30. Transactional Torts

"In business, sir, one has no friends, only correspondents."

– Alexandre Dumas

Introduction

In this chapter we look at torts that arise in the context of business transactions. These are often called "business torts," although businesses deal with *all* torts, from negligence to defamation. What makes these torts unique is that they are tied to deals and transactions – the *business of business*, if you like. We will see buyers suing sellers, lawyers suing accountants, and sports agents suing sports agents. As opposed to the personal injury torts we have been exploring, the primary harm here is economic. But that is not to say things don't get personal. Transactional-tort cases frequently involve a surprising amount of spite and pique – something you will see in the cases below.

There are a variety of causes of action that could fall under the umbrella of transactional torts, but this chapter covers a few particularly important ones: intentional economic interference, fraud, and breach of fiduciary duty. They are all torts that pick up where contract law leaves off in defining the legal landscape for conducting commerce.

For all transactional torts, it is important to keep in mind the overarching default rule: Where the gravamen of the plaintiff's complaint is that a contract has been breached, then the plaintiff's only remedy is breach of contract. Tort law is not supposed to interfere in the contractual context – at least not unless the rationale is highly compelling. But that is not to say that these torts are infrequently alleged. For plaintiffs in business disputes, tort law has great allure. Tort law's concepts of compensatory damages are more expansive than those under contract law. Plus, for real bad apples, there is the possibility of punitive damages. And business disputes often turn up bad apples. Also, plaintiffs going to trial on a tort may

benefit may from a strategic advantage. In a regular contract dispute, evidence that makes the defendant look bad is likely to be irrelevant, and therefore inadmissible. But if a tort is alleged, the plaintiff's lawyers may be able to put before the jury all sorts of disparaging evidence because it is relevant to showing tortious intent.

Because of these advantages, plaintiffs are always looking for ways to tortify contract disputes. And that means courts are always looking for ways to keep this drive toward tortification from getting out of hand. In fact, one theme that runs through the doctrines of intentional economic interference, fraud, and breach of fiduciary duty, is the existence of safeguards put into the doctrine that are meant to prevent workaday contract disputes from morphing into mudslinging tort litigation.

Intentional Economic Interference

The idea behind the cause of action for **intentional economic interference** is that a person should be free to seek economic opportunities without being impeded by intermeddling ne'er-do-wells.

Suppose I manage to get a contract with my neighbors to mow their lawn – something that will give me enough cash to go to the movies and buy a few new video games. Yet you – just because you want to see me fail – work to destroy my nascent lawn mowing business, and you manage to cause my neighbors to terminate my services.

At this point, I can sue you for intentional economic interference. But we should stop to wonder why I would need such a cause of action to sue you. Most of the things you could do to sabotage me are already tortious. For instance, you could tell lies about me that would cause my neighbor to fire me. You could steal my lawn mower. Or you could put sugar in the mower's gas tank. If you do all that to me, I can sue you for intentional economic interference, but I can also sue you for defamation, trespass to chattels, and conversion. So the question is, why does tort law need an independent cause of action for intentional economic interference?

The true value of the intentional economic interference tort shows its worth when something particularly sneaky is afoot. Say you convince your little brother and sister to go over to play with the neighbors' kids and convince them to host an elaborate tea party on the lawn during what you know to be the only hours I have free to get the mowing done. Let's say you do this two weeks in a row, at which point the neighbors terminate my services because I'm not getting the job done. In such a situation, I would have no claim for trespass, conversion, or defamation, but my claim for intentional economic interference will let me in the courthouse doors.

Instead of having a single tort of "intentional economic interference," many jurisdictions have two causes of action: the tort of **intentional interference with contract** and the separate tort of **intentional interference with prospective economic advantage**. Both torts are essentially the same, except that with the former, there is a contract between the plaintiff and a third party. With the later, there would have been a contract but for the defendant's actions.

Here is a statement of the blackletter rule for intentional economic interference:

> A plaintiff can establish **a prima facie case for intentional economic interference** by showing: (1) there is a valid contract or non-speculative economic expectancy between the plaintiff and a third party; (2) the defendant had knowledge of this economic interest; (3) the defendant intended to interfere with this economic interest; (4) but for the interference, the plaintiff would have received the benefit of the economic interest; and (5) the plaintiff thereby accrued damages.

These elements are mostly self-explanatory, but a few observations should be made.

First, it bears emphasis that the economic interest (the contract or prospective economic advantage) must arise between the plaintiff and a *third party* – that is, someone who is not the defendant. If the defendant backs out of a contract, the remedy is breach of contract.

