should prevent plaintiffs from turning run-of-the-mill breach of contract cases into actions for promissory fraud. Most states have some analog to Rule 9(b) of the Federal Rules of Civil Procedure, which requires plaintiffs to plead fraud in particularity. In New York, CPLR section 3016(b) requires that where a cause of action or defense is based on fraud, “the circumstances constituting the wrong shall be stated in detail.” We believe that where the claim is one of promissory fraud, courts or legislatures should require even more: a plaintiff should have to plead independent evidence – other than the mere fact of breach – of an initial intent not to perform. Finally, in cases that survive the pleading

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11 See Advent Elecs. v. Buckman, 918 F. Supp. 260, 264-65 (N.D. Ill. 1996) (requiring proof of a scheme or device to defraud); Jim-Bob, Inc. v. Mehling, 443 N.W.2d 451, 460 (Mich. Ct. App. 1989) (holding that “the evidence of fraudulent intent must relate to conduct by the actor at the time the representations are made or almost immediately thereafter”); Sanders v. First Nat’l Bank, 114 B.R. 507, 516 (M.D. Tenn. 1990) (requiring “direct proof of a misrepresentation of actual present intention”). New York sets an extra high evidentiary bar for the crime false promise, requiring evidence “excluding to a moral certainty every hypothesis except defendant’s intention or belief that the promise would not be performed.” N.Y. Penal Law § 155.05(2)(d) (Consol. 2001).
stage, judges should still be quick to grant motions for summary judgment when, after
discovery, the plaintiff cannot present independent evidence of bad intent.

Of course it is the attorneys representing parties to promissory fraud cases who
are responsible for developing evidence of the defendant’s initial intent. Whether you
represent plaintiff or defendant, it is helpful to think of the evidentiary question in terms
of changed circumstances: Are there any facts to suggest that between the time of
promising and the time of breach, the defendant changed his or her mind about
performing? (Remember, the central fact is not the defendant’s intent at the time of
breach, but at the time of promising.) The best defensive evidence is an unforeseen event
– such as a change in market price, increased cost of performance, or a better offer – that
explains why the defendant changed his or her mind about performing. Correspondingly,
a plaintiff who can argue no changed circumstances makes a good case for no change of
heart. For the same reason, the length of time between promise and breach can be
relevant. A short period between formation and the first sign of an intent to breach
narrows the window for changed circumstances to occur and makes it much less likely
that the defendant reconsidered performance. The longer the time, the more likely the
defendant had a change of heart.

A defendant’s partial performance can be strong evidence of an initial intent to
perform. Why invest in performance if you intend to breach? That said, we also see
cases where partial performance was used to string the plaintiff along – such as where a
remodeling contractor performs just enough (knocking down a wall, leaving some tools
at the house) to convince the plaintiff not to bring an immediate action for breach. As

\[12\] We explore evidence of misrepresented intent in much more detail with reference to the case law in
with all circumstantial evidence of intent, the appropriate inference will be highly context dependent.

In addition to changed circumstances, events and conditions at or around the time of promising can be strongly indicative of promisor intent. For instance, a buyer who is teetering on the edge of bankruptcy and purchases on credit probably knows that he or she will be unable to make the promised payments. Alternatively, independent evidence of deceit – for example, other lies surrounding the promise – can also show that the promisor was stringing the promisee along. Or the promisor may take actions inconsistent with performance. A contractor who promises to begin work immediately, but uses the down payment to buy plane ticket to Tahiti leaving the next day cannot intend to perform.

Practitioners should also remember the doctrine of chances. One broken promise may be the result of changed circumstances or chance, but a repeated string of similar breaches gives rise to the inference that they were all the result of a similar intent not to perform. Finally, while never dispositive – and certainly never enough on its own to survive a motion for summary judgment – the fact that the promisor did not perform is relevant to assessing his or her initial intent.

We summarize these various forms of evidence in Table 1.

Table 1

Circumstantial evidence of promisor intent

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<th>1. post-promise events</th>
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<td>a. whether there were any changed circumstances that account for a post-promise decision not to perform</td>
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b. the length of time between promise and nonperformance,
c. whether the promisor made any attempt to perform,

2. circumstances at or around the time of promising
   a. the promisor’s initial awareness of conditions likely to prevent her performance,
   b. evidence that the promisor intended to deceive the promisee
   c. other significant promisor behavior

3. other similar unexcused instances of non-performance (the doctrine of chances)

4. breach

Possible pitfalls and recommended reforms

While promissory fraud is a form of deceit like any other, these implicit representations of intent raise some unusual problems in litigation. Three bear special mention: the importance of separate proof of scienter, some problematic uses of promisor testimony as to intent, and the possibility of promises that do not represent an intent to perform.

