Chapter 0. Transactional Torts

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

– Alexandre Dumas

0.0 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 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.

0.1.0 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.

0.1.1.1 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.

Plaintiff prepared the necessary papers and at 4 p.m. on May 1, 1958, appeared with Mrs. Henderson and Mrs. Bridges before the Superior Court of Cowlitz County, at which time the will was offered for probate, Mrs. Henderson designated as executrix, and an order authorizing continuance of the business was entered. The following day, Mrs. Henderson was fully qualified as executrix and, with plaintiff's assistance, accounts at the bank were adjusted whereby business obligations, including the payroll of the business then due, were met, and a letter relating to and confirming an outstanding bid to a local school district for school construction dispatched. Plaintiff prepared to perfect and continue probate of the estate.

On May 6th, it was necessary for plaintiff to go to California. Before leaving, he checked with Mrs. Bridges to ascertain any immediate needs, and was informed there was none. Between May 6th and May 8th, Halvor Knudtzon, Sr., the senior member of the firm of Knudtzon and Associates, certified public accountants, returned from a trip. On May 8th, he was consulted by Mrs. Henderson relative to performing the tax work in connection with the estate. At this meeting, Mr. Knudtzon inquired of Mrs. Henderson if she had selected an attorney, to which she replied "Yes, I suppose Harry Calbom." Whereupon, Mr. Knudtzon shook his head and indicated, by inference at least, that plaintiff was unsatisfactory. Mr. Knudtzon thereupon recommended a list of attorneys from which one was selected.

On May 9th, plaintiff returned and was advised by Mrs. Bridges that another attorney was handling the probate matter. Thereupon, he contacted Mr. Knudtzon, Sr., and requested a meeting, which was arranged for that morning. Mr. Knudtzon, who was at home when contacted by plaintiff, telephoned his son at the office and advised him that plaintiff was coming in to confer with them, and that they would give him "a line of hot air." When confronted by plaintiff at their office, plaintiff was advised by Mr. Knudtzon, Sr., that they, as accountants, hired and fired attorneys for their clients and made reference to a former probate matter in which they had been instrumental in discharging the attorney.

Subsequently, an effort was made to pay plaintiff for services he had performed and secure his signature upon a notice of substitution of attorneys.

Plaintiff refused to submit a bill for his services up to the time of his termination, refused to agree to a substitution of attorneys, and instituted the present action against the defendants alleging intentional interference with plaintiff's employment contract.

Trial of the action consumed several days, at the conclusion of which the trial court rendered an oral decision in favor of plaintiff and thereafter entered findings of fact, conclusions of law, and judgment. The essence of the trial court's findings were: (a) Plaintiff was an ethical, reputable, and competent attorney; (b) plaintiff had a contract with the surviving widow to probate the estate of K.T. Henderson, pursuant to which plaintiff undertook performance of the probate proceedings; (c) defendants, with knowledge of plaintiff's contract of employment, intentionally, maliciously, and without justification induced the surviving widow to discharge plaintiff as attorney for the estate, and (d) plaintiff suffered damage in the amount of the reasonable attorney's fee he would have earned had he continued to the conclusion of the probate.~

Intentional and unjustified third-party interference with valid contractual relations or business expectancies constitutes a tort, with its taproot embedded in early decisions of the courts of England~.

The fundamental premise of the tort – that a person has a right to pursue his valid contractual and business expectancies unmolested by the wrongful and officious intermeddling of a third party – has been crystallized and defined in Restatement, Torts § 766, as follows:

> Except as stated in Section 698 [betrothal promises], one who, without a privilege to do so, induces or otherwise purposely causes a third person not to
>
> (a) perform a contract with another, or
>
> (b) enter into or continue a business relation with another
>
> is liable to the other for the harm caused thereby.

Clause (a) relates to those cases in which the purposeful interference of a third party induces or causes a breach of an existing and valid contract relationship. Clause (b) embraces two types of situations. One is that in which the interferor purposely induces or causes a party not to enter into a business relationship with another. The second is where a business relationship, terminable at the will of the parties thereto, exists, and the intermeddler purposely induces or causes a termination of such relationship. The distinction between the situations propounded by clauses (a) and (b) lies not so much in the nature of the wrong, as in the existence or nonexistence, and availability as a defense, of privilege or justification for the interference. Restatement, Torts § 766, Comment c.

The basic elements going into a prima facie establishment of the tort are (1) the existence of a valid contractual relationship or business expectancy; (2) knowledge of the relationship or expectancy on the part of the interferor; (3) intentional interference inducing or causing a breach or termination of the relationship or expectancy; and (4) resultant damage to the party whose relationship or expectancy has been disrupted. Ill will, spite, defamation, fraud, force, or coercion, on the part of the interferor, are not essential ingredients, although such may be shown for such bearing as they may have upon the defense of privilege.

The burden of showing privilege for interference with the expectancy involved rests upon the interferor. The basic issue raised by the assertion of the defense is whether, under the circumstances of the particular case, the interferor's conduct is justifiable, bearing in mind such factors as the nature of the interferor's conduct, the character of the expectancy with which the conduct interferes, the relationship between the various parties, the interest sought to be advanced by the interferor, and the social desirability of protecting the expectancy or the interferor's freedom of action. Some of the privileges and their limitations, which have been recognized, depending upon the circumstances and the factors involved, are legitimate business competition, financial interest, responsibility for the welfare of another, directing business policy, and the giving of requested advice.

Against the backdrop of the foregoing, we turn to defendants' contentions.