Tort law will not enter the mix. Another way of putting this is that a defendant cannot interfere with its own contract – it can merely breach it.

Although it may not be apparent at first glance, the blackletter formulation of intentional economic interference is very expansive. The fact is that competitors try to deny each other economic interests all the time. Check the elements above, and you'll see, for instance, that a car dealer undercutting a competitor's price could be actionable. But that's the essence of our free-market economy, and we don't want it to be deemed tortious. Another vast category of conduct that could be swept up into the scope of the prima facie case for intentional economic interference is what attorneys do: Give advice. Suppose a client asks you for a mixture of business and legal judgment about whether she or he should back out of a deal. Taking account of the legal liabilities and the business ramifications, you advise your client to do just that, and your client follows your advice. Check the elements above: That qualifies as a prima facie case. And yet we don't want attorney advice to be considered tortious.

Because of the overinclusive scope of the prima facie case for intentional economic interference, much of the doctrinal work is done in the form of affirmative defenses, in particular the nebulous and wide-ranging concepts of "privileges" and "justifications." Bona-fide competition, for instance, is considered a justification. Bona-fide business or legal advice is also considered a justification – although under some formulations, the advice must be asked for. Other justifications include having a financial interest in the matter or being in a position of responsibility for the welfare of the third party. Courts generally have wide latitude in determining whether to find conduct privileged or justified, and courts are expected to take public policy concerns into account in making that determination.

The fact that ill-defined defenses are so heavily relied upon to give shape to the doctrine of intentional economic interference means that even a losing claim can have legs in litigation. Since justifications are fact-intensive affirmative defenses, it follows that they generally cannot be used at the pleadings stage. This means that even a losing claim for intentional economic interference can have considerable

strategic value in litigation. Until it can be knocked out on summary judgment, it can permit discovery into otherwise irrelevant matters, drive up expense, and give defendants an extra incentive to settle.

Case: ***Calbom v. Knudtzon***

This intentional economic interference case pits accountants against a lawyer.

Calbom v. Knudtzon

Supreme Court of Washington
October 29, 1964

65 Wn.2d 157. HARRY B. CALBOM, JR., Respondent, v. HALVOR KNUDTZON, SR. et al., Appellants. No. 37076.

Justice ORRIS L. HAMILTON:

Plaintiff (respondent) instituted this action seeking recovery of damages upon the grounds that defendants (appellants) had interferred with and induced a breach of an attorney-client relationship. Defendants appeal from an adverse judgment.

On May 1, 1958, K.T. Henderson, sole proprietor of a successful general contracting business, unexpectedly died of a heart attack. His death created pressing problems pertaining to the continuing operations of his business. Mrs. Jessie Bridges, Mr. Henderson's office manager, immediately contacted plaintiff, who was personally acquainted with the Hendersons and who, as a practicing attorney, had served them occasionally. Plaintiff, in substance, advised Mrs. Bridges that before he could intelligently give counsel he would have to know whether Mr. Henderson left a will and, if so, who was named as executor or executrix therein, and the provisions thereof. Mrs. Bridges then contacted Mrs. Henderson and a meeting was arranged between plaintiff, Mrs. Henderson, and Mrs. Bridges. At this meeting, it was disclosed that Mr. Henderson had left a will naming Mrs. Henderson his executrix, and that she desired to continue the business. She requested that plaintiff make arrangements to carry out her wishes.

would be the best example yet of puffing in the pie-in the-sky sense.

AFFIRMED.

Questions to Ponder About *Speakers of Sport v. ProServ*

A. Judge Posner writes in this decision, "Once a case gets to the jury, all bets are off." Is he showing shockingly little faith in the jury system – especially considering his position as a judge? Or is he just being realistic?

B. Do you agree that a promise of obtaining $2 million to $4 million in endorsements is "pure fantasy and gross exaggeration" and "meaningless superlatives that no reasonable person would take seriously"? Do you think Rodriguez took it seriously?

C. Does the existence of tort doctrine in this area stifle competition by creating a cloud of possible liability when competitors fight for clients? Or does it aid competition by forcing business interests to provide information that is more accurate, thus leading to more efficient outcomes in the marketplace?

Fraud

The most hallowed way to turn a contract dispute into a tort lawsuit is through a charge of fraud. The cause of action for fraud, which is sometimes called "deceit" or "intentional misrepresentation," provides a cause of action where the defendant knowingly misrepresents facts for the purpose of inducing the plaintiff to do something, and the plaintiff actually, justifiably, and detrimentally relies on the misrepresentation.