In the traditional action for deceit, a plaintiff must prove scienter: that the defendant was not merely mistaken, but that he or she made the misrepresentation knowingly or with reckless disregard of the truth. In promissory fraud cases, however, we often find courts omitting separate proof of scienter. Courts reason that a promisor cannot be mistaken about his or her own intent. Thus if the defendant didn’t intend to perform, the misrepresentation must have been a knowing one, and hence there is no need for separate proof of scienter. As one Maryland court put it, “any promise that is made
with the present intention not to perform . . . is, perforce, an intentional misrepresentation.”13

While there is something to this intuition, defense attorneys should resist the assumption that every misrepresentation of intent is perforce an intentional misrepresentation. Two important exceptions are promises made by a principal’s agent, and cases where the defendant didn’t understand the meaning of his or her promise.

While a natural person always knows his or her own intent, an agent may not be aware of the principal’s intent, or a principal aware of an agent’s representations. In Leisure American Resorts v. Knutilla,14 for example, representatives of a time-share seller informed an owner that the company would repurchase the owner’s time-share, though the company’s policy was to repurchase only in hardship cases. While the Alabama Supreme Court affirmed a finding of promissory fraud, it described no evidence that the misrepresentations were made knowingly – that the representatives weren’t simply misinformed as to the company policy. Nor was there any discussion of whether a mistake of this sort was reckless, or whether it might be a mere matter of negligence or even a reasonable mistake. This was wrong. In such cases, separate proof of scienter should be required.

A promisor can also mistakenly misrepresent her intent if she doesn’t understand the meaning of her own promise. In Beneficial Personnel Services v. Rey,15 an employer promised to provide employees the same benefits as described in the Texas Worker’s

13 Miller v. Fairchild Indus., Inc., 629 A.2d 1293, 1304 (Md. Ct. Spec. App. 1993); see also Restatement (Second) of Torts § 530(1) cmt. b (1979) (If a speaker does not have the intention he represents himself to have, “he must of course be taken to know that he does not have it.”); Fowler V. Harper, et al., The Law of Torts § 7.8, 418 (3d ed. 1996) (“[I]nnocent false statements could scarcely include false statements of one’s own intention, or promissory fraud.”).
14 547 So.2d 424 (Ala. 1989).
15 927 S.W.2d 157 (Tex. App. 1996), vacated by request of both parties and without reference to the merits, 938 S.W.2d 717 (Tex. 1997).
Compensation Act, though an internal directive stated that employees were not to be allowed to choose their own doctors – a restriction that the Act would have disallowed. In this case, the Texas Court of Appeals correctly recognized that the misrepresentation would have been a matter of mistake if the employer didn’t understand what benefits were guaranteed by the Act – that is, didn’t understand the meaning of its promise. Thus separate proof of scienter was necessary. The court found the requirement met, however, because even if the misrepresentation was not knowing, such a mistake would have been reckless. Again, defense attorneys in such situations will do well to insist on separate proof of scienter.

The possibility of misrepresentations of intent that result from mistakes of meaning brings us to a second observable pitfall: the misuse of a defendant’s in-court testimony. A defendant to a breach of contract action should be allowed to argue an alternative interpretation of the contract. But then we must guard against allowing the plaintiff to turn those arguments against the defendant as evidence of an intent not to perform. Yet we find cases where just this happens – where a defendant’s legitimate alternative interpretation of the contract (“What I meant was…”) gets turned against the defendant as evidence promissory fraud (“But then you didn’t intend…”). Thus in our introductory example of the Ovitz/Eisner dispute, we would be comfortable allowing Ovitz to prove Eisner’s bad initial intent by pointing to the fact that Eisner immediately failed to perform (no changed circumstances), or that he took actions at the time of promising that were inconsistent with an intent to perform. We would be less sanguine, however, about any attempt to use Eisner’s testimony regarding his alternative interpretation of the contract to prove a bad initial intent. Eisner should be allowed to
argue a reasonable alternative interpretation without opening himself up to accusations of promissory fraud.

Similar issues arise where courts admit a defendant’s in-court denial that he or she ever made the promise as evidence of promissory fraud. As we noted above, a pattern of deception can be evidence of no intent to perform. Thus a defendant’s pre-litigation denial of a promise may be relevant to proving promissory fraud. But in-court statements should be treated with more suspicion. The Oregon Supreme Court correctly diagnosed the danger:

Such denial implies not at all that, if the promise were made, there was no intention to perform. And it certainly does not bar the defendant, when the evidence is all in, from saying to the plaintiff: “Even though the trier of fact may believe I made the promise, there is no proof that I did so fraudulently because of an intention not to perform.” Bad indeed would be the case of the honest man who has made no such promise, if when falsely charged with it, he may not deny it without having his truth considered as some evidence either that there was such undertaking or that it was deceitfully made.