Defendants first assert that the evidence does not support the trial court's finding concerning the existence of an attorney-client relationship between plaintiff and Mrs. Henderson whereby plaintiff would undertake the "long term" probate of the estate. This assertion is predicated upon the argument that the testimony of Mrs. Henderson and Mrs. Bridges, coupled with the surrounding circumstances, indicate that Mrs. Henderson only intended to engage plaintiff's services for the limited purpose of admitting the will to probate and securing an order authorizing continuation of the business.

We agree that the evidence presented by defendants upon this point is susceptible of the interpretation defendants would place upon it. However, such is not the only interpretation finding support in the evidence as a whole. The evidence reveals that at the meeting on May 1, 1958, after plaintiff had explained the necessity for probate proceedings, Mrs. Henderson stated to plaintiff she wanted him to "handle this thing for me." Plaintiff thereupon prepared all papers incidental to the admission of the will to probate;

arranged for the testimony of the witnesses to the will; appeared in court and presented the testimony of Mrs. Henderson, Mrs. Bridges, and the witnesses to the will; provided for, counseled, and participated in arrangements to meet pending business obligations; and, to all intents and purposes, became the attorney in fact and of record for the estate. Although the relationship thus established was terminable at the will of the parties, we are convinced the evidence and the reasonable inferences therefrom amply support the trial court's finding of an existing attorney-client relationship which plaintiff had every right to anticipate would continue, and which would have continued but for the intervention of defendants.~

Defendants next assert that the evidence does not support the trial court's finding that they had knowledge of the existence of the attorney-client relationship in issue. Here again, the evidence and the inferences therefrom produce a conflict. On the one hand, defendants claim they were advised by Mrs. Bridges that plaintiff's employment was limited. On the other hand, plaintiff's evidence indicates that defendants were not only aware of plaintiff's position as attorney in fact and of record for the estate, but in fact boasted of their ability to terminate that relationship. Additional evidence supportive of plaintiff's version is the admission of defendants that they determined to give plaintiff a "line of hot air" when he called upon them, rather than rely upon what they now assert was their knowledge of his status in the estate.

Although knowledge of the existence of the business relationship in issue is an essential element in establishing liability for interference therewith, it is sufficient if the evidence reveals that the alleged interferor had knowledge of facts giving rise to the existence of the relationship. It is not necessary that the interferor understand the legal significance of such facts.

We are satisfied that the evidence presented supports the trial court's finding of the requisite knowledge of the circumstances on the part of defendants.~

Defendants next contention is that plaintiff's employment as attorney for the estate created a conflict of interest with his duties as a member of the local school board, and was, therefore, contrary to public policy and invalid. This is predicated upon the fact that the Henderson Construction Company had pending before the school board a bid for school construction at the time plaintiff initiated the probate proceedings.

We find no merit in this contention because (a) plaintiff stepped down from the school board at the time it considered the bid; (b) the board did not consider the bid until May 12, 1958, at which time plaintiff's services with the estate had been terminated; (c) the board, upon advice of the prosecuting attorney, rejected the bid; and (d) neither plaintiff nor his successor represented the estate before the school board. It is possible that had plaintiff continued as counsel for the estate he would have been confronted with a choice between his position upon the school board and as attorney for the estate. The fact is, however, that he was not afforded this opportunity, and speculation that he might have made a wrong choice cannot now form the basis of a declaration that his continued employment as attorney for the estate would have been invalid. Particularly is this so in the face of the unchallenged finding by the trial court that plaintiff acted "at all times herein material … with the highest degree of integrity consistent with the professional ethics of an attorney at law."

Defendants next contend that their interference with plaintiff's relationship to the estate was privileged. Defendants predicate this assertion upon the claim that they occupied a confidential relationship with Mrs. Henderson by virtue of their long time service to the Hendersons as tax consultants. In essence, defendants rely upon the privileges capsulized in Restatement, Torts §§ 770 and 772, or a combination thereof.

> 'One who is charged with responsibility for the welfare of another is privileged purposely to cause him not to perform a contract, or enter into or continue a business relation, with a third person if the actor '(a) does not employ improper means and '(b) acts to protect the welfare of the other.' Restatement, Torts § 770.2

> 'One is privileged purposely to cause another not to perform a contract, or enter into or continue a business relation, with a third person by giving honest advice to the other within the scope of a request for advice made by him, except that, if the actor is under a special duty to the third person with reference to the accuracy of the advice, he is subject to liability for breach of that duty.' Restatement, Torts § 772.

The basic reason supporting both of the mentioned privileges is the protection of public and private interests in freedom of communication, decent conduct, and professional as well as lay counsel. Such privileges, however, do not justify officious, self-serving, or presumptious assumption of responsibility and interference with the rights of others. The burden of establishing the existence of such a privilege or privileges rests, as heretofore indicated, upon the one asserting justification thereby.

We are satisfied, from our examination of the record, that defendants have not sustained their burden of proof. Suffice it to say the evidence supports the trial court's finding that defendants' interference was malicious, intentional and without justification.

0.1.1.2 Questions to Ponder About *Calbom v. Kundtzon*

A. Are you surprised by the result here – that an accountant's shaking his head and suggesting other attorneys caused him to incur liability for intentional economic interference?

B. Of what significance is it that the Knudtzons decided to give Calbom "a line of hot air" and that they bragged about hiring and firing attorneys?

C. Issues of privilege or justification are supposed to take into account "the social desirability of protecting the expectancy or the interferor's freedom of action." Which way does that cut here?

D. Was Knudtzon disadvantaged by the fact that he was an accountant while Calbom was a lawyer? After all, judges decide cases, and judges are lawyers. Suppose this case had been decided by a board of accountants reviewing Knudtzon on professional ethics charges? And suppose the rule he was alleged to have violated was the same in substance as the cause of action for intentional economic interference. Do you think Knudtzon would be vindicated or disciplined?

E. Could Knudtzon have done anything to protect himself with regard to tort liability while still giving his advice to Mrs. Henderson?

0.1.2.1 Case: Speakers of Sport v. ProServ

The next case presents an example of a claim for intentional economic interference in the sports-agency context.

Speakers of Sport v. ProServ

United States Court of Appeals for the Seventh Circuit
May 13, 1999

178 F.3d 862. SPEAKERS OF SPORT, INC., Plaintiff-Appellant, v. PROSERV, INC., Defendant-Appellee. No. 98-3113. Before POSNER, Chief Judge, and FLAUM and MANION, Circuit Judges.

Chief Judge RICHARD A. POSNER:

The plaintiff, Speakers of Sport, appeals from the grant of summary judgment to the defendant, ProServ, in a diversity suit in which one sports agency has charged another with tortious interference with a business relationship and related violations of Illinois law. The essential facts, construed as favorably to the plaintiff as the record will permit, are as follows. Ivan Rodriguez, a highly successful catcher with the Texas Rangers baseball team, in 1991 signed the first of several one-year contracts making Speakers his agent. ProServ wanted to expand its representation of baseball players and to this end invited Rodriguez to its office in Washington and there promised that it would get him between $2 and $4 million in endorsements if he signed with ProServ − which he did, terminating his contract (which was terminable at will) with Speakers. This was in 1995. ProServ failed to obtain significant endorsement for Rodriguez and after just one year he switched to another agent who the following year landed him a five-year $42 million contract with the Rangers. Speakers brought this suit a few months later, charging that the promise of endorsements that ProServ had made to Rodriguez was fraudulent and had induced him to terminate his contract with Speakers.

The parties agree that the substantive issues in this diversity suit are governed by Illinois law, and we do not look behind such agreements so long as they are reasonable~.

Speakers could not sue Rodriguez for breach of contract, because he had not broken their contract, which was, as we said, terminable at will. Nor, therefore, could it accuse ProServ of inducing a breach of contract, as in *J.D. Edwards & Co. v. Podany,* 168 F.3d 1020, 1022 (7th Cir.1999). But Speakers did have a contract with Rodriguez, and inducing the termination of a contract, even when the termination is not a breach because the contract is terminable at will, can still be actionable under the tort law of Illinois, either as an interference with prospective economic advantage, or as an interference with the contract at will itself. Nothing turns on the difference in characterization.

There is in general nothing wrong with one sports agent trying to take a client from another if this can be done without precipitating a breach of contract. That is the process known as competition, which though painful, fierce, frequently ruthless, sometimes Darwinian in its pitilessness, is the cornerstone of our highly successful economic system. Competition is not a tort, but on the contrary provides a defense (the "competitor's privilege") to the tort of improper interference. It does not privilege inducing a breach of contract, − conduct usefully regarded as a separate tort from interfering with a business relationship without precipitating an actual breach of contract − but it does privilege inducing the lawful termination of a contract that is terminable at will. Sellers (including agents, who are sellers of services) do not "own" their customers, at least not without a contract with them that is not terminable at will.

There would be few more effective inhibitors of the competitive process than making it a tort for an agent to promise the client of another agent to do better by him, – which is pretty much what this case comes down to. It is true that Speakers argues only that the competitor may not make a promise that he knows he cannot fulfill, may not, that is, compete by fraud. Because the competitor's privilege does not include a right to get business from a competitor by means of fraud, it is hard to quarrel with this position in the abstract, but the practicalities are different. If the argument were accepted and the new agent made a promise that was not fulfilled, the old agent would have a shot at convincing a jury that the new agent had known from the start that he couldn't deliver on the promise. Once a case gets to the jury, all bets are off. The practical consequence of Speakers' approach, therefore, would be that a sports agent who lured away the client of another agent with a promise to do better by him would be running a grave legal risk.

This threat to the competitive process is blocked by the principle of Illinois law that promissory fraud is not actionable unless it is part of a scheme to defraud, that is, unless it is one element of a pattern of fraudulent acts. By requiring that the plaintiff show a pattern, by thus not letting him rest on proving a single promise, the law reduces the likelihood of a spurious suit; for a series of unfulfilled promises is better (though of course not conclusive) evidence of fraud than a single unfulfilled promise.

Criticized for vagueness, and rejected in most states, the Illinois rule yet makes sense in a case like this, if only as a filter against efforts to use the legal process to stifle competition. Consider in this connection the characterization by Speakers' own chairman of ProServ's promise to Rodriguez as "pure fantasy and gross exaggeration" – in other words, as puffing. Puffing in the usual sense signifies meaningless superlatives that no reasonable person would take seriously, and so it is not actionable as fraud. Rodriguez thus could not have sued ProServ (and has not attempted to) in respect of the promise of \$2–\$4 million in endorsements. If Rodriguez thus was not wronged, we do not understand on what theory Speakers can complain that ProServ competed with it unfairly.

The promise of endorsements was puffing not in the most common sense of a cascade of extravagant adjectives but in the equally valid sense of a sales pitch that is intended, and that a reasonable person in the position of the "promisee" would understand, to be aspirational rather than enforceable – an expression of hope rather than a commitment. It is not as if ProServ proposed to employ Rodriguez and pay him \$2 million a year. That would be the kind of promise that could found an enforceable obligation. ProServ proposed merely to get him endorsements of at least that amount. They would of course be paid by the companies whose products Rodriguez endorsed, rather than by ProServ. ProServ could not force them to pay Rodriguez, and it is not contended that he understood ProServ to be warranting a minimum level of endorsements in the sense that if they were not forthcoming ProServ would be legally obligated to make up the difference to him.

It is possible to make a binding promise of something over which one has no control; such a promise is called a warranty. But it is not plausible that this is what ProServ was doing – that it was guaranteeing Rodriguez a minimum of $2 million a year in outside earnings if he signed with it. The only reasonable meaning to attach to ProServ's so-called promise is that ProServ would try to get as many endorsements as possible for Rodriguez and that it was optimistic that it could get him at least $2 million worth of them. So understood, the "promise" was not a promise at all. But even if it was a promise (or a warranty), it cannot be the basis for a finding of fraud because it was not part of a scheme to defraud evidenced by more than the allegedly fraudulent promise itself.

It can be argued, however, that competition can be tortious even if it does not involve an actionable fraud (which in Illinois would not include a fraudulent promise) or other independently tortious act, such as defamation, or trademark or patent infringement, or a theft of a trade secret; that competitors should not be allowed to use "unfair" tactics; and that a promise known by the promisor when made to be unfulfillable is such a tactic, especially when used on a relatively unsophisticated, albeit very well to do, baseball player. Considerable support for this view can be found in the case law. The doctrine's conception of wrongful competition is vague – "wrongful by reason of ... an established standard of a trade or profession," or "a violation of recognized ethical rules or established customs or practices in the business community," or "improper because they [the challenged competitive tactics] violate an established standard of a trade or profession, or involve unethical conduct, ... sharp dealing[, or] overreaching." Worse, the established standards of a trade or profession in regard to competition, and its ideas of unethical competitive conduct, are likely to reflect a desire to limit competition for reasons related to the self-interest of the trade or profession rather than to the welfare of its customers or clients. We agree with Professor Perlman that the tort of interference with business relationships should be confined to cases in which the defendant employed unlawful means to stiff a competitor, Harvey S. Perlman, "Interference With Contract and Other Economic Expectancies: A Clash of Tort and Contract Doctrine," 49 *U. Chi. L.Rev.* 61 (1982), and we are reassured by the conclusion of his careful analysis that the case law is generally consistent with this position as a matter of outcomes as distinct from articulation.

Invoking the concept of "wrongful by reason of ... an established standard of a trade or profession," Speakers points to a rule of major league baseball forbidding players' agents to compete by means of misrepresentations. The rule is designed to protect the players, rather than their agents, so that even if it established a norm enforceable by law Speakers would not be entitled to invoke it; it is not a rule designed for Speakers' protection. In any event its violation would not be the kind of "wrongful" conduct that should trigger the tort of intentional interference; it would not be a violation of law.~

We add that even if Speakers could establish liability under either the common law of torts or the deceptive practices act, its suit would fail because it cannot possibly establish, as it seeks to do, a damages entitlement (the only relief it seeks) to the agent's fee on Rodriguez's $42 million contract. That contract was negotiated years after he left Speakers, and by another agent. Since Rodriguez had only a year-to-year contract with Speakers – terminable at will, moreover – and since obviously he was dissatisfied with Speakers at least to the extent of switching to ProServ and then when he became disillusioned with ProServ of *not* returning to Speakers' fold, the likelihood that Speakers would have retained him had ProServ not lured him away is too slight to ground an award of such damages. Such an award would be the best example yet of puffing in the pie-in the-sky sense.

AFFIRMED.

0.1.2.2 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?

0.2.0 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**.

0.2.1 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 million in the corporation and was its largest shareholder. Though he was not involved in the day-to-day operations of the company, Wade had access to the corporation's books, records, and financial information.

In 2009, Rose obtained a loan commitment for Rookwood from the Ohio Department of Development. Because the proceeds of the Ohio loan took longer than expected to reach the company, funding difficulties imperiled the development. To cover the shortfall, Rose sought temporary financing. He approached Berger about the possibility of making a short-term loan to the company. After negotiations between Rose and Berger, Berger agreed to lend Rookwood $100,000 to fund operations until the proceeds of the Ohio loan were delivered.

Berger was given the opportunity to examine the books of Rookwood. Given Rookwood's poor financial condition, Berger was unwilling to lend the company the funds without additional security. Therefore, as a condition of making the loan, Berger insisted that Rose and Wade co-sign the promissory note, and that Rose and Wade personally guarantee the debt.

The debt was to be evidenced by a promissory note which Berger had drafted. Berger ultimately admitted that he had copied documents originally prepared by a Cincinnati law firm for another transaction that also involved a promissory note and guaranty. Though not a lawyer, Berger "changed [the documents] to fit the circumstances" of the Rookwood deal. The changes took less than ten minutes. The documents provided that Berger would loan the corporation $100,000 in August 2009. The corporation, Rose, and Wade promised to repay the loan in one month with $10,000 in interest also due at that time. In a separate guaranty agreement, Rose and Wade personally guaranteed the loan repayment.

Rose presented Berger's note and guaranty to Wade. Despite examining the note for less than three minutes, and the guaranty for less than five, Wade signed the documents. He had not met with or spoken to Berger before signing the documents.

The promissory note provided, on its first page, that:

> This Note is secured by a first-priority security interest in the Assets of The Rookwood Corporation pursuant to the terms of a Security Agreement dated of even date herewith between The Rookwood Corporation and [Berger] (the "Security Agreement").

As it turned out, however, there was no security agreement and, therefore, no security interest existed.~

The requirement of justifiable reliance is best understood as testing the credibility of the claim that fraud induced a party to act. The necessity that the reliance is justified screens out pretextual claims or defenses put forward after adverse facts on the ground have rendered a party's promise unprofitable.

The question of justifiable reliance is one of fact, and the court must inquire into the nature of the transaction, the representation, and the relationship of the parties.

Wade testified that he would "probably not" have signed the note and guaranty if he had known that the first-priority security agreement identified in the note did not exist. He stated that he assumed that Berger would enforce the security interest to pay the debt rather than proceed against him.

Yet, the overwhelming weight of the evidence in the record reflects that Wade's assumption and his reliance on the fictitious representation were not justified. Wade was a principal investor in Rookwood. Before signing the note and guaranty, he had examined the corporation's financial statements. Although Berger's note stated that it was secured by a first-priority security interest, Wade knew that Rookwood had already given security interests in its assets and real property to another investor and to the Ohio development agency. Wade admitted that he had already personally guaranteed the payment of some of those loans.

Before signing Berger's note and guaranty, Wade, an experienced certified public accountant and former attorney, reviewed the documents, albeit very briefly. He admitted that under the guaranty's express terms, whether Berger's security 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.~

0.2.2 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.

0.2.3.1 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 containing the alleged misrepresentations. We review the allegations of the complaint and conclude that the trial court erred in sustaining demurrers without leave to amend to plaintiffs' causes of action charging fraud and violation of laws against unfair competition and deceptive advertising.~

Plaintiffs filed their original complaint on June 30, 1977, as a class action on behalf of "California residents who have been misled or deceived, or are threatened with the likelihood of being deceived or misled," by defendants in connection with the marketing of sugared cereals.

The principal defendant is General Foods Corporation, the manufacturer of five "sugared cereals" – Alpha Bits, Honeycomb, Fruity Pebbles, Sugar Crisp, and Cocoa Pebbles – which contain from 38 to 50 percent sugar by weight. The other corporate defendants are two advertising agencies – Benton and Bowles, Inc., and Ogilvy & Mather International, Inc. – which handled advertising of these cereals, and Safeway Stores, which sold the products to plaintiffs. Finally, the complaint includes as defendants numerous officers and employees of the corporate defendants.~

Paragraph 34 alleges that defendants "engaged in a sophisticated advertising and marketing program which is designed to capitalize on the unique susceptibilities of children and preschoolers in order to induce them to consume products which, although promoted and labelled as 'cereals,' are in fact more accurately described as sugar products, or candies." The complaint thereafter refers to sugared cereals as "candy breakfasts."

Paragraph 35 lists some 19 representations allegedly made in television commercials aimed at children. Most of these representations are not explicit but, according to plaintiffs, implicit in the advertising. Paragraph 35 of the complaint reads as follows:

> The advertising scheme routinely and repeatedly employs and utilizes, in commercials aimed at children, each of the following representations which are conveyed both visually and verbally: (a) Children and young children who regularly eat candy breakfasts are bigger, stronger, more energetic,

happier, more invulnerable, and braver than they would have been if they did not eat candy breakfasts. (b) Eating candy breakfasts is a 'fun' thing for children to do, and is invariably equated with entertainment and adventure. (c) The sweet taste of a product ensures or correlates with nutritional merit. (d) Eating candy breakfasts will make children happy. (e) Bright colors in foods ensure or correlate with nutritional merit. (f) Candy breakfasts are grain products. (g) Candy breakfasts are more healthful and nutritious for a child than most other kinds and types of cereals. (h) Adding small amounts of vitamins and minerals to a product automatically makes it 'nutritious.' (i) Candy breakfasts inherently possess and/or impart to those ingesting them magical powers, such as the capacity to cause apes and fantastic creatures to appear or disappear. (j) Candy breakfasts contain adequate amounts of the essential elements of a growing child's diet, including protein. (k) The 'premiums' (small toys packaged in with the candy breakfast as an inducement to the child) are very valuable and are offered free as a prize in each box of candy breakfast. (l) Candy breakfasts are the most important part of a 'well-balanced breakfast' and are at least as nutritious as milk, toast and juice. (m) Candy breakfasts calm a child's fears and dispel a child's anxiety. ... (n) Candy breakfasts have visual characteristics which they do not in fact possess, such as vivid colors and the capacity to glitter or to enlarge from their actual size to a larger size.

"In addition to the foregoing representations specified in Paragraph 35 (a) through (n), in each of the commercials for each of the products specified below the advertising scheme repeatedly, uniformly and consistently utilizes and relies upon the following representations with respect to particular products: (o) Cocoa Pebbles are good for a child to eat whenever he or she is hungry, and it is a sound nutritional practice to eat chocolatey tasting foods, such as Cocoa Pebbles, for breakfast. (p) Honeycomb (i) contains honey and (ii) consists of pieces which are each at least two (2) inches in diameter and (iii) will make a child big and strong. (q) Alpha-Bits (i) will enable a child to conquer his or her enemies, (ii) can be used by a child easily to spell words in his or her spoon, (iii) are an effective cure for the child's anxieties, and (iv) have magical powers and can impart magical powers to a child. ...

> (r) Fruity Pebbles (i) contain fruit and (ii) emit auras, rainbows or mesmerizing colors. (s) Super Sugar Crisp (i) should be eaten as a snack food without danger to dental health, (ii) should be eaten as a nutritious snack whenever a child is hungry, (iii) makes a child smart and (iv) is coated with golden sugar and such sugar is very valuable."

Plaintiffs allege that commercials containing these representations are broadcast daily. Although the commercials changed every 60 days, "they retain consistent themes and each convey ... the representations as set forth." Defendants, but not plaintiffs, know the exact times, dates, and places of broadcasts. Plaintiffs further allege that the same representations appear in other media, and on the cereal packages themselves. Paragraph 42 asserts that defendants concealed material facts:

> In the advertising scheme planned and participated in by each and every Defendant, none of the following facts are ever disclosed: (a) The percentage of sugar and chemicals together in the products advertised ranges from 38% to 50% of the total weight of the product; (b) There is no honey in Honeycomb, no fruit in Fruity Pebbles, and the premiums packed into the boxes of Alpha Bits and Super Sugar Crisp cost no more than a few pennies at most; (c) Eating candy breakfasts may contribute to tooth decay in children and adults; (d) Eating candy breakfasts as a snack will cause tooth decay; (e) Children should brush their teeth soon after eating sugary foods; (f) For many children, excessive sugar consumption will have serious and detrimental health consequences, including obesity, heart disease, and other adverse health consequences; (g) For children with already existing health problems, especially diabetes, consuming candy breakfasts may have serious and detrimental health consequences; (h) There is a serious controversy over the adverse effects of sugar on the health of children; (i) Candy breakfasts are not the most important part of a balanced breakfast; (j) If eaten at all, candy breakfasts should not be consumed in large quantities and whenever a child is hungry; (k) Candy breakfasts cost more per serving than non-pre-sweetened breakfast cereals or hot cereals and more than other foods of better nutritional value than candy breakfasts; (l) A child's welfare is best served by accepting nutritional advice from his or her parents when such advice conflicts with

> advice given in television commercials; (m) The happy, adventure-filled fantasy portrayal of eating candy breakfasts is unrealistic and cannot be duplicated by any child.

Such concealment, plaintiffs allege, when joined with the affirmative misrepresentations listed in paragraph 35, render the advertisements misleading and deceptive.

The complaint asserts at length the special susceptibility of children to defendants' "advertising scheme," and explains how defendants take advantage of this vulnerability. It further asserts that, as defendants know, the desires and beliefs of children influence and often determine the decision of adults to buy certain breakfast foods.~

The third through sixth causes of action set out various aspects of the tort of fraud.~ Each of these causes of action~ claims compensatory damages of $10 million; those counts asserting intentional misrepresentation include a prayer for punitive damages. The prayer for relief is extensive, and includes some novel requests. In addition to seeking damages, restitution, and injunctive relief, plaintiffs seek warning labels in stores and on packages, creation of funds for research on the health effects of sugar consumption by young children, public interest representatives on defendants' boards of directors, and public access to defendants' research on the health effects of their products. ↳We discuss plaintiffs' right to seek damages, restitution, and injunctive relief in this opinion, but take no position on the suitability of the other remedies requested.↵

Defendants demurred to the fourth amended complaint for failure to state a cause of action and for uncertainty. The trial court sustained the demurrers without leave to amend. The trial judge explained the basis for his ruling: "[I]n order to state a cause of action for fraud or for breach of warranty, there must be alleged with specificity the basis for the cause and that is, if there are advertisements which contain fraudulent matters, those advertisements must be set out. [–] In paragraph 35, which is the heart of the allegations concerning the conveying of the representations, we have just a series of very general allegations to which there is no reference of an advertisement actually made. ... [–] Paragraph 38 which makes the allegations concerning media dissemination set out no television stations, no other media, except for the fact that these ads were run on television stations every day in Southern California for a four-year period. [–] This gives the defendant practically no kind of information concerning that which the defendant must answer, and it doesn't give the court a sufficient factual basis for its administration of the case."~

Plaintiffs base their third, fourth, fifth and sixth causes of action on the tort of fraud. Civil Code section 1710 defines that tort:

> A deceit [fraud] ... is either: 1. The suggestion, as a fact, of that which is not true, by one who does not believe it to be true; 2. The assertion, as a fact, of that which is not true, by one who has no reasonable ground for believing it to be true; 3. The suppression of a fact, by one who is bound to disclose it, or who gives information of other facts which are likely to mislead for want of communication of that fact ....~

[Witkin explains the pleading requirement of specificity:]

> Fraud actions ... are subject to strict requirements of particularity in pleading. The idea seems to be that allegations of fraud involve a serious attack on character, and fairness to the defendant demands that he should receive the fullest possible details of the charge in order to prepare his defense. Accordingly the rule is everywhere followed that fraud must be specifically pleaded. The effect of this rule is twofold: (a) General pleading of the legal conclusion of 'fraud' is insufficient; the facts constituting the fraud must be alleged. (b) Every element of the cause of action for fraud must be alleged in the proper manner (i.e., factually and specifically), and the policy of liberal construction of the pleadings ... will not ordinarily be invoked to sustain a pleading defective in any material respect. (3 Witkin, Cal. Procedure (2d ed. 1971) Pleading, § 574)

Witkin adds, however, that:

> In reading the cases one gains the impression that entirely too much emphasis has been laid upon the requirement of specific pleading. The characterization of some actions as 'disfavored' has little to recommend it ... and actions based on fraud are so numerous and commonplace that the implications of immoral conduct are seldom considered more serious than those involved in other intentional torts. Hence, while it seems sound to require specific pleading of the facts of fraud rather than general conclusions, the courts should not look askance at the complaint, and seek to absolve the defendant from liability on highly technical requirements of form in pleading. Pleading facts in ordinary and concise language is as permissible in fraud cases as in any others, and liberal

> construction of the pleading is as much a duty of the court in these as in other cases. (3 Witkin, op. cit. supra, Pleading, § 575, quoted in Lacy v. Laurentide Finance Corp. (1972) 28 Cal.App.3d 251, 258, fn. 2.)

The specificity requirement serves two purposes. The first is notice to the defendant, to "furnish the defendant with certain definite charges which can be intelligently met." The pleading of fraud, however, is also the last remaining habitat of the common law notion that a complaint should be sufficiently specific that the court can weed out nonmeritorious actions on the basis of the pleadings. Thus the pleading should be sufficient "'to enable the court to determine whether, on the facts pleaded, there is any foundation, prima facie at least, for the charge of fraud.'"

We observe, however, certain exceptions which mitigate the rigor of the rule requiring specific pleading of fraud. Less specificity is required when "it appears from the nature of the allegations that the defendant must necessarily possess full information concerning the facts of the controversy,"; "[e]ven under the strict rules of common law pleading, one of the canons was that less particularity is required when the facts lie more in the knowledge of the opposite party ... ."

Additionally, in a case such as the present one, considerations of practicality enter in. A complaint should be kept to reasonable length, and plaintiffs' fourth amended complaint, 64 pages long, strains at that limit.~ A complaint which set out each advertisement verbatim, and specified the time, place, and medium, might seem to represent perfect compliance with the specificity requirement, but as a practical matter, it would provide less effective notice and be less useful in framing the issues than would a shorter, more generalized version.

Defendants object to the allegations of misrepresentation on the ground that the complaint fails to state the time and place of each misrepresentation, to identify the speaker and listener, and to set out the representation verbatim or in close paraphrase. The place and time of the television advertisements, however, is fully known to defendant General Foods, but became available to plaintiffs only through discovery. That defendant equally knows the distribution of cereal box advertisements. A lengthy list of the dates and times of cereal ads on California television stations would add nothing of value to the complaint; the same is true for a list of California grocers marketing General Foods cereals. The language of the complaint – all ads for sugared cereals within a given four-year period – is sufficient to define the subject of the complaint and provide notice to defendants.

General Foods also knows the content of each questioned advertisement. Plaintiffs initially lacked such detailed knowledge, and although they have now obtained copies of the television storyboards through discovery, quotation or attachment of such copies to the complaint would consume thousands of pages. Attachment of the storyboards, moreover, would not redress defendants' grievance, which is, as we understand it, not that they lacked knowledge of the content of the commercials but that they do not understand what it is in the images and words that gives rise to the alleged misrepresentations.

For plaintiffs to provide an explanation for every advertisement would be obviously impractical. We believe, however, that the trial court could reasonably require plaintiffs to set out or attach a representative selection of advertisements, to state the misrepresentations made by those advertisements, and to indicate the language or images upon which any implied misrepresentations are based. This is a method of pleading which has been endorsed in other cases involving numerous misrepresentations· It represents a reasonable accommodation between defendants' right to a pleading sufficiently specific "that the court can ascertain for itself if the representations ... were in fact material, and of an actionable nature", and the importance of avoiding pleading requirements so burdensome as to preclude relief in cases involving multiple misrepresentations.~

Defendants also object that the complaint does not indicate that any particular child relied upon or even saw any particular television advertisement. They point out that although the complaint does assert that each of the adult plaintiffs purchased General Foods' products at a Safeway Store, it does not state which advertisements they, or their children, saw and relied upon.

A specific statement of the advertisements seen and relied upon by the individual plaintiffs would serve to demonstrate both that they possess a valid cause of action in their individual capacity and that they are proper representatives for the class plaintiffs. The realistic setting of the case, however, may make such specific pleading impossible. A long-term advertising campaign may seek to persuade by cumulative impact, not by a particular representation on a particular date. Children in particular are unlikely to recall the specific advertisements which led them to desire a product, but even adults buying a product in a store will not often remember the date and exact message of the advertisements which induced them to make that purchase. Plaintiffs should be able to base their cause of action upon an allegation that they acted in response to an advertising campaign even if they cannot recall the specific advertisements.~

> Although the parties argue primarily the sufficiency and specificity of the pleadings, the underlying controversy is of much greater dimension. Defendants engaged in a nationwide, long-term advertising campaign designed to persuade children to influence their parents to buy sugared cereals. Adapted to its audience, the campaign sought to persuade less by direct representation than by imagery and example. While maintaining a constant theme, the particular advertisements changed frequently. Plaintiffs now contend that these advertisements were deceptive and misleading, and while we do not know the actual truth of those charges, we must assume them true for the purpose of this appeal. Yet, if we apply strict requirements of specificity in pleading as defendants argue, the result would be to eliminate the private lawsuit as a practical remedy to redress such past deception or prevent further deception. By directing their advertisements to children, and changing them frequently, 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.~

0.2.3.2 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?

0.3 Other Misrepresentation Torts

In addition to liability for fraud – which is premised on an intentional misrepresentation – the law sometimes allows causes of action for misrepresentations even where there is no intent to deceive. These include actions for negligently made misrepresentations and even innocently made misrepresentations (what you could call strict-liability misrepresentation). Some courts even categorize these theories of recovery as particular species of fraud. Here's a brief look at the relevant concepts:

The cause of action known as **negligent misrepresentation** allows a claim where the misrepresentation was made as a result of negligent error. This cause of action is broader than fraud in one sense, since it reaches beyond situations involving an intentional falsehood. But in other important ways, the cause of action for negligent misrepresentation is narrower, as courts are willing to recognize it only in a limited range of situations. Yet before we can understand negligent misrepresentation and its place in the law, we need first to back up and provide some context vis-à-vis negligence law.

If a negligently made misrepresentation causes property damage or personal injury, then there is a cause of action in negligence – that is, the everyday garden-variety cause of action for negligence, which is covered in Part II of this book. In such a case, there's no need for a tort of negligent misrepresentation to enable recovery. Professor Kenneth S. Abraham gives the example of one person asking another if a ladder is safe to stand on. Suppose I say, "I've inspected the ladder, and it's safe." And further suppose I did, in fact, inspect the ladder, but I did so negligently – that is, not up to the standards of the reasonable person. (For instance, perhaps I just looked the ladder over from a distance and didn't notice the conspicuously absent bolts on the seventh step.) If you break your leg in a fall from the ladder as the result of relying on my advice, I am liable for your injuries in negligence – just plain-old negligence. Sure, I made what could be described as a "negligent misrepresentation," but the misrepresentation was merely the mode by which I breached my duty of care.

The need for a particular cause of action known as negligent misrepresentation comes up when there is no injury to person or property, but where the injury is instead purely economic. Frequently the situation is an investment gone wrong: Money is lost, but no blood is spilled and nothing tangible has been damaged. In such a case, a regular-old negligence cause of action will not work because of negligence's prima facie requirement of an injury to person or property. The concept that negligence cases cannot proceed on pure economic loss alone is often called the "economic loss rule." (The relevant doctrine is discussed in Chapter 9 of Volume One of *Torts: Cases and Context*.)

Bearing this in mind, you can see that the cause of action for negligent misrepresentation can either be looked at as an evolution of fraud (that is, an offshoot of fraud that lacks the scienter requirement) or as a special form of negligence (that is, one that incorporates an exception to the economic loss rule). Either way, the tort of negligent misrepresentation tends to be narrow, applying only in certain situations. And while the tort varies in its scope among jurisdictions – in some states it looms larger than in others – it is everywhere more limited in scope than either fraud or negligence. Now that you have that context, you can understand where negligent misrepresentation comes in.

Negligent misrepresentation's native habitat, as a tort, is the investment-gone-wrong scenario. For example, an investor in a land-development deal or a small- to medium-sized company has lost a very large amount of money and is looking for someone to blame. In this scenario, the archetypal negligent misrepresentation claim is the client of an accountant or attorney suing that accountant or attorney for an incorrect representation that the client relied upon to her or his detriment in making the investment.

Here is a realistic scenario: Suppose an accountant is hired by a would-be investor to review a company's books, and suppose the accountant departs from the standard practice for professional accountants in doing this work and thus negligently fails to uncover massive accounting irregularities and balance-sheet problems that would flag the company as a bad investment. The investor (i.e., the client of the accountant) who loses her or his investment because of relying on the negligent accounting work has a good cause of action against the accountant for negligent misrepresentation.

This core example of negligent misrepresentation is probably actionable in just about all jurisdictions. Once we start to move away from this core example, however, the jurisdictional differences begin to accumulate.

Beyond accountants and attorneys, causes of action for negligent misrepresentation might also be had against other professional suppliers of information, such as surveyors, public weighers, or real estate agents. And outside of these professional contexts, a court might recognize a cause of action for negligent misrepresentation in situations where there is a special relationship of trust between the plaintiff and defendant.

Another way in which many cases expand outward from the core client-vs-accountant-or-attorney example is in allowing non-clients to sue. That is, sometimes a third party to client-professional relationship will be able to pursue a claim. Suppose a company hires an accounting firm to audits its books. The report of the audit might be detrimentally relied upon by third parties: If the audit report is shown to a would-be investor, that person might rely on the accounting firm's work in deciding whether or not to invest.

Courts take different approaches in determining whether a third party – that is, one not in contractual privity with the defendant – may sue for negligent misrepresentation. Courts often allow a cause of action where the defendant had actual knowledge that the third party was relying on the defendant's statements. Some courts, however, go further and allow a cause of action so long as the third party's reliance was foreseeable.

As a whole, the law of negligent misrepresentation is often less than clear, and it is subject to considerable variation among jurisdictions.

A different cause of action, one recognized by some courts, is that of **innocent misrepresentation**. This tort applies where a party made a misrepresentation (even absent intent or negligence), the plaintiff detrimentally relied on the misrepresentation, and the defendant benefited thereby. Alternatively, this can be called an action for "strict liability misrepresentation."

Suppose sellers of a house represent that their home is free of termites, and suppose they make this representation innocently and non-negligently, yet the house in fact has termites. If the sale goes through, the sellers have benefitted from this innocent misrepresentation because they sold their house for a higher price than they would have had the termite infestation been known. Under these facts, some courts would allow a cause of action for innocent misrepresentation, permitting the buyers to recover the costs of repairs and remediation from the sellers. This has the effect of giving the buyers the expected benefit of their bargain.

[Notes on editing of cases in this chapter:

Various edits are not marked in the text. They have been left unmarked because to mark them would have made the text substantially less readable. Among such unmarked edits, whole citations and portions of citations have been liberally removed from the readings. Typesetting has been standardized. Footnote references and footnotes may have been removed. In particular, in *Calbom v. Knudtzon,* the character "s" was replaced with "§" in multiple places. And in *Committee on Children's Television v. General Foods,* material from footnotes was worked into the text without annotation, and the text was changed to accommodate this.]