Here is the blackletter formulation:

> A plaintiff can establish a **prima facie case for fraud** by showing: (1) A material misrepresentation by defendant, (2) scienter (defendant's knowledge of falsity), (3) the defendant's intent to induce reliance on the part of the plaintiff, (4) the plaintiff's (a) actual and (b) justifiable reliance on the misrepresentation,

> and (5) the plaintiff's accrual of actual damages as a result.

Several of these elements bear elaboration.

First, the there must be a **misrepresentation**. The misrepresentation is usually an affirmative statement of fact that turns out to not be true. There are as many examples of misrepresentations as there are con-artists: saying that land is owned free and clear by the defendant (when it's not), saying that certain computer equipment can process a certain amount of data per hour (when it can't), or saying that a certain motor oil meets certain industry standards (when it doesn't). Any of these sorts of statements, if false, can be the basis for a fraud claim.

Yet a misrepresentation does not need to be an affirmative statement of fact to be the basis of a fraud claim. Actively concealing facts can count as a misrepresentation as well, as can nondisclosure when there is a duty to disclose. Suppose a real estate agent installs a fake circuit-breaker panel to make a home inspector think that a house's wiring is up to code. That concealment counts as a fraudulent misrepresentation.

Even a promise can constitute a misrepresentation – that is, if the defendant has no intention of keeping it. Taking an advance payment from your neighbor for mowing the lawn next weekend – when you already have airplane tickets to abscond overseas – counts as a fraudulent misrepresentation. Where a promise is the basis of a fraud claim, the cause of action is sometimes called "promissory fraud."

It is often said that the misrepresentation must be **material**. In law, to say something is material is to say "it matters." Suppose a sales associate at a used car lot lies by telling you the car you are thinking about buying was inspected on Tuesday, when, in fact, it was inspected on Monday. This misrepresentation is immaterial, and therefore it could not be used as the basis for a fraud claim. However, suppose the sales associate tells you the car has never been involved in an accident – when, in fact, it once skidded off the road into a lake where it sat for three days before being pulled out. That is

definitely a material misrepresentation. So it could form the basis for a fraud claim.

Second is the requirement of **scienter**. The word scienter ("sigh-EN-tur," among other pronunciations) is a legal term that often comes up in economic contexts. It is from the Latin for "to know," the same root word underlying "science." In fraud, the scienter requirement is the requirement that the plaintiff either knew that the representation was false or else acted recklessly as to the truth in making the statement.

Third, is the **intent** requirement – the defendant had to intend for the plaintiff to rely on the statement at issue. Typically, the defendant's intent to have the plaintiff rely on the misrepresentation is for the ultimate purpose of monetary gain.

While the first three elements focus on the defendant, the final two directly concern the plaintiff.

The fourth element is **reliance** – that the plaintiff actually and justifiably relied on the misrepresentation. Courts usually present this as one element, but it is useful to break it down into two sub-elements: (a) actual reliance, and (b) justifiable reliance.

The requirement of **actual reliance** is an actual causation requirement, and it can be measured by the but-for test. Would the plaintiff have avoided undertaking the detrimental action but for the defendant's misrepresentation? That is, but for the misrepresentation, would the plaintiff have suffered the complained of loss? Actual reliance is subjective – it has to do with what the plaintiff actually believed.

The requirement of **justifiable reliance**, on the other hand, is objective: It must have been reasonable for the plaintiff to have been fooled by the misrepresentation.

Working together, the requirements of actual and justifiable reliance greatly cut down on the possible universe of fraud cases that can be brought. Actual and justifiable reliance call for a plaintiff who threads the needle: If the plaintiff is savvy enough to avoid actually being swindled, then the plaintiff has no case. If the plaintiff *should have been*

savvy enough to avoid being swindled, then the plaintiff has no case. Thus, fraud requires a goldilocks plaintiff: One unaware enough to have been actually duped, but not so gullible as to be objectively unreasonable.

Finally, fraud requires actual damages, an insistence captured in the requirement that the plaintiff relied on the misrepresentation to the plaintiff's **detriment**.

Case: *Berger v. Wade*

The following case illustrates how the requirement of justifiable reliance can screen out cases the law deems unworthy of compensation. It also reveals another aspect of fraud doctrine – its use as a defense to enforcement of contractual obligations.

Berger v. Wade

Court of Appeals of Ohio, First District
March 28, 2014

Alfred J. BERGER, Jr., Plaintiff–Appellant, v. Martin WADE, Defendant–Appellee/Third–Party Plaintiff, and Christopher Rose, Third–Party Defendant. No. C–120863.