At the very least, where such statements are admitted, courts should insist on separate proof of scienter – for the reasons discussed above.

Finally, litigators should keep in mind is the possibility that some promises might not represent an intent to perform. The Second Restatement of Torts gets it seriously wrong when it declares that “a promise necessarily carries with it the implied assertion of an intention to perform.” The drafters here would have done well to recall Holmes’s

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16 Holland v. Lentz, 397 P.2d 787, 796 (Or. 1964) (quoting McCreight v. Davey Tree Expert Co., 254 N.W. 623, 625 (Minn. 1934)).
17 Restatement (Second) of Torts § 530, cmt. c (1977). The Second Restatement of Contracts takes a more nuanced view, stipulating that “[i]f it is reasonable to do so, the promisee may properly interpret a promise as an assertion that the promisor intends to perform the promise.” Restatement (Second) of Contracts § 171(2) (1981). The comments indicate that when the drafters inserted the “if reasonable to do so” proviso,
famous dictum that “the duty to keep a contract at common law means a prediction that you must pay damages if you do not keep it, – and nothing else.”\textsuperscript{18} Between sophisticated, repeat-players, it may be understood that one or both parties retains an option of breaching and paying damages – and therefore may only intend to perform or pay damages.\textsuperscript{19} To take a particularly stark example, in some circumstances Delaware corporate law requires acquisition targets to affirmatively solicit better offers and to auction the firm to the highest bidder once takeover becomes inevitable.\textsuperscript{20} Acquirers entering into merger agreement should know that the target may have a duty before closing to consider, and even to solicit, subsequent better offers that may cause it to breach the merger agreement. The target company cannot intend to perform a merger agreement come what may, for the law permits it to have at most a conditional intent.

We believe that, as an empirical matter, most contracts do represent an intent to perform. But certainly there are contexts – for example, against a background of mutually understood business practices – where this is not the parties’ understanding. And we see no reason why, in a given case, the parties should not be able explicitly to disclaim any representation of an intent to perform, thereby avoiding most liability for promissory fraud. Thus what the Second Restatement of Torts takes as a necessary representation, we would recommend as an interpretive default: Courts should interpret a


\textsuperscript{19} The Southern District has suggested that the legitimacy of an intent to perform or pay damages explains New York’s (old) reluctance to recognize promissory fraud: “The rationale for this rule is that a party need not be expressing an unconditional intention to perform by contracting, and may instead be expressing an intention either to perform or suffer the ordinary contractual consequences for a breach.” \textit{VTech Holdings Ltd. v. Lucent Technologies, Inc.}, 172 \textit{F.Supp.2d} 435, 439 (S.D.N.Y. 2001).

\textsuperscript{20} \textit{Revlon v. MacAndrews & Forbes}, 506 A.2d 173, 182 (Del. 1986) (when a sale is inevitable, the target’s board of directors is required to act as would “auctioneers charged with getting the best price for the stockholders at a sale of the company.”).
promise as implicitly representing an intent to perform *absent evidence to the contrary*. Such evidence can include local business practice, course of dealings between the parties, and the explicit terms of the contract.

Assuming that a court were to accept the defendant’s argument that he or she made a “Holmesian” promise, which did not represent an intent to perform, the plaintiff might still push forward with a claim of promissory fraud. The point here – and it will be our last one – turns on the difference between *not intending* to perform and *intending not* to perform.

If the parties treat the contract as a promise to perform or pay damages, it is perfectly acceptable if the promisor does not intend to perform. Thus he or she might intend to perform only under certain (undisclosed) conditions, or might intend to perform or pay damages, all without misrepresentation. But it would still be wrongful if the promisor entered into the agreement with an affirmative intent not to perform – believing from the start that performance would not happen. A comparison to option contracts is helpful here. If Gertrude buys an option to purchase Pablo’s house, she does not commit promissory fraud if she intends to purchase only under certain undisclosed circumstances. The point of an option is to allow the option holder to decide later on. But Gertrude arguably commits promissory fraud if, at the time of purchase, she intends not to exercise the option under any circumstances, but buys it merely to keep Pablo from selling to a third party. Similarly, a Holmesian promisor who intends to breach in any circumstances is still guilty of promissory fraud.

The idea of insincere promises is familiar in literature. In the *Producers*, the audience knows that Max Bialystock never intends to give his investors a return from
Springtime for Hitler. In the Frog Prince, the Brothers Grimm tell us that the king’s daughter never intends to befriend the frog, though she promises to do so if he will retrieve her golden ball. And after so many bad acts, who can believe that Lucy ever intended to hold the football for Charlie Brown. These are cases of art imitating life. But while literature has plumbed the idea of insincere promising, the law has only begun to do so. The challenge of promissory fraud is to craft an appropriate response to this special form of bad behavior.