PER CURIAM:

[Alleged fraud victim Martin Wade signed a guaranty for a short-term business loan of $100,000 evidenced by a promissory note. When Wade was called upon for payment, he claimed to be the victim of fraud.]

~Alfred J. Berger, Jr., appeals from the trial court's judgment in favor of defendant-appellee/third-party plaintiff Martin Wade, on Berger's claim that Wade had failed to repay a business loan that he had personally guaranteed. Berger contends that the trial court erred when it found that he had fraudulently induced Wade into executing the guaranty agreement. We agree and reverse.

In 2006, third-party defendant Christopher Rose, a local developer, approached Wade about investing in The Rookwood Corporation, doing business as The Rookwood Pottery Company ("Rookwood"). By 2009, Wade had invested over $1

> agreement existed or not, Berger could proceed against Wade personally if the note was not repaid. Wade acknowledged that he had waived the right to require Berger to proceed first against "any other person or any security." In light of these facts, Wade's assumption that Berger would not elect to proceed against him for the funds, and his reliance on that assumption, was simply not sustainable.
>
> We hold that Wade's belief that the fictitious security agreement would protect him from having to satisfy the amount due on the note was not justified under the circumstances. Accordingly, we conclude that the judgment as to the fraudulent-inducement defense was against the manifest weight of the evidence. The third assignment of error is sustained.~

Fraud: Pleading Requirements

Fraud has a procedural component that plays a strong role in shaping the tort in practice. Unlike most tort claims, a claim for fraud must be pled with "specificity." This longstanding requirement is entirely independent of the recent "Twiqbal" doctrine – which you may have learned about in your civil procedure class – that has ratcheted up pleading requirements in federal courts. *See Bell Atlantic Corp. v. Twombly*, 550 U.S. 544 (2007) and *Ashcroft v. Iqbal*, 556 U.S. 662 (2009).

Fraud's pleading requirement means that plaintiffs alleging fraud must come right out at the beginning of the lawsuit and explain how they were suckered by the defendant. The standard justification for this requirement is that without it, plaintiffs could go on "fishing expeditions," filing lawsuits on speculation and then using the powerful mechanisms of civil discovery to churn up evidence to see if there is anything upon which to base a claim.

The pleading requirement reflects a congenital difficulty for fraud doctrine. Its substantive foundation is an allegation of the plaintiff's ignorance. That seems to invite plaintiffs to use alleged ignorance as a shield at the pleading stage, thus creating fertile ground for strategic behavior aimed at garnering low-value settlements from defendants simply wanting to avoid litigation expense. On the other hand, fraud,

in fact, is meant to address situations where a plaintiff suffers losses on account of a defendant intentionally denying to the plaintiff the full facts, so it seems unjust to require the plaintiff to know everything in detail before filing suit. Thus, courts trying to strike the right balance are put in a difficult position.

Case: *Committee on Children's Television v. General Foods*

The following case shows the cause of action for fraud used in a novel way for consumer "impact litigation" – that is, litigation intended to have society-wide effect. The case also shows how the pleading requirement works to shape the substance of the fraud tort.

Committee on Children's Television v. General Foods

Supreme Court of California
December 22, 1983

Cal.3d 197. Committee on Children's Television, Inc., et al., Plaintiffs and Appellants, v. General Foods Corporation et al., Defendants and Respondents. L.A. No. 31603. Named plaintiffs included five organizations (The Committee on Children's Television, Inc.; the California Society of Dentistry for Children; the American G.I. Forum of California; the Mexican-American Political Association; the League of United Latin American Citizens), as well as individual adults, and individual children. Opinion by Broussard, J., with Mosk, Richardson, Kaus, Reynoso and Grodin JJ., concurring. Separate concurring and dissenting opinion by Bird, C. J, not reproduced here.

Justice ALLEN E. BROUSSARD:

Plaintiffs appeal from a judgment of dismissal following a trial court order sustaining demurrers without leave to amend to their fourth amended complaint. The complaint essentially charges defendants – General Foods Corporation, Safeway Stores, and two advertising agencies – with fraudulent, misleading and deceptive advertising in the marketing of sugared breakfast cereals. The trial court found its allegations insufficient because they fail to state with specificity the advertisements

> defendants would have obtained practical immunity from statutory and common law remedies designed to protect consumers from misleading advertising.
>
> It can be argued that administrative investigation and rule making would be a better method of regulating advertising of this scope and character. The California Legislature, however, has not established the necessary administrative structure. It has enacted consumer protection statutes and codified common law remedies which in principle apply to all deceptive advertising, regardless of complexity and scale, and, we believe, regardless of whether the advertisement seeks to influence the consumer directly or through his children. Established rules of pleading should not be applied so inflexibly that they bar use of such remedies.~
>
> Plaintiffs should be permitted to amend their complaint on behalf of the parent and child plaintiffs under the causes of action for fraud.~

Questions to Ponder About *Committee on Children's Television v. General Foods*

A. Does the court strike the right balance with the specificity requirement? That is, does the holding take due account of the need to prevent strategic gamesmanship, give defendants the capacity to fairly defend themselves, and yet allow meritorious claims to move forward?

B. Do you find it problematic that this case is in court? Should litigation be used in this way to challenge industry-wide practices? Or would this better be left to regulation – such as through the U.S. Food and Drug Administration? Or is there any problem with allowing regulation and this kind of litigation to co-exist?

Breach of Fiduciary Duty

There are many sorts of "duties" under the law. In negligence, a person owes a *duty of due care* to all foreseeable plaintiffs to use appropriate cautions to avoid injury. When two parties conclude a contract, one party will owe a *contractual duty* to the other. Another kind of duty under the law is *fiduciary duty*.

The word "fiduciary" comes from the Latin *fiducia,* "to trust," and it appears related to *fidelis,* meaning "faithful." A fiduciary duty is a very high duty – much higher than a contractual duty and much, much higher than the duty of due care. In a fiduciary relationship, one party is assumed to be looking out for the other and protecting the others' interests – thus, "fiduciary duty."

While a contractual duty arises out of a contract, and while a duty of due care arises out of being within injury-range of another person, a fiduciary duty only arises in a relationship where "special confidence and trust is reposed in the integrity and fidelity of another and there is a resulting position of superiority or influence, acquired by virtue of this special trust." *Groob v. KeyBank*, 108 Ohio St.3d 348, 351 (Ohio 2006) (internal quotes omitted).

When one person owes a fiduciary duty to another, that person is "bound to act in good faith and with due regard to the interests of the one reposing confidence." *Steelvest, Inc. v. Scansteel Service Center, Inc.,* 807 S.W.2d 476, 485 (Ky. 1991) (internal quotes omitted). If the fiduciary – the person owing the fiduciary duty – does not act in good faith and with due regard to the interests of the person to whom the duty is owed and thereby causes damages to that person, the fiduciary is liable for the tort of breach of fiduciary duty.

Here is a blackletter formulation for the tort:

> A plaintiff can establish a **prima facie case for breach of fiduciary duty** by showing: (1) the existence of a fiduciary duty owed by the defendant to the plaintiff, (2) misconduct by the defendant in contravention of the fiduciary duty, (3) damages suffered by the plaintiff resulting from the misconduct.

The key is knowing which relationships count as fiduciary relationships. Fiduciary duties are owed by trustees to their beneficiaries, by attorneys to their clients, and by agents to their principals. In these fiduciary relationships, the fiduciary duty is one-way: Attorneys owe a fiduciary duty to clients, but clients do not owe a fiduciary duty to their attorneys. To put it more plainly: Clients can

screw over their attorneys. But attorneys are not allowed to screw over their clients.

Other fiduciary duties are bilateral. In a business partnership, partners owe each other a fiduciary duty. And in a business joint venture, joint venturers owe one another a fiduciary duty.

It's important to understand that in the overall scheme of commercial enterprise and human interaction, fiduciary duties are the exception, not the default. Most business transactions do not give rise to a fiduciary duty. In a regular "arms-length" transaction, it is assumed that each party is looking out for itself. Thus, there is no need to recognize a fiduciary duty.

But where there is a fiduciary duty, breach of it is, under the eyes of the law, a much graver offense than breaching a mere contractual duty. Breaching a contract is breaking one's word. But breaching a fiduciary duty is an act of *faithlessness*. Correspondingly, breach of contract is just breach of contract. But breach of fiduciary duty is a tort, and, as such, it is subject to tort remedies, including, where warranted, punitive damages – something that is off the table for a breach of contract cause of action.

Case: *April Enterprises v. KTTV*

The following case entertains a claim for breach of fiduciary duty in a unique context: a production/distribution deal for children's television.

April Enterprises v. KTTV

Court of Appeals of California, Second Appellate District, Division Seven
October 5, 1983

147 Cal. App. 3d 805. APRIL ENTERPRISES, INC., Plaintiff and Appellant, v. KTTV et al., Defendants and Respondents. Civ. No. 66885. Opinion by Johnson, J., with Schauer, P. J., and Thompson, J., concurring.

Justice EARL JOHNSON, JR.: