**Business Torts Outline**

1. **Negligent Conduct Causing Pure Economic Loss**
2. **Fraud and Negligent Misrepresentation**

**A. Fraud**

**B. Negligent Misrepresentation**

**C. Innocent Misrepresentation**

1. **Interference with Existing and Prospective Contractual Relations**
2. **Insurance Torts**
3. **Fiduciary Duty and Shareholder Oppression**
4. **The Boundary Between Tort and Contract**
5. **DTPA**

**Business Torts Outline**

**INTRODUCTION**

**What is the difference between Torts and Business Torts?**

**Regular Torts 🡪**Personal Injury OR Property damage (Physical harm/injury) **Business Torts🡪** Pure Economic Harm (Money): e.g.**=** Fraud - They arise in an economic setting and focus on economic harm (sometimes they thus span the boundary between tort and contract)

**What difference does it make?**

* + 1. No punitive damages in K (purpose of K law is compensation; give BOB, no punishment)
		2. Generally, longer Statute Of Limitations in K than in tort.
		3. Statutes might impact decision to go K or T route.
		4. K defenses may be a problem (doctrinal limitations – statute of frauds, parole evidence, etc.)
		5. Emotional harm damages generally not available in K and are available in T.
		6. **Goals of K and T are different.**
			1. **Main goal of Tort** is to put the person where they were before the harm occurred. Also, punitive damages available to deter bad behavior. Vindication of social policy.
			2. **K law is different;** main goal here is to give people the benefit of their bargains. No punitives b/c goal is to encourage economic efficiency & K formation. Freedom of K. Compensatory damages.

**Expectations in Business contexts:**

1. **Arms-Length Transactions:**

Usually, there is NO EXPECTATION OF ACCURACY:

* No expectation among business people that they will exercise reasonable care that the statements they make to each other are true; **EXCEPTION:** where info is transferred as part of a service (**i.e.** legal, accounting advice)
* No expectation that statements made in commercial transactions are guaranteed to be true; **EXCEPTION(s):** whenthereisanexpress guarantee of accuracy.
1. **Transactions amongst Fiduciaries:**

Almost always, there is an expectation of accuracy due to the duty of reasonable care.

**Losses Due to Emotional Disturbances § 353 (M1 pp. 2)**

**Punitive Damages§ 355(M1 pp. 4)**

**Who can be a plaintiff - § 552 (M1 pp. 44)**

1. **Negligent Conduct Causing Pure Economic Loss**
2. **Majority Rule**

In most of tort law, the trend has been to expand duties beyond just those in **privity** with the **tortfeasor**. This is *not* true of purely economic losses, which remain restricted.

**Robins Dry Dock v. Flint**: Charterer of a steamship sued for profits lost when Δ dry dock negligently damaged vessel’s propeller. Propeller had to be replaced & charterer sued for loss of use of that vessel during the repair **(cited in Testbank).**

**Testbank Case (Federal 5th Circuit Court of Appeals) [Interrupting Business]**

**Majority** **Rule**: **Recovery for pure economic loss is ONLY allowed if physical damage to property occurs (or under other specially recognized action).**

**Facts:** Two ships collide on the Mississippi River, PCP released, so Coast Guard closes outlet. Fishing and other economic activities were suspended. **Cause of Action:** Traditional negligence action of fisherman for lost income.

**P’s Arg:** Rule requiring physical damage OR property damages, is arbitrary & unfair. It should be replaced by a rule allowing the trier of fact to determine questions of remoteness.

**D’s Arg:** Motion for summary judgment on all claims for economic loss unaccompanied by physical damage to property. The district court granted the summary judgment.

**Issue:** Is physical damage to a proprietary interest still a prerequisite to recovery for economic loss in cases of unintentional maritime tort?

**Held.** Yes – physical damage is still required. Case dismissed (for defendant).

**Justifications**:

* + 1. **Over-Deterrence**: we’re already letting the fishermen, etc. sue – diminishing marginal utility
		2. **Creates a Bright Line Rule**
		3. **Insurance (efficiency) rationale** (related to bright line) – helps people know who needs to buy insurance (ex: business interruption insurance) – 1st party insurance preferable b/c it’s more efficient.
		4. **Floodgates** (bad reason – “because you hurt too many people, none of them can recover”?)
		5. **Lost profits speculative** (couldn’t you deal with this through procedural rules?)
		6. **Leaves the decision up to the judge** (decided in summary judgment vs. minority rule that will result in jury trials = more expensive)

**Dissent:** We should use the normal tort rules of **foreseeability & proximate cause**.

* + 1. We don’t know where the point of diminishing marginal utility is, so err on the side of caution
		2. Case-by-case analysis is better than bright line rule
		3. Fairness: Majority rule is unfair b/c it denies compensation to innocent Δ’s
		4. πs are not likely to have purchased 1st party business interruption insurance (mom & pop don’t make enough $ for this); why should they have to pay when the wrong is not their fault?

1. **Minority Rule**

**Minority Rule:** – A 3rd Party canrecover even if the tort injured the 3rd party independently of any relationship (as long as the injuries were foreseeable & proximate results, as per usual tort law)

* A 3rd party **cannot** claim economic damages where their only connection with the tort is through their K relationship.
1. **Fraud and Negligent Misrepresentation**
* **What do these torts seek to redress?** Harm caused by the communication of false information.
* **Are all misrepresentations recoverable?** No – because the degree of care expected of the party making a statement of fact varies by situation.

**Fraud**

**ELEMENTS:**

**WHO CAN BE A π?** Anyone that the speaker intended: [1] to rely, or [2] had reason to expect would rely

(acted w/purpose or desire to cause reliance or knew w/substantial certainty that reliance would result).

**→** Includes **actual** and **constructive** knowledge.

**DUTY:** Extends to the world: anyone can be a Δ.

1. **FALSITY:** False statement of material fact **OR** **\*Failure to disclose {act}**
2. **SCIENTER:** Knowledge statement is false **OR** Reckless disregard of truth or falsity **{knowledge}**
3. **INTENT:** intentthat the plaintiff rely **OR reason to expect pl. will rely** on statement. **{intent to deceive}**

**→** Highly foreseeable that you would rely, [higher standard than reasonably foreseeable]

1. **JUSTIFIABLE RELIANCE:** actual reliance on statement by plaintiff **{causation}**

**A.** Statement must be material [of substantial importance to the transaction in question], and

**B.** not so preposterous or lacking in credibility that plaintiff should not have relied upon it. **[R2d § 531(1)]**

**→** Does not have to be “reasonable.” So if you don’t make an investigation, but you shouldn’t have had too, then it’s okay. Don’t push this too far: you do normally have to act reasonably, but r2d permits SOME circumstances where you don’t have too.

1. **DAMAGES: Can be pure economic loss** (Fraud is exception to gen. rule)**,** property or personal injury.

**→** BOB (Benefit of bargain) damages

1. **\*Duty to Disclose:** If you are bringing action for failure to disclose, thenyou need to prove this add’l element.

**Bad Motive→** NOT an element, but good to get punitive damages.

**Caveat Emptor:** (“let the buyer beware”) The onus is still on the buyer to ask about material information (and perform due diligence) **→** a false answer to such a question would constitute a fraud. Statutes can alter caveat emptor rule. TX examples: DTPA; Housing Act = seller must disclose certain things. \*\*

**Swinton v. Whitinsville Savings Bank, (Mass. 1942) [Caveat Emptor: No Duty to disclose]**

**Rule: Failure to disclose to a buyer in an arms-length transaction does not give rise to a cause of action for recovery of damages caused by the undisclosed condition (caveat emptor).**

**Relief Sought**: Damages + cost of repairs.

**Facts:** Bank (D) sold a house infested w/ termites to Swinton (P, appellant) in September 1938. Swinton’s complaint alleged that he did not know of the termite infestation when he purchased the house, he could not observe the condition when he inspected the house, and that Bank knew of the infestation and did not inform him. Swinton alleged that the defendant fraudulently concealed the termite infestation.

**Procedural:** Trial court granted the defendant’s motion to dismiss and the plaintiff appealed.

**Issue:** Does a failure to inform the buyer of a house of a termite infestation give rise to a cause of action for recovery of damages caused by the undisclosed condition?

**Holding:** No. A failure to inform the buyer of a house of a termite infestation does not give rise to a cause of action for recovery of damages caused by the undisclosed condition.

* Swinton’s complaint did not provide sufficient facts to show that Bank knowingly made false statements or misrepresentations. The complaint did not offer proof that the plaintiff had asked whether there was a termite infestation or whether the defendant had been aware of one;
* In Massachusetts, a contract cannot be made voidable for mere nondisclosure
* Unless there was a duty to disclose, the seller had no obligation to disclose the infestation. .
* Defendant did not (1) have a fiduciary duty to the plaintiff and (2) was not family, therefore did not have a duty to disclose.

**The caveat emptor rule applies in arms-length** **transactions** →but Statutes can alter caveat emptor.

**§ 529 = Half-truths [creating false impression] are fraudulent when you say something, but by failing to add something else, what you did say was misleading.** E.g. saying that a company is in great shape, has great reserves, but failing to disclose that it’s about to lose a major lawsuit, etc.

**§ 550 = liability for fraudulent concealment**

**§ 554 = Liability for Non-Disclosures**= requires proving a duty to disclose.

**§ 551 = Liability for non-disclosure [M1 pp. 14]**

1. Silence gets you in trouble, but only if there is a duty to disclose;
2. If you have a duty, you must disclose. These common law duties may include:
	1. **Fiduciaries** / other **relationships** **based** **on** **trust** **& confidence** (i.e. family, etc.);
	2. **Half**-**truths**: Matters that you know are necessary to disclose to prevent partial or ambiguous statements (e.g. Can’t say a company is solvent by pointing to balance sheets when you know the company has three pending, losing lawsuits against them: must disclose lawsuits);
	3. **Subsequently** **acquired** **information** that you know will render earlier representations untrue or misleading (e.g. You’re selling a cow and say it can have babies, then you find out it can’t; you must disclose this after-acquired information.)
	4. **Duty to Fix:** Falsity of representation made when you thought that nobody would rely on it, but they do – you must correct it.
	5. **Basic Facts:** If you that the other is about to enter transaction as a mistake to them and that you know that customs of the trade OR other objective circumstances would create a reasonable expectation of disclosure.

↓ ?

 **Comment J**: “Basic fact,” is a fact assumed by the parties as a basis of the transaction. It is an important part of what is bargained for (also largely useless)

↓

**Comment L:** ppl are nervous because they don’t know what a basic fact is and this category has been expanding. The law here is unsettled. [reasonable expectation language can be altered by relationship i.e. family]

**Illustrations**

**Basic Fact:** A sells B a house, without disclosing that it is riddled with termites. This is a fact basic to the transaction [YES→ it does contradict *Swinton*, which is why it’s confusing.]

**NOT Basic Fact:** A sells B a house, knowing that B is buying on mistaken belief that a highway is planned that will pass near the house and make it worth more. A does not disclose to B that the highway is not planned. This is NOT a fact basic to the transaction.

**↓ ↓**

**These are just illustrations of facts that are basic/not basic to the transaction; it does not mean you actually have to disclose them.**

**§ 551(2)e by Jurisdiction**

**Texas =** Courts don’t know, unsettled, but there is case law that says they reject § 551(2)e

**Other States =** Some accept, some don’t = you can kick around arguments to try.

**How do you find out if it fits the “basic fact” exception under (2)e?**

**DO THE LATENT DEFECY ANALYSIS**

1. **What is the thing?** It is a house
2. **Is there a latent defect?**  Termites = yes; no highway = no.

**OR**

**EQUAL ACCESS TO INFO ANALYSIS**

1. **Who has best access v. is there relatively equal access?**
2. **If both sides have equal access =** don’t have to disclose
3. **If only one-side has access =** dohavetodisclose.

**[Scienter]** [*See also* Derry v. Peek]

***Croyle v. Moses:*** *“*An *active concealment* may constitute an act sufficient to base liability.*”*

**Take- Away Rule: Actions can be statements that give rise to fraud.**

**EXAMPLES**

* Concealing the fact that a horse has a latent defects by hitching him up differently, it’s like hanging a painting over a hole: it’s fraudulent.
* Stacking sheets of metal, etc. and intentionally putting the damaged ones at the bottom: it’s fraudulent (even as accident, it would be = **Scienter**);

**[INTENT that party rely upon: Privity not req’d]**

**Intent + reason to expect [high foreseeability]**

***Griffith v. Byers Construction Co.* (SC of Kansas: 1973):**

**Take- Away Rule**: **Privity is NOT req’d in a fraudulent concealment action if the party affected is a member of a class of persons that the vendor ultimately intended to reach [element #3].**

**Facts:** Developer gets land ready for subdivision by dividing land into lots, making roads, and other stuff; then he sells the lots to builders who build houses and then sell them to buyers. The buyers attempt to plant vegetation but it keeps dying they find out that this is because the development is on top of an abandoned oil field.

**Cause of action:** Breach of Implied warranty & Fraud.

**Procedural:** Lower court dismissed action and owners appealed.

**Issue:** Does Vendee have a cause of action for concealment of material fact against a vendor with whom there is no privity?

**Holding**: Yes. Because Defendant knew or should have known of the condition of the soil, it fraudulently concealed that fact. Implied warranty was thrown out, because it would have req’d specific knowledge of purpose [that defendant knew ppl would want to grow vegetation]

* **Grading was the misrepresentation** [like hiding hole in wall with photo frame]
* Privity is not essential in fraud claim so long as the third party was the intended[element #3] beneficiary of person who made fraudulent misrepresentation or concealment would be subject to pecuniary loss to persons who he intended or had reason to expect would rely on misrepresentation.

**§ 531 ANALYSIS [M1 pp. 21]**

* **Who was the developers silence intended to affect?**  It was intended to affect the buyers.
* **But** **developer sold to the builders?** Doesn’t matter: he still had reason to expect that
* **Does NOT mean foreseeable: it’s more like high foreseeability**

**Jenkins v. McCormick Case [Case that may fit the R2d §551 analysis] [m2 p. 55]**

* **Rule:** “Where a vendor has knowledge of a defect in property which is not within the fair and reasonable reach of the vendee and which he could not discover by the exercise of reasonable diligence, the silence and failure of the vendor to disclose the defect in the property constitutes actionable fraudulent concealment.”
* Approximates Rule in R2d §551
* This was the rule cited in *Griffith* and extended.

**Derry v. Peek (House of Lords, 1889) [Scienter = Req’d mental state]**
**Rule:** Misrepresentation, alone, is not sufficient to prove deceit [NEED Scienter].
**Facts:** Plaintiff received brochure saying that a company would have the exclusive right to use steam or mechanical power. Plaintiff relied on this info to buy shares in the company. The board of trade refused to allow steam or mechanical power, and the company was wound up, unable to complete its work.

**Cause** **of** **Action:** Plaintiff brought suit against Defendant for fraudulent misrepresentations.

**Procedural**: The trial judge dismissed the action. On appeal, the dismissal was reversed.
**Issue:** Whether it is deceit when a company forms a prospectus to solicit investors, which later proves to be wrong?

**Held:** Reversed.
\* The House of Lords reversed the judgment of the court of appeals, and reinstated the judgment of the lower court. The court found this to be an action of deceit, under which the establishment of misrepresentation alone is not enough to prove liability. In this case, Plaintiff relied on the prospectus, which may have been misrepresentation, but Defendants reasonably believed they could glean approval of the board of trade and should not be held liable for their later failure to do so.

**Discussion.** An action of deceit will only stand in a court when a plaintiff can show not only misrepresentation, but also that defendants knew they would be unable to follow through with their representations.

**Scienter means you**

1. **Knew information was false; OR**
2. **Made statement without belief in its truth, OR**
3. **Made statement recklessly , carelessly as to whether it was true or false.**

**\*The burden of proof lies on the claimant\***

**Negligent Misrepresentation**

**ELEMENTS:** **WHO CAN BE A π?** Anyone that theSpeaker intended to supply π or a limited group π is in w/info or knew recipient intended to supply π or a limited group π is in w/info. Also, must be a link btw Δ and π. It is usually a **professional. [R2d § 552 =** Persons/group/limited group of persons who defendant intended to influence or knew that the client intended to influence.**]**

**DUTY:** Duty for pecuniary loss limited by **R2d § 552**, Δ can only be one who gives information in a transaction in which he has a pecuniary interest. Duty for Physical injury is limited by **R2d § 311 [see below].**

1. **FALSITY:** False statement of material fact **OR** Failure to disclose\*

**R2d is silent on whether you can bring a silence claim → so you can try.**

1. **NEGLIGENCE:** Lack of care/competence **(DIFF. from Fraud)**
2. **\*INTENT:** intentthat the plaintiff rely on the statement. **[Clients always rely on Professional Info]**
3. **JUSTIFIABLE RELIANCE:** reasonable (+ actual) reliance on the statement by plaintiff
4. **DAMAGES: OOP:** Out-of-pocket expenses **[*See R2d §* 552(B)]**
5. **\*Duty to Disclose:** If you are bringing action for failure to disclose, thenyou need to prove this add’l element [Recover out of pocket expenses, according to R2d §552(b)].

**Bad Motive→** NOT an element, but good to get punitive damages.

\*In fraud there is aspect of constructive knowledge, in R2D there is NONE. This makes sense; you want the more culpable tort to have the widest scope of liability; so fraud should apply to more people [stick it to ppl who are more culpable].

**Do you need Privity to sue for Negligent Misrepresentation?**  You can be held liable if you make a negligent misrepresentation that causes: **This is the starting point** Because of Testbank.

1. **Property damage → No privity req’d**
2. **Physical harm →No privity req’d**
3. **Pure economic loss → PRIVITY REQUIRED [Ultramares → changed]**

**R2d § 311 - Negligent Misrepresentation Involving Risk of Physical Harm [M1 pp. 27]**

1. “One who negligently gives false information to another is subject to liability for physical harm caused by action taken by the other in reasonable reliance upon such information, where such harm results
2. To the other, or
3. To such third persons as the actor should expect to be put in peril by the action taken.
4. Such negligence may consist of failure to exercise reasonable care
5. In ascertaining the accuracy of the information,
6. In the manner in which it is communicated.”

**R2d § 552 - Information Negligently Supplied For The Guidance Of Others**

1. “One who, in the course of his business, profession or employment, or in any other transaction in which he has a pecuniary interest, supplies false information for the guidance of others in their business transactions, is subject to liability for pecuniary loss caused to them by their justifiable reliance upon the information, if he fails to exercise reasonable care or competence in obtaining or communicating the information.
2. Except as stated in Subsection (3), the liability stated in Subsection (1) is limited to loss suffered
3. by the person or one of a limited group of persons for whose benefit and guidance he intends to supply the information or knows that the recipient intends to supply it; and
4. through reliance upon it in a transaction that he intends the information to influence or knows that the recipient so intends or in a substantially similar transaction.
5. The liability of one who is under a public duty to give the information extends to loss suffered by any of the class of persons for whose benefit the duty is created, in any of the transactions in which it is intended to protect them.”

**Can we sue non-professionals like the blockbuster employee?**

* Yes: NOTHING IN R2d § 552 specifically bars such a case, BUT
* Professionals have standards of care that outline what the professional standards are – video attendants don’t have such an objective criteria. In addition, lawyers, accountants are paid specifically for their advice, opinions, so they KNOW someone will rely on it [3rd Element: Intent that party relies upon it]. If you sue a video attendant, how do you measure a defined standard of care? Since professions have standards of care, a judiciary can handle them. Because there is a benchmark by which to compare individuals conduct.
* Moll suggests a case might appear soon that says ***prima* *facie***, it appears to apply, however, professionals have standards of care we can measure against and this will restrict any holding.
1. **Ultramares Case (NY: Old Standard): [Old Rule = Requires Privity]** [Approach 1]

**(Old) Privity Rule: If you are not in privity you cannot sue for a negligent misrepresentation.**

**Privity Test:** if you are in contract w/ someone you are in privity.

It was the rule for years, similar to Testbank Case. It sort of makes sense → every major corporation in the world must get loans; can only get it w/ audit because banks require it. Think of how many people could overlook audit reports. There may be no way of limiting it – this is what Cardozo meant in his old rule if you’re not in privity, you cannot sue.

**What are the worries under Ultra Mires (privity) scenario?** It is the “Disaster Scenario” whereby investors rely on the report to invest, but are not in privity so cannot recover. Thus, the message sent is that the bank can only sue if in privity. Since the accounting firm may have done a poor job, it would expose bank to liability because bad ppl can get easier loans [facilitated by incompetent audits].

**There are only TWO reasons to get audited**: (1) investors demand it, and (2) if you want a loan, banks demand it. So if you make constructive knowledge the standard, you’re going back to indeterminate liability: all auditors know it’s for one of these two classes.

1. **Credit Alliance Corporation v. Arthur Andersen & Co. (New York : 1985)** [Approach 2]

**Near-Privity Rule: To sue you need privity or a relationship so close to privity that you knew/ should have known that the party would rely on their statements in extending credit.**

**Near Privity Test:**

**(1)** Accountants must be aware that the financial reports were for a particular **known** **purpose**

**(2)** In the furtherance that a **known** **party** was intended to rely and

**(3)** There must have been some **conduct** **linking** the accountant linking to that party.

**Why is this near-privity?** Because there is no contractual relationship, but if the auditor ultimately knows who it’s for and what the purpose of it is for and there is conduct connecting the accountants to the bankers, its close enough that they should have known **[similar to third-party beneficiary analysis].**

**Facts:** Two cases, both involved Banks (Credit Alliance + EAB) suing accounting firms (Arthur Anderson + Strahs & Kaye) for failure to conduct investigations in accordance with proper auditing standards, when Plaintiffs relied on Defendant’s financial reports in lending money to another party. **Issue:** Whether an accountant may be held liable, absent privity, to a third party who relies to his detriment on a negligently prepared financial statement?

**Holding**:

\***Credit Alliance**, the court held that there was no privity and that Defendant could not have known that a form report, which it presented to its client would eventually be relied upon by Plaintiff.
\***EAB**, the court held that under its facts, the Defendant knew it was preparing reports that would be used to obtain credit, and they were liable to Plaintiff to the extent of their reliance.

↓

**DIFFERENCE:** EAB was aware that their financial statements would be used by outside creditors [Facts showed that EAB claimed in writing that the accountants knew about them]. In Credit Alliance, Defendant prepared form reports, which it gave to its clients; but it did not reasonably know [there was no proof that they knew] that those reports would be given to another party. **Constructive knowledge [of use of docs] does not suffice** →must be actual knowledge. **↓ What if you know the audit is for a narrow class of people→** Still requires conduct linking plaintiff (Moll suggests you might need some affirmative linking conduct) [Alleging a mere chain bank as opposed to a specific branch might not be enough].

**Justification for the Near Privity Rule?**

* If you know who, what, when, from the outset, you can protect yourself;
* Can protect with liability insurance;
* So it seems you can know the party and the purpose, but the issue is the 3rd point: you don’t want to link the accountant to that party (put a link on the web, etc.)
* Don’t forget that Ultramares opinion by Cardozo – by re-writing it as such, they are in essence overruling Ultramares. They don’t however frame it that way –they frame it as consistent with Ultramares.

**RATIONALES of Case**:

* Don’t want to overrule Cardozo, so make it as close as possible, OR
* Assumption of the Risk – if you know the purpose, you are basically assuming the risk
* **Assumption of the risk** → if you knew the purpose, you assumed the risk. **Problem:** Accountants can just “stay ignorant” since constructive knowledge doesn’t help auditor predict for known risk.

**DEFENDANT DEFENSE: Try and get out on summary judgment by:**

1. **Attacking one of the three prongs** Person had (1) no known purpose

(2) no known party

(3) no linking conduct.

2. **Argue that you were NOT negligent.**

1. **Citizens State Bank v. Timm, Schmidt & Co. (SC of Wisc. 1983) [Minority Rule]**

**Foreseeability Rule:** “Liability will be imposed on accountants for the foreseeable injuries resulting from their negligent acts.” **Exception** = matter of **public-policy,** which will be decided by the courts.

**Brief Fact Summary.** Plaintiff brought suit against Defendant after it relied on Defendant’s financial statements in extending cash to a company, which later went bankrupt.
**Longer Facts:** Defendant prepared the financial statements of Clintonville Fire Apparatus, Inc. (CFA), and certified that it prepared its statements in accordance with generally accepted accounting principles. CFA obtained loans from Plaintiff, relying on Defendant’s statements. Defendant later discovered mistakes, totaling $400,000.00, in Plaintiff’s statements and notified creditors that called all of their loans due. CFA went into receivership and was later liquidated and dissolved. Plaintiff brought suit against Defendant for amounts still owed on loans they made in reliance of their statements. The trial court granted summary judgment and the court of appeals affirmed.
**Issue.** Whether an accountant can be held liable to a creditor when the creditor relies on accountant’s financial reporting in extending credit to a company that is later found to be insolvent? ↓

**Held.** Yes. The SC of Wisconsin considered [Ultramares] and the Court decided to overrule it, holding that absent a showing that public policy was to the contrary, it was not unfair to hold an account liable for another party’s damages sustained in reliance on the accountant’s reports.
↓
**Discussion.**  While an accountant may not be held liable when damages are unforeseen to another party, he may be held liable when it is foreseeable that another party will rely on his reports.

**Why is this very BROAD (“liberal”)? Criticism of Case:**

All of these things are foreseeable, since we know that someone will rely on an audit (that’s their purpose). This is a REGULAR negligence standard as in *Palsgaf.* ALL that matters here is foreseeability. Of course, audits will be used by somebody. It doesn’t matter that client didn’t tell you purpose/party/conduct.

**Public-Policy Defense**: Gives the PUBLIC POLICY defense to those being sued.

**What are the “Public Policy” factors?** They are really more “unforeseeable” factors [Moll says **RIDICULOUS**]:

* **(1)**
* (2) injury is too wholly out of proportion to the culpability of the negligent tort-feasor;
* (3) in retrospect it appears too highly extraordinary that the negligence should have brought about the harm (But this is basically unforeseeability);
* **(4) Basically the same as 2;**
* (5) Fraud.

**Policy Rationales behind Citizens Bank** (TORT LAW IS ALL ABOUT POLICY, SO THIS IS IMPORTANT):

* Protection of innocent 3rd parties;
* Deterring accountants from negligent practices (threat of liability deters negligence)

**Counter-Arg:** that’s not the only thing that will deter – they might go out of business or be fired if they are negligent (market forces will deter), **Counter-Counter Arg**: Some people are actually paying for shoddy accounting work. (Moll is suggesting that some courts may adopt strict or lenient rules, because sometimes they think these cases are crap: no shareholders actually read accountings)

* Failing to adopt this standard would result in higher prices for bank loans because banks will have to charge more interest to make sure that this risk does not get realized OR they may make their own audits, etc. and that’s unnecessary.
* Banks could also decide simply not to lend because the risks are too great.

**How should accountants protect themselves?** Insurance. **Problem**: Even Test bank admitted that you can’t buy insurance for indeterminate liability. That’s the problem. How do you write a policy for ALL reasonably foreseeable injuries? Insurance Companies will put a cap, and how will they know what to charge anyways?

1. **R2d § 552 [Majority Rule] *Also*  Texas rule → *See McCamish for specifics*]**

Who can be sued? **§ 552(1)**

Anyone who: **1.** Gives negligent information **2.** In a transaction **3.** In which they have a pecuniary (monetary)interest.

**Comment C:** If the transaction is gratuitous, then there is no liability (Curbstone advice to a former client: Person not liable under § 552.).

**Comment D**: Pecuniary interest normally lies in the consideration paid to him. Indirect financial interests also qualify.

Who can be a plaintiff element? **§ 552(2)**

1. **person/ group of persons / limited group of persons who suffered loss, AND**
2. **Whose benefit and guidance Defendant intended to supply\***

[slightly less hard standard, must only know a certain type of person/group will rely on it]

 **\*Test:** “limited group” TEST: Did auditor [actually] know (1) Person? (2)Group of persons? (3) Limited groups?

If answer is no for all, Creditor NOT liable.

**Defense:** Auditor can say that this is still a “huge group.” You can make this arg. Because statement says “by a person OR limited group” which means that if you are not going to say a specific person, you need to specify a limited group:

1. How “limited” is a “limited group**”?** Do “investors” qualify?
2. A “limited group” may NOT necessarily be small, it’s just specifically defined.
* Bank seems to be a “limited group” – since federally or state chartered, we know who they are

**Defense2:** Scenario of: “I need an audit for a bank loan for $10,000.” The audit is then used for $10 million

* Auditor can now argue that the actual purpose of the loan was different and therefore unknown. Since the representation was for $10,000 and the loan was for $10 million actual knowledge is therefore not

**Rationale of R2d § 552**

* Give notice to auditor that it has MAY assume the risk OR not
* Make the auditor aware of the potential exposure (who its going too, what it’s for) then you know what the risk coming out of it is and you can choose who to serve, thus who you will expose your liability too, or you can get insurance).

**When do you measure auditor’s knowledge?** From the time the auditor enters into the contract. The reason being, that the auditor can only be expected to safeguard himself against risk if he is measured by his knowledge at the point in which he/she enters into the contract. After, it’s too late for him to limit liability – he/she has already entered into the contract.

**PROBLEMS** ↓ ***Monco Case*** (5th Circuit) - The court states that you should measure liability from the time the AUDITOR publishes the report. As such, they disagree.

1. **Monco Case** (5th Circuit)[R2d §552: When do you measure “knowledge” of the auditor?**]**

**The court states that they measure liability from the time the AUDITOR publishes the report. (contradicts above)**

**Possible** **explanations** (Yessika):

1. If K is for a certain amount, they change deal, then the auditor can say the contract is different so they can either refuse to do it for the increased amount OR re-negotiate the deal, get more insurance, etc.
2. When the auditor publishes report, that is the point that the auditor puts people on notice, so as a result, before they publish they are better positioned to limit liability by changing what they publish.

**Point**: Moll doesn’t like the Monco Case, he sees it as problematic. He liked Yessika Monagas’ explanation however.

**Lawyer Case**

**TX Law: McCamish Case [Lawyer Case] [M2 p. 77]**

**Rule: R2d §552 applies to lawyers, thus lawyers have a duty that runs to non-clients, and thus, an attorney may be subject to a negligent misrepresentation claim even if there is no legal malpractice claim.**

The Supreme Court of Texas limits the duty owed by attorney’s non-clients, to situations in which the attorney is:  **(1)** Aware of the non-client and  **(2)** Intends for the non-client to rely on the information provided. Id. at 794

**Cause of action** is available only when information is transferred by an attorney to a known party for a known purpose) → consistent **with R2d §552**

**How is this similar to accountants?** The duty to non-clients is similar to the duty of accountants giving financial information to their client, which the accountant knows will be given to third party, but is not limited to that situation.

**Are attorney cases different from lawyers?**

**Yes**: if a third-party is suing a lawyer, it is NOT a party in privity→ deals with scenario where: You representing a client who arguably ran a red light and hurt a plaintiff. Client says “please try and settle.” As attorney, you call up plaintiff who is at this point unrepresented (allowing a lawyer to call plaintiff directly). You offer to pay for $60,000, say that “this is about what juries are paying for”. He accepts. Then he finds out that juries usually award “$120,000.” Thus he sues for negligent misrepresentation resulting in pecuniary loss.

**POINT**: lawyers are different because if they owe duties to another client then they may be exposed and get sued by opposing client defending their own client. That would expose them to being something like a **real** **estate** **agent** = they only pass on offers, never seem to negotiate. **Problems:** Encourages lawyers to litigate rather than settle; Conflicts with a lawyer’s duty to defend his client arduously.

**Can you bring a suit against someone who isn’t a professional under R2D § 552?**

**Yes**. Because it’s was a business transaction with a pecuniary interest. So it seems that it SHOULD apply to ordinary arms-length transactions.

1. **Weisman v. Connors (MD)[No duty in arms-length transactions] [Near-Privity Rule]**

**Rule: In arms-length commercial transactions, two sophisticated businessmen do NOT owe each other any duties. This case is where the only result is Economic Loss.**

**Adopts different tests based upon type of injury:**

**[1] Physical injury or [2] Property damage occurred→ No personal relationship needed; simple negligence, focuses on “foreseeability.” → Citizens Bank Rule**

 **[3] Economic Loss ONLY→ Must show an “intimate nexus” between parties → Near Privity Rule**

1. **Billy v. Arthur Young (SC of Cali: 1992) [Near Privity Rule]**

**Contains detail on what accountants and auditors;**

**Rejects Wisconsin’s “reasonably foreseeable” test {simple negligence} for TWO REASONS:**

↓

1. **Indeterminate** **Liability** is a problem because it’s NOT proportionate to the auditors fault **because** they did NOT keep the books; they only sampled them by testing it. The real bad guy is the ACTUAL company being audited:
* **Missing** **the “cooking of the books”** we must remember, may NOT even be negligent. The process might have been good [it’s not perfect, it’s based on a sampling] OR it could have been negligent.
1. **Liability would also be massively disproportional to fault because people deciding to invest in a company will look at:**
* What is the business doing? How good are they? Stock analysis, assets and losses. Assessments of the market and whether it will expand. **Court says however, that NOBODY invests in a company based solely on the audit report.** So it’s ridiculous to hold them so liable. The audit report is only one factor when people decide to invest, but when it goes belly up, the investor always goes after the auditor since it’s the only solvent entity left (IMPORTANT POINT).
* Investors reading audit reports are NOT like consumers of products. They are sophisticated parties and have other means to protect themselves.
* If the business goes belly up , auditor will get sued. This may mean that start-up companies won’t get audits because they will refuse to do so, since the fledgling businesses may fail.
1. **Winter v. G.P. Putnam’s Son**

**Rule: Publisher/Author cannot be sued for a Negligent Misrepresentation contained in a book [did not make the statement].**

**Facts:** Plaintiffs buy book on mushrooms. Go out and eat mushrooms book said was safe. Require liver transplant. This is like the restatement example of the truck waiving to a car, signaling that it’s safe to pass. This was a negligent misrepresentation causing PHYSICAL injury, NOT a pecuniary one so it should have been easy.

**Issue**: Whether you can you sue a publisher for negligent misrepresentation?

**Reasoning:**

* *Prima facie* **R2D §552** applies, but **versus** First Amendment :
* Allowing suit could have a First amendment “chilling effect;”
* Don’t want each author/publisher having to defend books;
1. **Innocent Misrepresentation**

**ELEMENTS:**

* **Must only prove the statement was FALSE.**

**In K law =** innocent misrepresentation carries obligation to rescind a contract.

**In T Law** = Liability is only imposed when the defendant has warranted the truth of his statement.

1. **Richard v. A. Waldman’s & Sons, Inc. [Very few states recognize]**

**Rule:** Innocent Misrepresentation is Strict Liability: You told me x, but y actually happened. **Must only prove that the statement was false.** Court says “ought to have known” will then do the rest.

**Facts**:A Housesale survey shows house is on the lot. House is sold. It turns out that the house is so far out of the boundaries that simply by opening back door you are encroaching on another property. Plaintiff finds out and sues about the misrepresentation.

**Issue**: Whether plaintiff can recover for an innocent misrepresentation.

**Holding**:Court says you can sue for damages for Innocent Misrepresentation. Says “ought to know” thus, no Scienter and no negligence need be proven. Innocent Misrepresentation is arguably **strict liability =**  all that needs to be proven is that the statements were false.

**When does negligent misrepresentation turn into innocent misrepresentation?** Waldman described it as “you ought to know” which sounds like negligence – so its sounds the same. Moll thinks as follows

1. **Damages:** Waldman surprisingly awarded **expectation damages** (what was represented to you – (minus) what you got)↓
2. **Breach** **of** **warranty** (strict liability) gives expectation damages but you MUST meet all the contract damages.
3. **R2d** also has an innocent misrepresentation provision; 552(c); difference is that they use **reliance damages** (value paid – value got); in this way, innocent misrepresentation in tort would be different than in contracts = lower damage (thus, only need to meet contract doctrines if you go for contract breach according to R2d). **[putting you in a place you would have been if the contract had been performed]** NOTE: if you can’t come up with these figures, COST OF REPAIR is often used as a proxy to measure expectation damages.

**POINT:** From tort perspective: you get all the advantages of contract judgment, without having to satisfy statute of frauds, etc. Plaintiff doesn’t have to prove culpability and they get expectation damages. BUT, bringing a contract claim is problematic because of: Illusory rule, statute of frauds, etc. Difference: expectation damages gives you equiv. of what you received and where you should be; reliance is where are you know, we’ll get you back to where you started.

**Fraud =** knowingly misrepresenting /should have known

**Negligent Misrepresentation** Did not act as a reasonable person

**Innocent Representation:** Ought to have known.

**Justifiable Reliance:**

**Fact is material If [Misrepresentation of Material Fact §538(1) (M1 pp. 11)]**

1. A reasonable person would attach importance **(Objective Reliance)** OR
2. The maker of the representation knows or has reason to know the person would attach importance **(Subjective Reliance)**.

**R2d s§541 [M1 pp. 81]**

* **If a fraudulent misrepresentation is made to you, you do not have to investigate, even if it would be easy. But you DO have to do a sensory investigation (look, hear, see, smell etc.)**

**Williams v. Rank & Son Buick, Inc.**

**Rule:** If someone could have found it through “ordinary observation,” then they did not justifiably rely upon the statement [court says he should have hit switch→ may suggest more than ordinary observation is req’d].

**Facts:** Man goes to buy car, says it’s important it have a/c. Guy gives him car, he test drives for 1.5 hrs., goes back and buys car. **[Moll says application of facts here seems wrong]** **Issue:** Whether buyer justifiably relied on salesmen’s misrepresentation that there was air conditioning. **Holding:** No. **Reasoning**: He was an educated businessman; he could read and had 1.5 hrs. to drive – so he could have checked the a/c himself.

* “It is apparent that the obviousness of a statement’s falsity vitiates reliance since no one can rely upon a known falsity.”
* If someone could have found it through ordinary observation, then they did not justifiably rely upon the statement.

“No great search was required to disclose the absence of the air conditioning unit since a mere **flip of the knob** was all that was necessary” = you should have looked, and gone a bit further by trying it out.

**Discussion**: While, in misrepresentation cases, a plaintiff who is fraudulently induced may recover damages, the court will also consider the role of the plaintiff’s reliance, in comparison to the reliance made by a reasonable man→ **Contributory Negligence. [IMPORTANT FOR EXAM]**

**POINT:** Moll says **r2d** is correct. You can’t rely on statements that are “obviously false,” this means using your senses. Cases thus linger on how much is required. If court feels you could find out easily that it was false there is ALWAYS the risk that the court will still hold it against you. Court will want you to have **flipped the proverbial switch.**

**Do you have to investigate fraudulent statements in order to rely on them?** No – you must just use your senses. [M1 pp. 83]

**What if you do commence your own investigation, what is the effect?** If plaintiff conducted his own investigation it suggests he did NOT rely on the misrepresentation or you wouldn’t have made your own investigation. Many older Texas cases make this point. **Moll** suggests however that this is incorrect: simply because you rely on one thing does not mean you can’t rely on another. Often, reliance is based on multiple sources.

**Evidentiary Point**: doing your own investigation may be evidence of non-reliance but it’s NOT preclusive: it’s a factual matter NOT a legal matter, as the court makes it out to be. Moll says more modern courts would say that doing your own investigation is “**evidence**” you did not rely,

**R2d s§540– Duty to Investigate [M1 pp. 81]**

**R2d s§541–Representation of Fact by Adverse Party [M1 pp. 82]**

**R2d s§545A– Contributory Negligence [Fraud] [M1 pp. 83]**

***Prima* *Facie* *Defense*:** What **§** 541(a) is saying is that this shouldn’t bar your claim in certain instances. This applies to the reason rational on prima facie case. **This is why most fraud cases say justifiable reliance, NOT reasonable reliance.**

There is no affirmative defense for contributory negligence but that’s too superficial: because the REASON you can’t bring it is that contributory negligence was that you didn’t act as a reasonable person.

**R2d s§552A– Contributory Negligence [Negligent Misrepresentation] [M1 pp. 85]**

**R2d s§539– Representation of Opinion Implying Justifying Facts [M1 pp. 86]**

Most of the time you cannot rely on ….?? Opinions ??

**R2d s§542–Opinion of Adverse Party [M1 pp. 89]**

**General Rule** is that youCANNOT rely on an opinion of an adverse party: why would you [“the recipient of a fraudulent…”]!

**R2d s§543–Opinion of Apparently Disinterested Person [M1 pp. 92]**

**General Rule** is that you can trust the opinions of disinterested as per the examples.

**R2d s§545–Misrepresentation of Law [M1 pp. 95]**

**R2d s§530– Misrepresentation of Intention [M1 pp. 99]**

**Not true that (1)** Youcannot bring a fraud claim based on an opinion” **(2)** You cannot rely on an opinion because it is NOT a statement of fact.

 → this is NOT true. **It is a fact that something is your opinion** (therefore, a claim can be brought on such a basis). EX: “In my opinion, this is a lovely shirt.” The fact is that he thinks it’s a lovely shirt: thus, if someone finds a note somewhere that says that he hated the shirt, but he wore it because it was his only clean one, **evidence** proves he lied about his opinion.

**Puffing Cases**

**Vulcan metals Co. v. Simmons Mfg. Co & Saxby v. Southern Land Co.** These are “puffing ” cases – about “sales talk.” According to these talks, one person cannot rely upon these statements because they are adverse parties. Your guard is supposed to be up.

E.g. “this car is the best in the American market”, “top-of-the-line” etc. It’s based on Learned Hand’s point: if these words weren’t there, we would wonder why. It is “bullshit” that we (are supposed to) know is “bullshit.”

**“Special knowledge” exception** → you should be able to rely on special knowledge of an expert]; even though this usually means extra degrees. Usually experience wouldn’t apply for buying a horse, but would apply for buying a diamond.

**How do you recognize that something is puffing?**

1. “This cleaner has never been on the market before” = NOT puffing
2. “This cleaner is absolutely perfect in even the smallest detail” = Puffing

First statement is verifiable, second statement is not; it’s too vague.

**FACTORS Inquiry into puffery:**

1. Is the statement objectively verifiable or not?
2. Specificity of the statement (more specific, less likely its puffery; might tie to first point )
3. Whether it was oral or written? (written representations are more objectively verifiable. **Oral** has interpretation errors, etc.)

**R2d §539 Comment C**

**R2d §549 Comment E**

**Hanberry v. Hearst Corp. (m2 pp. 104)**

**Facts**: Good housekeeping magazine. Plaintiff says she bought shoes from a store and the shoes were slippery and unsafe. She falls and hurts herself. She sues the store and also the Good Housekeeping for putting its seal of approval on the shoes. **Procedural**:Shesues shoe co. AND publisher under negligent misrepresentation saying they put the seal of approval on. Publisher responds that there seal was just an Opinion – you cannot bring a claim based solely upon an opinion.

**Issue:** whether a seal is an opinion.

**Holding:** Court says that the plaintiff CAN justifiably rely on this opinion because they represented to the public that they possessed superior knowledge. Also, they were NOT a disinterested party since they were getting a kick-back. NOTE that in the case, the court doesn’t say you simply can’t bring an opinion claim.

**Claims based on legal opinions: § 545**

**Statements of Prediction versus Statements of Intention**

1. Must be a “misrepresentation of existing fact” not a “ statement about the future ”
2. This is also NOT true.

**Statements of Intention**

1. Statement of future (technically)
2. Section 530 (M1 pp. 99)

**McElrath v. Electric Investment Co. & Burgdorfer v. Thielemann** [m2 pp. 106 to 110]

1. When you enter a contract that represents that you will do things and you know you have no intent to do them then you are also making a **fraudulent misrepresentation = you have intent to deceive at time of representation.**
2. If you sign the contract and then, one second after, find out that you don’t have the funds to do it because you just lost a lawsuit– then this is DIFFEERENT. This is **negligent misrepresentation = at time you signed, you did NOT have intent (= scienter)**
3. **One could counter that if you knew at time you had lawsuit, and you signed anyways, you were reckless and thus there WAS reckless conduct = scienter = it was fraudulent.**
4. **If court wouldn’t buy fraud here (it’s not reckless) then you say that at the very least it was unreasonable at time.**

**Lack of delay between time entering contracts and breaching** can be good circumstantial evidence that you NEVER intended to honor your contract, intentionally deceived.

**DAMAGES for MISREPRESENTATION**

**Hinkle Case**

**Facts:** Hinkle bought a 1969 Ford galaxy. Defendant had screwed with the odometer. Damages claimed in vicinity of $100,000: it was a 1971 case for a 1969 car. Point is that the claim was very high.

**What is the majority rule for measure for fraud? →** Benefit of bargain measure of damages [you get the value of the thing represented minus the value of the thing that you got.] **(Value of new ford galaxy) – (what he got: old, damaged car)**

**MAJORITY RULE FOR the TORT OF FRAUD is EXACTY WHAT it would be for BREACH OF K =** expectation damages (this is not consistent with tort; goes beyond).

**MINORITY RULE IS A RELIANCE MEASURE OF DAMAGES: diff between price you paid, minus the value of the thing that you got. {makes you whole again} = reliance damages (This is consistent with tort).**

**TEXAS RULE for Fraud Damages**→ Texas lets plaintiff choose whether they want OOP or BOB: will chose OOP when they strike a BAD BARGAIN. **M2 pp.114 (cont’d).**

**Plaintiff can chose whether they want (1) Out-of-pocket or (2) Reliance damages:**

Why would you ever want reliance damages? If you struck a BAD BARGAIN, you don’t want to be in the position of if the bargain was performed; you would prefer reliance damages.

***SEE* [M2 pp. 114] FOR CALCULATIBNG DAMAGES: OOP/BOB**

Note 7 (m2 pp. 115) = **Some places let you get consequential** **damages** → If you buy a horse that was lied about being well-tempered, but really he isn’t and then a person gets injured, he can sue for the consequences

**Punitives**: If you can prove that defendants conduct was: wanton/callous, reckless disregard, etc. THEN you can get (if you can show there was INTENT to HURT)

**Negligent Misrepresentation damages: M1 pp. 109 {r2d s 552b}**

1. **OOP expenses**
2. **Consequential damages if you can prove them**
3. **NO punitive or BOB**
4. **Interference with Existing and Prospective Contractual Relations**
5. **Existing Contract**

Economic Relationships:

**Contracts→** Law allows claims for interfering with these ones **Prospective Contracts (might become K)\* Gifts/Promises/wills→** Law DOES NOT go so far as to saying that interfering with ALL OF THESE is tortious.

**Point of K**: get resources allocated to people that value them the most
**Efficient breach of a K** = Breaching a K is NOT considered a morally repugnant act; sometimes if it encouraged to breach them, when efficient: if the overall effect of the breach is that nobody is made worse off and the resources make it to the person who values them the most. **Tort** **law** is based on morally repugnant acts, so TORT is still an issue when C comes in and interferes (when A has contract to sell apples to B for $10, C approaches A and offers $15, A breaches sells to C, B goes onto market buys apples for $11 … etc.).

**Lumley v. Gye (Queens Bench: 1853) [ORIGINAL: ELEMENTS of IIEC & IIPC the same]**

**Rule:** the tort of intentional interference with an existing contract by third person DOES exist.

**Elements:**

1. **Intent**

→ Acting w/ purpose or desire of causing the prohibited conduct (most common) OR

→ Knowing w/ substantial certainty that a result will occur.

→ Must therefore have known a K existed if you had intent to interfere with it. **[R2D §766]**

1. **Interference (M1 p. 113)**
2. **Existing/Prospective** **contract**
3. **Damages [Injury]**

**Facts**: Lumley is an Opera manager, rival is Gye. Wagner is opera singer. Lumley enters K with Wagner to sing at opera house; before Wagner is supposed to sing, Gye chats up Wagner and persuades her to sing for him. **Procedural:** Two lawsuits emerged; 1st (not in case): Lumley sued Wagner on a negative covenant in the employment K that said that if she doesn’t sing for him, she can’t sing for anyone. Lumley sues her to enforce the negative covenant and he prevails; court enjoins Wagner from singing for anyone but Lumley. **2nd lawsuit** is the subject of the present case; Lumley sues Gye saying that he **intentionally interfered with an existing contract. →**Gye wants Demurrer (motion to dismiss on deficient pleadings – saying this cause of action does NOT exist).

**Issue:** Whether an action exists against someone who maliciously procures an abandonment of contract, with pecuniary damages resulting. **Holding**: Yes. The tort of intentional interference with an existing contract DOES exist.

**Why do we need this tort**? Let’s say Gye kidnapped Wagner and she didn’t show up: Wagner could claim Impossibility/impracticability because she was a victim of a criminal act, but how would Lumley recover? Wagner couldn’t sue Gye to recover for kidnapping, Lumley sue Wagner because Contract doctrine would excuse Wagner’s performance. This INDEPENDENT claim in TORT is needed so that Lumley can go directly after Gye.

**Without this cause of action, would Lumley have a remedy?**  Yes – he could sue Wagner for breach of k and get consequential damages (K Consequential damages; any damages that were foreseeable at time the contract was FORMED; Tort Consequential Damages: any damages that were foreseeable at time of ????)

**What is different between this and the apple example?** It deals with specific, limited services rather than fungible goods which can be replaced; specific performance was at stake.

**Bacon v. St. Paul Union Stockyards Co (S. C. of Minnesota: 1924) [INTENT]**

**Facts**: Ps employer works in a stockyard (there is an employment contract between employer and employee). Defendant is the owner of the stockyard; he locks up the yards so that plaintiff cannot get to his business in the stockyards. Employee sues stockyards saying that he has intentionally interfered with his existing employment contract.

**Issues:** Whether defendant had requisite intent?

**Holding:** No proof that defendant specifically intended to interfere with employee’s employment K with employer.

↓

**Intent**: Here he may not have intended in traditional sense, but did have knowledge w/ substantial certainty that this would interfere with substantial certainty with employment contracts. Needed some evidence for why defendant shut the stockyard, to go this route.

1. **Prospective Contract**

**Della Penna v. Toyota Motor Sales (SC of Cali: 1995) [IIPC middle ground]**

**Rule:** Showing that there was an interference with an economic relationship is not enough to make a case for the tort of “interference with economic relations.” Plaintiff must [1] ***prima******facie***show the regular elements [2] + defendant knowingly interfered with plaintiff’s expectancy [3]+ that the intention to interfere was itself **WRONGFUL→** by some legal measure beyond the fact of interference itself**.**

**IIPC Elements (4 I’s: Intent, Interference, Injury, and Improper):**

1. **Economic relationship containing probable future benefit to ¶**
2. **Δ’s knowledge of existing relationship**
3. **“That Δ intentionally engaged in wrongful acts or conduct designed to interfere or disrupt” the relationship**
4. **Actual disruption**
5. **Damages to plaintiff as result of the act.**

**Wrongful =** any manner of intentional of intentional invasion of ¶’s interests may be sufficient if the purpose

is not a proper one (Must be “wrongful by some legal measure beyond the fact of interference itself.”).

\* P must allege & prove more than prima facie tort, but must not negate all defenses.

**So what does “wrongful” (improper mean)?**

1. Majority does NOT say what it means.
2. So how could we define it?
3. Wrongful motive (for interfering) [bad motive = improper]

“by virtue of an improper motive”

1. Illegal acts (breaking the law = fraud, distortion, etc.)[means of interference = illegal]

“wrongfulness may lie in the method used”

1. Tortious conduct = improper
2. Unethical = improper

**POINT**: one may disagree what is ethical, tortious etc. but at least they are defined since there are existing definitions. We can look to already existing standards to determine what it should be whereas, if we chose to define it by **improper motive:** 1. There is no existing legal standard, definitions, etc. 2. How do you prove such a state of mind? - people often act with multiple motives - difference between defendants who are corporations and businesses (how do you get a “businesses motive” when it has a BofD; shareholders, etc.-whose prevails)?

**OVERALL PROBLEM:** A Bad motive might still be accomplished with legal (good) conduct. Scary to let juries loose on this.

**Facts**: The Plaintiff, Della Penna (Plaintiff), is a distributor of automobiles. The Defendant, Toyota Motor Sales, U.S.A., Inc. (Defendant), made a policy disallowing the sale and distribution of the Lexis line of cars outside the United States. The Defendant published a list of “offenders”, parties supposedly guilty of this practice and told its franchise owners not to do business with them, threatening punishment if they did. **Procedural**: On trial the jury instruction explains what the elements are for IIPC. **D’s Arg:** Jury instruction wrong, should require plaintiff to prove that defendant engaged in “wrongful acts” as opposed to acts that merely interfered but were not wrongful. Trial court agrees; plaintiff appeals. **Issue**: Whether to reconstruct the formal elements of the tort of IIPC. **Holding**: No. In order to recover for a disruption of economic relationship, one must prove that the acts that lead to the disruption were wrong – beyond what one would normally do to increase one’s own business. Mere evidence that the disruption happened is not enough to make a case for the tort of interference with economic relations.

**Now plaintiff must to prove that Δ’s conduct was improper**: this is a HUGE difference because now as a [prima facie element, summary judgment etc., are available to defendant.

**DEFENSE→ Defendant can offer affirmative defense AFTER prima facie case is made.**

**Problem:** People still being sued and it gives impression that the whole US economic model could be tortious: it’s all competitive with people trying to take each other’s perspective Ks away

1. This is not a frivolous lawsuit if plaintiff can meet prima facie case; on the other hand, it’s unfair to drag the person into a lawsuit.
2. Plaintiffs burden is so easy it seems to encourage behavior

**Concurrence**: Della Pena concurrence said that they should adopt an **objective standard.** Says we should forget “motive” and look for “objectively unlawful conduct” – stuff that is independently tortious or interference with trade (and prob. criminal, though he didn’t mention it) **[pp. 151-152]**.

**Tuttle v. Buck (Minnesota: 1909) [M2 pp. 122] [IIEC]**

**Rule: If sole motive is bad, it is actionable in tort.**

**Facts:** Man of wealth in community maliciously opens rival barber shop at rock-bottom prices, for the simple purpose of ruining another person’s business.

**Issue:** Is it a bad/improper motive?

**Holding:** Yes, court said he was guilty of wanton wrong and actionable tort was permitted, noting that his sole motive was bad/improper – he wasn’t even making a profit which could have been a second motive. Court said it was the moral equivalent to “highway robbery.”

**Discussion.** How is it different from Coke & Pepsi merely competing? Even if you have smoking gun where Pepsi wants to hurt Coke; they also have motive of wanting to increase profits, market share, etc. It is thus the **MIXED motives** which makes it hard to decide in areas that look at bad motive: **Ways to solve:**

1. IfONLY **one motive,** and it’s bad, then its punishable
2. If you can prove **ANY proper motive,** then court will disregard your improper ones (problem is that jurisdictions will tailor this to a predominant motive)

**Concern about letting impropriety being motivated by bad motive, they might focus on such instead of the conduct itself which was good, competitive behavior.**

**R2d § 870→** “One who intentionally causes injury to another is subject to liability to the other for that injury, if his conduct is generally culpable and not justifiable under the circumstances.”

**Rd § 766→** Existing: Causing a 3rd party not to perform his contract with the plaintiff [Lumley sues Gye].

**Rd § 766A→** Existing: Preventing plaintiff from making/performing his own K [Employee sues 3rd party interfering with his ability to work, like Bacon Case].

**RD § 766B**→Interference with Prospective Ks→

**RD § 767**→ **Δ’s conduct must be “improper” according to a balancing approach of 7 factors.** Fails to say which party bears the burden of proof. **Defense:** Δ can escape liability y showing that his conduct was justifiable + did not include use of “wrongful means.” [See Adler Case Below ↓]

**Adler, Barish, Daniels, Levin and Creskoff v. Epstein (SC of PA: 1978) {IIEC}**

**Rule: R2d § 766 defining “intentionally and improperly interfer[ing]”**

**Facts:** Plaintiff is law firm, defendant is a former associate who solicited business before leaving his position. He sends letters to clients saying he was leaving (ok) and they could keep his services (ok) and he also sends them forms that if signed and returned, will sever their ties to plaintiff and take on his firm for services (this went too far → he interfered by soliciting w/ existing clients and possibly interfered with possible future contracts). **Issue**: Whether defendant is guilty of IIEC.

**P’s Arg:** Conduct of sending form letters, etc. is IIEC.

**Dis Arg:** The conduct was **privileged** and there is therefore no right of action. Also say that as commercial speech, his actions are protected by First & Fourteenth Amendments.

**Held:** you cannot interfere with existing or prospective contracts. **Discussion:** In Adler Case (interference w/ existing K) all I’s were proved – prima facie case made. Burden shifted to defendant to justify why he should be permitted to justify breaching the contract.

**Law**: **Rd § 767**: “one who intentionally and improperly interferes” … **what does it mean? → § 767**:

1. The nature of the actor’s conduct
2. The actors motive
3. The interests of the other with which the actor’s conduct interferes
4. The interests sought to be advanced by the actor
5. The social interests protecting the freedom of action of the actor and the contractual interests of the other
6. The proximity of remoteness of the actor’s conduct to the interference, and
7. The relations between parties.

↓ **[Question is whether interference is improper, after weighing these factors Use Comment J M1 pp. 171]**

**Who has the burden to prove impropriety?**

1. Both r2d definitions don’t say who has the burden to prove what is “improper”
2. So you go to the 7 prong balancing factor – but who has the burden is NOT clear.

**What is “burden-shifting” consideration between prospective and existing Ks?** We want to balance competition with protecting economic relationship. With a potential K we want the burden to be on Plaintiff; but with existing Ks, we want to protect them, so one might put the burden of proving that action was NOT improper for defendant – because defendant already did something wrongful (broke the contract), so if they must be but on defensive that this was NOT improper, then we will make defendant defend against this. **Texas** is a good example where the courts bifurcate the burden. **What reasons would work for DEFENSE?**

1. Social welfare/ public health – protect people from cancer... etc.
2. First Amendment
3. R2d allows you to make these args. under RD **§** 767 (d) & (e).

**Leigh Furniture v. Isom (1982: SC of Utah) [Mean Breach] [M2 p.133]**

**Rule: Mean Breach (**breach of K with intent to injure) is enough. Breaching Covenant of good faith could be a mean breach. Defendant's liability may arise from improper motives or from the use of improper means. **Problem**→ Moll finds this interesting because it means breach of k can be a predicate for a tort; this approaches the taboo world that every breach of k might be a tort.

**Facts:** Isom buys Leigh Furniture Store from Leigh and Wife, but since he doesn’t have enough money, he gets secured so it’s still technically in their possession. He is trying to negotiate prospective k’s with customers and suppliers, but Leigh and wife keep coming into the store, yelling at him and interfering with his transactions. **Procedural:** He sues the corporation (really the couple) for intentional interference with existing and prospective k’s **Law**: Utah uses the 4 I’s elements for IIEC & IIPER (IIPC) [766B] **Issues:** Whether Utah has action for IIPC and if so, whether the tort was proved. **Held:** Yes, Utah follows 4 I’s approach & **“Improper means”** can be anything we can measure, that is objective. Isom loses on existing Ks because he is an actual party: you can’t sue someone else in this tort if you are in privity with them. So court looks at IIPER (Intentional Interference with Prospective Economic Relation). Does not make the case on “improper purpose,” but is successful on improper means: Leigh breached with intent to injure because Leigh furniture violated the **covenant of good faith**, since he kept coming in to interfere.

**“the predominant motive” V. § 768 – [ANY good motive, is okay].**

**UTAH** **LAW**

* **Utah uses the 4 I’s elements for IIEC & IIPER (IIPC) [766B] Here the “predominant motive” is the issue**→ they were more concerned about their secured transaction, so the court says that the predominant motive was economic motivation. It would have come out the same way under s 768 here anyways.
* For “improper purpose” they require the predominant motive to be the improper one (recognizing that several motives may motivate action);
* “improper” means they usually want objective conduct **i.e.** violation of some objective standards of conduct, etc.

**Why does court say a plain breach of K is not enough? They must do more than just breach** (breach k w/ intent to injure)**?**

1. Regular breach =There was an efficient breach argument;
2. Mean breach = There was a moral wrong argument. Since contract remedies can’t remedy a moral wrong (no Punitives), we need the possibility of tort remedies.

**Rationales for Punitives in Late Breach?**

* You are sticking it to the other side when they are most vulnerable (**i.e.** at the last second where the other party cannot really cover in time for your breach; since K damages are supposed to cover for going into market and getting goods, they should cover – since late breach means you lost good will value, you want payment.
* **Breach designed to destroy fledgling business:** You can also think of it as a **mean breach** as a breach designed to put a fledgling business out of business. **What would there damages be?** It’s so speculative – could they have been Microsoft? We can’t quantify what the fledgling business would have been, it’s too speculative – but the person is hurt severely. Contract AND tort can’t solve this, but tort arguably does a better job.

**Defenses to Interference with Existing & Prospective Contracts**

**Richardson v. La Rancherita Case (Cali: 1979)**

**DEFENSE to Existing & Prospective Ks:** Protection is afforded to defendant when (1) he has a “legally protected interest” (2) in good faith, he threatens to protect it (3) the threat is to protect it by appropriate means. [*See* R2d § 773 – M1 pp. 181] → Moll says court treats “good faith” as “good motive” and that their selfish interest of gouging price was not enough; had to take into account lessee. **Defendant must be right in his belief that he had a legal right [see lang. M2 pp. 145].**

1. **Here La Rancherita has legal right to protect its contractual term: the anti-assignment clause;**
2. **He claims it in good faith [they lose here, court says clause was not asserted in good faith]**
3. **He used appropriate means, by trying to get lawyers involved, etc.**

**Facts**: La Rancherita is leasing a building to Breg. . The lease has an anti- assignment provision that means that the Lessee cannot assign the lease to anyone without permission from the Lessor. Breg is not turning a profit, so they want to assign the lease to Bomze, since the lessor basically won’t approve it (he wants to gouge the rent for permission). So Breg Corporation instead sells all of the stock to Bomze. Since Breg owns the lease and now Bomze owns Breg, the lease is effectively assigned to Bomze, though technically still assigned to Breg.

**Procedural**: Breg brings declaratory suit against La Rancherita to show that it’s all valid. **Suit is for IIEK**, since Breg and Bomze have an existing contract (766A claim since Plaintiff is the party being directly interfered with).

**ELEMENTS**:

1. **Intent**: Did La Rancherita have purpose/desire to interfere or knew that interference would substantially result? **Of course**
2. **Interference:** Was there interference – **yes.**
3. **Injury:** Was there interference? **Yes**

**The elements are met, so burden shifts to La Rancherita to give an affirmative defense.**

**Held**:Defendant lost: Court said that “to merely equate reliance on an attorney’s advice with ‘good faith’ is to shield hose parties from liability who seek and obtain counsel. To create such a blanket rule of immunity is unwarranted.” **Problem:** Layman relied on counsel’s advice on asserting the anti-assignment clause, how else was he supposed to know?

* Court says the purpose of an **anti-assignment clause** is to ensure a solvent lessee; and here La Rancherita never made an effort to enquire into Bomze solvency. Instead, all they seemed to care about was re-doing the deal for better financial concessions (price-gouging).
* Court says they didn’t assert their legal right in **good faith** because the only way to do so was to care about the solvency of Bomze (that is the purpose behind the anti-assignment clause)
* Moll proposes that court reads “good faith” as meaning “good motive” – you must assert your legal right with a good motive. Motive to renegotiate the deal is not good. Only good motive would be caring about financial condition of the assignee.

**If you have a legal right to do something, who cares about the motive?**

**What does R2d § 773 mean when they say you must assert a legal right in good faith?**

1. **To assert a legal right in good faith means, that in your head you must have thought you had the legal right (subjective inquiry);** La Rancherita passed this – they did element.
2. **Motive: reason for asserting the legal right must be for a good motive (objective inquiry);**
* Moll suggests that one could argue they did have an objective theory because they hired independent lawyers. La Rancherita failed this element. CRITIQUE: doesn’t understand how they could be serious about second guessing the lawyers opinions.
* Moll suggests one other theory: Maybe this opinion should have been resolved on element one: did they really have a legal right?
* Maybe they didn’t; there was no legal right to interfere with the transaction – but if that is true, then the case should have done that: and it didn’t – they wrote opinion as if it was decided on opinion two.

**Brimelow v. Casson (Chancery Division: 1923)** [Common law defense; prima facie 3 I’s]

**Rule:** Defense of **public policy OR other over-arching** justification may excuse a *prima facie* showing of Intentional interference with a contractual agreement.

**Facts:** A union representative for actors intentionally induces a breach of contract entered into between a chorus group manager and various theatres, because the manager underpaid members of the chorus for performances.

**Cause of Action:** Manager sues the representative for IIEC.

**Issue.** Whether there is a legal justification for an intentional interference with an existing contractual agreement?

**Law**: Three I’s

1. **Intent**: Did union have purpose/desire to interfere or knew that interference would substantially result? **Yes.**
2. **Interference:** Was there interference – **yes.** Some theaters broke the contract.
3. **Injury:** Was there injury? **Yes.** The theater company lost money.
* **Prima facie case is met – burden switches to defendant to give a good reason for the interference.**

**The elements are met, so burden shifts to La Rancherita to give an affirmative defense.**

**D’s Argument {DEFENSE}:** He interfered on basis of public policy rationale of social welfare; fare wages were not paid.

**Held.** (Justice Russell). Yes. “[p]rima facie interference with a man’s contractual rights and with his right to carry on his business as he wills is actionable; but it is clear on the authorities that interference with contractual rights may be justified; a fortiori the inducing of other not to contract with a person may be justified.” The union was forced to take extreme measures to end the practice of underpayment of the chorus group members. These extreme measures included inducing the proprietors of theaters to either break existing contracts or to refuse to enter into contracts. The manager of the chorus group had a duty fix the problem of underpayment of the members. Therefore, even though there is no bright-line rule for such cases, the circumstances in this case allow for legal justification for interference with a contractual agreement. The action to enjoin the union from interfering with the contract is dismissed with costs.

**Discussion.** This case is quite interesting because the Chancery Division makes a ruling not by using any concrete rule set out by law or in other cases, but, the court, seems to go with a moral or gut feel as to how to decide this case. The court is doubtful that the manager of the chorus group would receive any “sympathy or support [from] decent men and women.”

**Possible Public Policy Rationales [M2 pp. 145, n1]:**

**Existing Ks: Prospective Ks:**

* Reasonable and disinterested motive for the - Picketing and boycott activity to prevent racial discrimination

protection of other individuals or protection - Protection of students;

of the public; - Acting to protect ethical standards of medical association.

**ALL are BIG public policy arguments, some are First Amendment type args. such as “picketing” for a reason.**

**Pennzoil v. Texaco (Tex. Ct. App: 1987) (IIEC Defense)**

**Rule [defense for IIEC]:**  There was no K; it was only a prospective contract. If you succeed and are then hit with “IIPC” you argue that you were just competing.

**Facts:** Pennzoil had allegedly entered into K to buy Getty Oils reserves. Texaco came and made a better offer to Getty. Pennzoil sued Texaco for intentional interference with an existing contract.

**Texaco** **Arg**: There was no contract, only a letter of intent.

**Holding**: Jury found there was a binding contract. The lawyer for plaintiff won by attacking defenses notion that since no lawyers had finalized something, there was no contract. He said “are you saying that simply because there were no lawyers involved, there was no contract – that’s ridiculous.” Jury found that Texaco did interfere.

**Damages**: Awarded $7.5 billion + $3 billion in **punitive damages**. Texaco filed bankruptcy; punitive damages got reduced to $1 billion.

**Harmon v. HHarmon (Supreme Court of Maine: 1979) (IIEC case) [GIFTS]**

**Rule [defense for IIEC]:**

**Facts**: Harmon’s mom puts him in the will. He is expecting money. The brother and sister-and-law go to the mom and ask her to cut him out. Apparently she does go ahead and change the will to cut him out. This is NOT a contract – it pushes further to encompass another economic relationship: inheritance under a will.

**Cause of Action:** Plaintiff sues says that the brother intentionally interfered with possibility that he would get an inheritance.

**Issue**: Should the court recognize an IIEC cause of action to cover interference in a will by 3rd party?

**Holding:** Yes. Since the law protects prospective k, they will also extend it. PROBLEM: the mother might have cut him out of the will either way (she was still alive at time of the case). ↓

**Problem to calculate damage** They won’t give him the full amount of what he was supposed to get. Moll suggests that since defendant intentionally interfered with chance that is how you calculate the damages. You proved .51% chance. That is worth .51 % of total amount. That will be damages. POINT: this is the problem of calculating damages for **loss of chance (first year tort law)**.

**Efficient Breach Problem: Discreet Ks v. Relational Ks**

**Apple** **Example**

* A breaches contract with B and instead is convinced to sell apples to C. A will make money, B will sue A and recover money. So A will still come out ahead, B will get damages and C will get the apples which it values: nobody is made worse off and some are made better off, ideally.
* **IIEC/IIPC is criticized as deterring efficient breach which is a staple of American law:** C is less likely to approach A since C might be sued if he does (The tort deters).

**Relational Contracts**

**Does something differentiate the contract in *Lumley v. Gye* from the Apples example?**

* Apples are fungible goods and thus easily replaceable whereas services are NOT;
* Economists say efficient breach is good and the interference tort gets in the way. But the critique you can respond with is that this is ONLY true in fungible goods contexts.
* When services are involved, you cannot replace the person, so since you can’t get the actual real deal and cover yourself, then the **breach is NOT efficient:** with contracts for unique services, there are no efficient breaches by definition since you cannot replace and therefore not compensate for the loss AND because in the process, B losses the good-will of the customers who wanted his services.
* **These Ks are called Relational Contracts (as opposed to discreet contracts)**

**Relational Contracts**: Contracts characterized by

[1] long-duration [2] personal involvement/cooperation of the parties and [3] the exchange, at least in part of things that are difficult to monetize. **Examples:** marriage Ks, employment Ks.

**Think of them on a spectrum**:

Discreet K----------------------------------------------------------------------------------------- Relational K (arms-length w/someone u will never c again, you are being selfish) (long duration, personal element, difficult to monetize things such as love, quality of life)

**Why does this matter?** Apple K is a discreet K; it is one time, easy to monetize and we don’t care about preserving relationships. Damages are market-based where efficient breach can work. Most of these cases however are brought in relational K cases, where it is very difficult to quantify damages and to compensate for them. Replacing a rare commodity, losing goodwill (how much – hard to quantify).

* Many people thus respond that intentional interference torts operate in areas where there cannot be an efficient breach. Thus, the torts do not interfere.
* Moll says that the reality is that this is incorrect because the law does NOT make a distinction. It applies in Discreet Ks as well as in Relational Ks; while most cases operate in the relational K, nothing prevents them from operating in the Discreet K area.
* Perhaps in the Discreet Ks, B will be compensated for breach of K, but will also sue for IIEC K. Perhaps the court will allow **efficient breach** to emerge as a defense in this case, since they were already compensated.

**Texas Line of Cases**

**Texas follows the Majority rule [see Adler]**

**R2D § 767**→ **Δ’s conduct must be “improper” according to a balancing approach of 7 factors.** Fails to say which party bears the burden of proof.

**Defense:** Δ can escape liability by showing that his conduct was justifiable + did not include use of “wrongful means.” [See Adler Case]

**ELEMENTS OF IIEC IN Texas [Three I’s + K, just re-organized]**

(1) an existing contract subject to interference; {K + Interference}

(2) an intentional and willful act of interference; {Intentional + willful act of interference}

(3) proximate cause of P’s damage; and {Proximate cause}

(4) actual damages (injury).  {Damage}

**Justification Defense**: *See Texas Beef Cattle*

**Holloway v. HSkinner (SC of Texas: 1995) (Failed IIEC case) [Old test, bad law]**

**Rule: To hold the agent of a company severally liable for IIEC, must prove that the agent’s act of interference “was so contrary to the corporation’s interests that his actions could only have been motivated by personal interests.”** Plaintiff must prove more than fact that defendant benefitted from breach, but that he acted willfully or intentionally to serve his personal interests. **Test application:**  Test requires you ONLY be motivated by a personal interest, does NOT weigh mixed motives.

**Defendant:** To prevail, must act in (1) good faith, and (2) Believe the act to be in the best interest of the corporation.

**Facts**: Skinner owned a sandwich shop and was approached by Holloway and Culligan to purchase the franchise. Instead, all three parties agreed to joint ownership under the corporation of Holligan, Inc. Skinner contributed the store franchise, its name and its trade secrets. Holloway and Culligan provided capital and management skills. Skinner eventually left the corporation due to bad relations with Holloway and the corporation defaulted on its financial obligation to Skinner. Skinner first successfully sued the corporation, but it was bankrupt. **Cause of Action:** Skinner now sues Holloway for IIEC on the obligations due to him. **Procedural:** Skinner won at trial level, was affirmed by appellate court. **Issue**: Whether Holloway’s status as a corporate agent barred Skinner’s claim against him for IIEC, since he must be suing a 3rd party for IIEC. **D’s Arg:** There is insufficient evidence to support finding that he tortiously interfered (also argued he had affirmative defense of legal justification, but court did not give weight, since they agreed with his first argument). **Holding**: No – reversed. Skinner did NOT present evidence that Holloway interfered with the contract [in his personal capacity]. As a result, the law should see Holloway’s actions as imputable to Holligan Corp: they are the same person as far as business actions go and since the rule is that the Breachor and the Interferor cannot be the same party on the same contract (*See* Leigh Furniture).

Corporations would substantially be prevented from similarly abandoning disadvantageous but valid contracts, if their human agents could be held personally liable for interference with the contract.

**Discussion ↓** You look as to whether the agent acted in such a way that was completely against the corporation. If he did then it suggests he was not acting for the corporation, since an agent of a corporation acts in favor of the corporation. If we accepted it, then we would have to allow both action for breach of k AND an IIEC claim always.

**Concurrence→** Says we should ask whether an agent is acting w/in the scope of his authority [legal question, not factual].

**What if you act in a way that has a corporate purpose, but which is outside your scope of duties (you have no authority)?**

1. Practicing Lawyers don’t care about the Concurrence; it means nothing since the majority’s holding is very clear. Moll raises it because he has a subtle and important goal – asking whether an agent acts w/in the scope of authority is usually a question of **law, reserved for the judge. Hecht might be suggesting that this will be easier since people can get out on summary judgment since it’s not a factual question.**
2. Moll doesn’t like this because if someone was acting solely in their authority they weren’t acting in their interest. Thus motive does come in and it is a motive of fact.

**Powell Industries v. Allen (Supreme Court of Texas: 1998)**

**Rule:** If corporation doesn’t complain, it’s not against their interests and therefore, plaintiff will not prevail.

Usually corporation will write affidavit because **{1}** they have ties to defendant **{2}** not doing so might open them up to liability for breach of K.

**DEFENSE:** Defense lawyers now can go to the BofD (since it’s usually the CFO or CEO who is defendant) and gets an affidavit saying they support defendant and as a result, all these cases will start to get thrown out on Summary Judgment.

**Facts**: Powell is the agent (president and CEO) of Powell Industries Corporation. Powell Industries employs Allen as CFO. Powell asks Allen to charge personal bills through the corporation. Allen responds that the corporation is publicly held so he cannot do such a thing. Allen calls a BofD meeting to raise concerns of Powell’s conduct. Board does not side with Allen and authorizes Powell to do whatever he wants to Allen, so he fires him.

**Cause of Action: IIEC.** [The most logical cause of action would have been a contractual issue, but this was probably an employment-at-will issue, though usually a CFO has an Employment Contract. So now he brings an IIEC suit alleging that Mr. Powell intentionally interfered with his K with Powell Industries. This is the same setup as *Holloway.*] **Issue:** Whether Powell is individually liable?

**Defendant’s Arg:** Based on agency law, Powell’s actions were imputable to the corporation and therefore, were one and the same as Powell Industries, so he cannot be held individually liable.

**Holding**: Texas now adopts the approach that Hecht suggested in his Holloway Concurrence: “A corporation is a better judge of its own best interests than a jury or court. A principal’s complaint about its agent’s actions is NOT conclusive of whether the agent acted against the principal’s best interests. However, if a corporation does not complain about its agent’s actions, then the agent cannot be held to have acted contrary to the corporation’s interests.” ↓

**Plaintiff’s Cause of Action killed for these types of suits:** Justice Hecht killed these suits since the plaintiff’s attorney cannot get through the MSJ. The BofDs silence screws you – the corporation itself must complain, and EVEN if they do, it’s not conclusive that it was against the corporation’s interests.

**Texas Beef Cattle v. Green (SC of Texas: 1995) [IIEC] [Affirmative Defense]**

**Rule:** Actual malice need not be shown for recovery of **compensatory damages** for IIEC; it **must** however be shown to recover **punitive damages. Actual malice→** “ill-will, spite, evil motive, or purposing the injury of another.”

**Justification** **Defense**: Affirmative[[1]](#footnote-1) defense based on either the exercise of:

(1) one’s own legal rights[TYPE 1 defense] → If trial court found as matter of law, that defendant had a legal right to interfere with a K than he has conclusively established the justification defense and motivation behind assertion of the right is irrelevant.“ Improper motives cannot turn lawful actions into actionable torts. or

(2) a good-faith claim to a colorable legal right, even though that claim can ultimately prove to be mistaken[TYPE 2 defense]. → If Defendant cannot establish a legal right, can still prevail on (A) if trial court establishes that he interfered while exercising a colorable legal right, AND (B) the jury finds that although mistaken, the defendant exercised that colorable legal right in good faith.

**Court distinguishes:**

**Actual malice→** triggers recovery of punitive damages.

**Legal malice** (infliction of harm, must be intentional + w/out justification) **→** Negates justification defense.

**Facts:** Green was searching for a buyer of 253 cattle. Florence and O’Brien worked for Texas Beef. Were supposed to buy but didn’t, so Green sold to Cargill. Florence stole the cows after misrepresenting that they had shipped to Cargill. The deal got messed up, nobody knew whose cattle were whose and lawsuits start flying.

**Causes of Action:** Many lawsuits came out. Texas Beef first sued Green in multiple, frivolous lawsuits. Green then responded by suing Texas Beef and O’Brien for IIEC on theory that by frivolously suing him multiple times, they IIEC he had with Cargill.

**Procedural**: The Jury contradictorily found that [1] Texas Beef & O’Brien were legally justified in interfering with the K; [2] that O’Brien had interfered with actual malice, and acted with a purpose to injure. Court doesn’t understand why he can be legally justified AND having acted w/ motive to injure. As a result, the court says that the second jury finding eviscerates {trumps} the first one – since they purportedly can’t be reconciled.

**Holding**: O’Brien and Texas beef established the affirmative justification defense. This made the jury’s actual malice finding irrelevant. Therefore, they reverse. ↓

**Hypothetical on asserting a valid legal right:** A has a contract to buy land from B; C has easement across Bs land. C goes to A and says “don’t sell because I have an easement on it and I will use it.” At trial in discovery there are smoking gun memos from C that he has an easement but he doesn’t want to use it, he just wants to ruin Bs transaction. A drops out contract and B sues C for IIEC.

**Prima Facie case (Texas Position):**

1. C intended to interfere; he had the desire to interfere and knew it would result

2. C did interfere

3. Yes, we are assuming there was an injury

**Does C have a defense?** Yes. His easement was a legal defense; his maliciousness had no bearing on this. The mere legal right exculpated him. Texas courts won’t pry: improper motives cannot transform legal actions into torts.

**Type 2 defense: a good-faith claim to a colorable legal right, even though that claim ultimately proves to be mistaken. [TYPE 2]** Means You didn’t have a legal right, but you thought you did and the court agrees. Texas Beef (they did NOT establish their legal right) but even though, the question then was did they have a good-faith claim to a legal right? Here the jury can enquire into the good faith of the defendant’s belief that he had a legal right (even though he didn’t. **This defense is good because (1) you didn’t have a right but (2) reasonable people thought you had a right and (3) the jury believes you {it’s like near privity; its close enough}**

But then court says that this is into type 1, this is type 2, but that good-faith doesn’t come in so it’s reversed {m1 p. 217}. So the question arises:

**Is it possible to assert a legal right in good-faith and have an intent to injure?**

**TWO ways to understand this case:**

**ONE**: Easiest way to explain the case is that the trial judge went crazy; he caused the appeal by trying to reconcile the differences and as a result, had to deal with **Dual- mixed motives:** [1]Asserting a right in good-faith AND [2]having an intent to injure (you want to gain in the process, but you also want to hurt someone else). ↓ *Leigh* *Furniture* resolves by saying the pre-dominant motive has to be the bad one to subject to liability. So in the hypothetical, the guy might want to protect his legal right of an easement and hurt someone else.

**TWO**: MOLL says they may have meant you had to believe that you had a colorable legal right.

**What is different from Texas result and §773 (La Rancherita result)?** They don’t care about your motives, just your right.

**Why was §773 in La Rancherita interpreted differently?** It was interpreted to read that you have to assert a claim with good faith, and that means good motive. They implied on circumstantial evidence that the motive there was to gouge the plaintiff because the anti-assignment clause should only have been used to ensure the lease was not insolvent lessee.

In **Texas** “good faith” would have to mean BELIEF (inside someone’s head) that you actually had the right.[*La* *Rancherita* says you have a right if you believe it and you are right; Texas says, if you think you reasonably had a right and reasonable people agree with you then you have it]

**For Moll – the motive relates to why you would exercise a right. Nobody doubts you have it, but some might doubt WHY you exercised it.**

**\*\*POINT**: now you have doctrine that gives you an affirmative defense; you must have a legal right. If you made a Public Policy argument in Texas that is NOT an assertion of a legal right, will it work? Moll suggests it would probably work, but he does not know.

**Calvillo v. Gonzalez (1996: SC of Texas) [IIPC, but Walmart changes Calvillo] [BAD LAW]**

**Employment at Will Contracts→ Are treated as IIPC cases since they can be terminated at any time.**

**Defense: “Good faith is not a relevant factor in determining justification if the defendant acts to assert a legal right.” [re-affirms the Affirmative Defense of *Texas* *Beef* as not requiring an inquiry into motive.]**

**Facts**: Calvillo has a K with a hospital that gives him the exclusive discretion over which anesthesiologists to provide to the Hospital. Gonzalez is another anesthesiologist with employment K at hospital. Both men have a disagreement. Calvillo then excludes Gonzalez from rotations, excluding him from future work and from future work contracts:

**Cause of Action:** Gonzalez sues for IIPC claiming Calvillo tortiously interfered with his [prospective] business relations with the hospital [*Sterner v. Marathon* - employment at will cases are treated as a IIPC: even though employment at will is usually seen as a K, since it can be terminated at any time, its treated as a prospective k].

**Defendants Arg:** Since he claimed he was exercising a valid legal right by excluding Gonzales, he had an affirmative defense [type 1] entitling him to a MSJ.

**Texas treating IIPC and IIEC the same:** In the late 1990s was operating under what Della Penne complained about→ they treated IIEC and IIPC as different.

**Defenses:** All the *Della* *Penne* defenses would have been assertable in the Texas cases. Up until 2001 not much of what Texas said made any sense, but then they reached the Walmart case.

**Walmart Case (2001: SC of Texas) {IIPC/IIBR is different tort→ switch to 4 I’s} [GOOD LAW]**

**Texas IIPC ELEMENTS**

**RULE:** Finally follows *Della* *Penne* (Cali) and says that intentionally interfering with an existing contract is wrong on its own, but that interfering with a prospective contract is not necessarily wrong. **Thus:**

**For IIPC Cause of Action, Plaintiff must prove *prima facie*:**

**[1] intent**

**[2] interference**

**[3] injury, and**

**[4] that Δ’s conduct was improper.**

**“Improper” means:** “independently tortious or unlawful” [adopts *Della Penne Concurrence* view].

**“Independently tortious” means:** something that would violate some other tort duty.

**“Unlawful” means:** something recognized as unlawful under the common law or statute.

**Defense:** There is NO affirmative defense for IIPC anymore. Defendant must instead raise defenses as elements are being argued, during which plaintiff is trying to argue impropriety.

**Examples→ Δ who threatens customer with bodily harm if he does business with plaintiff would be liable (criminal).**

 **→ Δ who competed legally for the customer’s business would NOT be liable (legal).**

* Walmart changes Calvillo [IIPC]
* Says you can’t treat IIEC and IIPC cases as the same;
* Intentionally interfering with an existing contract → wrong on its own
* Interfering with a prospective contract → not necessarily wrong.

Thus, P must establish impropriety for prospective Ks

**“Improper means” is an objective standard →** “Motive” is NOT the way to establish an IIPC case→ the means by which you interfere must already be wrongful by some existing standards (criminal, civil law or professional standards).

**Is purposefully Breaching a Contract knowing it will interfere with someone else now “independently tortious”?**  We don’t know. It might NOT be independently tortious, but wrongful→ That case may come soon.

**What happens now w/ the affirmative defense of justification from Texas Beef?** Walmart tells us there is no longer the affirmative defense of justification. Texas says P must prove 4 Is. If he does, he wins. There is no burden shifting to defense. This simply means defendant would show his evidence as part of the Plaintiffs prima facie case. When P tries to prove that it was wrongful/ independently tortious, then you can bring out [1] 1st amendment [2] justification on public policy, etc. right there (so it’s not an affirmative defense anymore, you just argue it against the plaintiffs prima facie case) **. So if P meets *prima* *facie* case, they win. So if someone says they will raise a justification defense in Texas, you say “no, you can’t: [*See* Walmart]**

**POINT**: Texas has now arrived where California was. Both IIEX and IIPC are now treated as DIFFERENT. This means different causes of action, different elements, and that the law will protect existing contracts more so than prospective contracts.

**Does it cover Improper Motive?** No – Texas does NOT allow improper motive to be the basis for the suit (*See* Texas Beef)

1. **Insurance Torts**
2. **Duty to Defend**
3. **Duty to Indemnify (Pay)**
4. **Duty to Settle**

**Fundamental Insurance Concepts**

**Two types of policies:**

**Claims-Made policy:** provides coverage for any claim that is made against the insured within the policy period even if the claim is based on underlying events that occurred outside the policy period.

**Occurrence Policy:** provides coverage for injuries that occur during the policy period, even if a claim is NOT made within the policy period.

**Two Types of Insurances:**

**1st Party Insurance:** Covers insurance to the insured person. Protecting the insured person (e.g. Health Insurance).

**3rd Party Insurance (Liability):** Insurance covering injuries to a third parties person or property that are caused by the insured. ↓ **Contract for 3rd Party (liability) coverage makes two promises:**

1. **Duty to defend:** if you get sued, the insurance company promises to provide you with a defense, if it is potentially within the coverage of the policy – (even if it is a frivolous suit, claim is meritless).
2. **Duty to pay (indemnify):** promise to pay the insured, up to policy limits, for any tort judgment/ damages caused.[[2]](#footnote-2)\*
* **These are separate duties that have different meanings**
1. **Duty to Defend**

**North Star Mutual Insurance Co. v. R.W. (Minn: 1988)**

**TEST for DUTY TO DEFEND?** If a claim is made against an insurer which COULD result in liability, the insurer has a duty to defend. **Whose burden is it to prove?** Insured must prove he has a valid contractual right with insurer. **TX has DIFFERENT RULE, see below.**

**Facts:** TF and RW have sex. RW comes down with Herpes. She sues TF for negligent transmission of herpes. TF has a homeowner’s policy for property; like most policies it has 1st and 3rd party liability protection – for people injured on your property. Since TF had sex in the house and has insurance policy, he makes a claim under his policy: saying I caused bodily injury through an occurrence in my house, I might be liable for it. Here, the insured is making a claim under the 3rd party policy. TF forwards the suit to his insurance company; they deny coverage completely; won’t defend and won’t pay.

**Northstar’s Argument:** There should be a per se rule against coverage of transition of sexual disease. This is not what these policies are designed to do. They say that [1] there is an exclusion for an intentional act (sex was intentional), and [2] this is not an accident.

**TF Arg:** Result was accident; of course sex (conduct) is not accidental.

**Procedural Posture:** Northstar sues TF for declaratory judgment on Duty to Defend→ so that court declares that Northstar is correct that the lawsuit falls outside of coverage. \* ↓TF might have to sue Northstar in 3rd judgment if he wins in first, because they will probably refuse to pay, asserting that they thought his conduct was intentional, not negligent. **[DUTY TO PAY SUIT]**

**Holding**: Northstar did owe a duty to defend; deferred question on whether to indemnify, since there is no point to rule on it until the first lawsuit is resolved.

**Declaratory Judgments:** Determined by state or federal statute; says that you are simply asking the court to declare your rights. Insurance companies usually file these because:

1. They get “closer” that they are right. Consumer statutes may otherwise expose them to 3x the liability later, if its proven that they wrongfully denied coverage;
2. They get to know if that is part of their risk. Thus, if it is, they can find the reserves to cover them (that’s how insurance companies work, then, they invest the rest).
3. If they sue, then as plaintiff they get to choose the venue/forum to sue in (Federal court would be preferable to TX court).

**Why does a duty to defend not necessarily mean that there is a duty to pay?**  Because the duty to pay is based on **actual** **fact**. At this point, those facts have not been proven yet. The allegation may not be true. If this is the case, there was a duty to defend, but there is no duty to indemnify because you were not negligent.

**Duty to Defend:** arises if the allegations could/potentially fall within the coverage of the policy, the insurance company must provide a defense. (Based on alleged facts)

**Duty** **to** **pay**: Arises if the facts as proven fall within the policy, insurance company must pay up to its coverage. (Based on proved facts)

**\*Some courts will stay this second lawsuit through case law or statute until the first case is resolved** (why should someone who bought policy to avoid being sued, now have to pay two lawsuits). Other states will let it go forward, but only on question of “duty to defend” but not the “duty to indemnify.” **Why?** Because courts don’t like to give advisory opinions; stuff that can get picked up as precedent, unless they actually do need to defend. If TF wins the lawsuit, then they don’t have to resolve the duty to indemnify question – because there was no issue.

**If the court decides that there is a duty to defend, does that automatically mean that there is a duty to pay?** No. A duty to defend means that the allegations potentially fall into coverage. Thus, duty to defend is based on **alleged** **facts**. Means that if you take allegations, and accept them as true, do they potentially fall into coverage. If yes, you must defend.

**Insurance does NOT cover intentional torts and therefore causes incentive to under plead:**

1. **Why is there an incentive to under** **plead?** - Because an intentional tort/ intentional injury would probably not be covered by the insurance policy, therefore, the defendant would probably not get a defense). As a result they chose to plead an unintentional cause of action. **E.g.** – “Negligent Child Molestation.”
2. **Why doesn’t insurance protect from intentional torts? →**Moral hazards – they say it would be wrong.

Insurance companies thusdon’t save for intentional injuries – but they still get claimed (vis-à-vis negligence actions). As a result, they make everyone pay higher premiums to compensate [there is thus an argument that they SHOULD cover intentional torts].

**National Union FI Co. v. Merchants Fast Motor Lines (SC of TX: 1997) [TX D2D rule; Damages]**

**TEXAS Test for Duty to Defend: “Eight Corners Rule:”** if there is POTENTIALLY a claim, they must defend. To find out, look to four corners of the petition + four corners of the insurance policy. See whether the facts as alleged could potentially have coverage in the policy. → You don’t look at ANYTHING else. You take facts plead, assume they are true and ask “could these facts fall within the scope of the policy.” Theoretically you should focus on the FACTUAL ALLEGATION though, NOT the label of the claim (the reason is, the policy may specifically deny coverage for something, but if the allegation of claim is wrong, then defendant would still get stuck). If there is any doubt, you resolve this in favor of the insured.

**Facts:** Trucker driving, gun allegedly “negligently discharged,” killing Gonzales who was driving in a car next to the truck.

**Cause of Action:** Wrongful death action based on negligent discharge of a firearm (underpleaded to an unintentional tort f from battery, an intentional tort).

**Procedural:** Insurance company is asking for a declaratory judgment that it has no duty to defend.

**Issue**: Whether insurer must defend.

**Holding**: Insurance co prevails because there is no “causal relationship.” They don’t cover for any injury in a truck; they cover injuries resulting from “the ownership, maintenance or use of a covered auto.” A gun does not fall within the regular operation of a truck. Thus there was no nexus between use of the truck and the accident from a gun. **This is usually a plaintiff’s lawyer error – you need to make allegations within the confines of the policy, to trigger the language.** (This would usually result in dismissal of the case, without prejudice...so you would re-plead, unless you are passed the statute of limitations)

**\*\*POINT**: You must link the gun discharge to **“ownership, maintenance or use of a truck.” (The policy language).**

**How could we make up facts for the plaintiff to trigger the duty to defend due to “bodily injury” based on “ownership, maintenance or use of a truck”?**

→Allege that the use of a gun is part of trucking, thus the part of the “use” of the truck involved the gun.→ Allege that the “use” of the truck made the gun discharge **(i.e.** tire blowout caused gun to discharge**)** → Allege that “use” of the truck required breaking suddenly, which caused the gun to discharge. → Allege that “use” of the truck involved swerving from a pothole, which suddenly caused the gun to discharge.

**DAMAGES for breach of Duty to Defend:**

**What are the DAMAGES for the duty to defend?** Generally, it is purely a contractual duty →since it’s in the policy, damages are contractual damages, so award can be:

1. Policy Limits;
2. Attorney’s fees in the underlying tort action;
3. Attorney’s fees in your action against insurance co. to get them to comply for the duty to defend.
4. **Duty to Pay**

**Duty** **to** **pay**: Arises if the facts as proven fall within the policy, insurance company must pay up to its coverage. (Based on proved facts)

Thus, person who is originally being sued might have three lawsuits:

* First being him getting sued for **Negligence**
* Second, him suing insurance for **Duty to Defend**
* Third, him suing insurance under the **Duty to Pay**, since often enough, insurance companies will refuse, argue that conduct was intentional [See *Northstar Case*].
1. **Duty to Settle**

**Crisci v. Security Insurance Co. (1967: SC of Cali)**

**Duty to Settle arises from an implied covenant of good faith, based on contractual provisions saying that neither party will do anything to injure the other. Standard:** whether a prudent insurer without policy limits would have settled the offer. In **California,** if insurer fails to settle when they should, they are liable for ALL excess it costs, even if above the policy coverage.

**Facts**: DiMare is coming down stairs in an apt. complex she rented from Crisci. She fell through the stairs and was hanging 15 feet from the ground. She claims physical injuries and psychosis. Crisci had insurance policy for $10,000.

**Procedural Posture of settlement process:**

1. **Dimare sues Crisci for negligence**→ Crisci claims to insurance co Security. They do an investigation into the accident based on the psychosis of DiMare; they believe that if they don’t find anything showing prior psychosis, judgment will be in excess of $100,000. If not, it will only be about $3500
2. **Settlement** **offers**:
3. **$10,000 →**

**Crisci:** would want this since the insurance co will cover ALL of it; doesn’t have to deal with lawsuits, lost time, expense, embarrassment, etc.

**Insurance Co:** Would not want to settle if they had a good case for winning at less than $10,000 because they will not be liable for anything in excess of $10,000.

**Overall:** Insurance Co. refuses to settle

1. **$9,000→**

**Crisci** offers to pay $2,500 of this

**Insurance Co:** Still could pay more, decides not to.

**Overall:** they refuse to pay.

Since no settlement was reached, Crisci’s case goes to trial, she loses and is court says she owes $100,000 + $25,000 in mental anguish. Crisci sues the Insurance Company saying they had a duty to settle. That is this case.

**Holding:** Insurance co. cannot take away the benefit of a contract. One of the benefits of the contract is the ability to settle; insurance co. took this away so they are liable for the excess. **COI in Crisci:** Yes. Insurance co. would either pay $10,000 OR $10,000 + the trial costs – thus, they would emerge fine, but Crisci might get hit with a lot of excess.

**How to calculate a settlement**

**Assume that a policy is for $100,000; plaintiff makes $99,000 settlement claim. You are defense counsel for insurance and are asked for your assessment of whether to settle. You’re absolute lowest possible assessment of trial costs is $20,000.**

1. **Judgment = 40,000** = 40,000 + 20,000 = $60,000 most insurance will have to pay
2. **Judgment = over 79,000 =** $79,000 + 20,000 = 99, 000 most insurance will have to pay
3. **Settlement = $99, 000** = $99,000.
4. **J = $200,000** = $100,000 + $20,000 = $120, 000.

If they have reason to believe that they would only have to risk investing the extra $20,000 for an 80% chance that you would settle for much less, the insurance company has incentives contrary to yours. You don’t want ANY excess judgment, and scenario #4 would produce excess of $80,000 of liability for you. **This is a COI: thus, courts require the companies to have a DUTY TO SETTLE.**

**Where does the duty to settle come from?** It is not expressly in the contract. It comes from the **implied covenant of good faith** based on insurance Ks which have such provisions saying that “neither party will do anything which will injure the right of the other to receive the benefits of the agreement; . . .”.

**What about in TEXAS?** Texas does not recognize implied covenants of good-faith. **How does Texas get it? Law of Agency**

**↓**

**Stowers Furniture v. American Indemnity (Texas: 1929) [Stowers Doctrine]**

**Rule: Stowers Doctrine in Texas provides a Duty to Settle through the Law of Agency.** Stowers duty (to settle) is activated by a settlement demand when three prerequisites are met:

1. The claim against the insured is within the scope of coverage (similar to expected value analysis);
2. The demand is within the policy limits;
3. The terms of the demand are such that an ordinarily prudent insurer would accept it, considering the likelihood and degreed of the insured’s potential exposure to an excess judgment.

In Texas, failing to settle will not expose insurance co to excess if suit is litigated. Result is people attempt to make settlement demands within the policy limits to ensure that the duty to settle is triggered; insurer is now more worried about liability in tort.

**Facts:** Similar to previous case; same kind of conflict. In Texas, the Duty to Settle did NOT come out of the implied covenant of good faith, because that does NOT exist here.

**Holding:** Duty to Settle in Texas arises from Agency. Since Insurance Co. assumes the responsibility of acting as the exclusive and absolute agent pertaining to all matters of litigation. Since they are the agent of the insured, they have fiduciary duties→ **duty of care** means that they must act as an “ordinarily prudent person would”... must settle in an appropriate way**.**

Crisci set up basic standard: Probability (of scenario 1) x magnitude of scenario 1

+

 Probability (of scenario 2) x magnitude of scenario 2

+

 Probability (of scenario 3) x magnitude of scenario 3

Insurance says “what is probability we will lose and what is likelihood of winning?”  **= expected value analysis**

**90% chance of 200,000 losses = 180,000 of expected trial; + estimated defense costs (say, 20,000) = 200,000** … so conclusion is that you should settle for anything less than $200,000 but nothing more. Notion is that Insurance Companies should be deciding based on rationalization.

**Policy Argument: Should it be possible to recover for breach of the duty to settle?**

**Argument that it should be recoverable:** since breach of tort can result in mental anguish damages and the duty to settle sounds in tort, there should be mental anguish damages (and tort)→ Texas law is consistent with this. [This is a nice pure example of the erosion between breach of contract and tort law: awarding mental anguish for a breach of a contract’s implied covenant].

**Argument that it should NOT be recoverable:**  this is contract law, w doesn’t usually allow this in contract law, and therefore it should not be allowed here.There is no explicit provision in the insurance contract to settle. It was derived from the implied covenant of good faith and fair dealing which is an *implied term of the contract.* So when you breach it, we could treat it as though you breached an explicit term and thus, you should get contract damages – which still does NOT allow mental anguish, so again should not be allowed.

**Do we “over consume” Liability Insurance?**

* Many older doctors consider less insurance is better. Rationale is that having less of an accessible money pocket makes you less of a target. Lawyers will be more likely to sue when there is a higher liability. **Response is that doctor still has $4 million in personal assets – so they might still be accessed. Having said that, it is not EASY access, because one can hide money, get liens, put it in 401Ks where it isn’t accessible, etc.**
* **Subrogation (p. 292):** this is the insurance companies right to step into the shoes of the Insured and to make a claim for their loss. EX: your neighbor negligently starts a fire that spreads and burns down your house. You make a claim under your homeowners policy and they pay you back 100%. You are made whole, but the insurance company is out of money due to neighbor’s tort: subrogation is their right to sue on your behalf and keep the money recovered. **Such a right is usually explicitly mandated in a contractual provision.** Even if it isn’t, most courts will grant insurance companies with an equitable right for subrogation.
1. **Duty of Good Faith**

Duty of Good faith in Texas during late 80s and early 90s was very important; it was a time when many Democrats were on the Supreme Court of Texas. It was favorable to plaintiffs [This is NOT the standard today].

**Arnold v. Nat’l County Mutual Insurance Co. (1987: Texas) (History ONLY)**

**Rule:** In absence of a duty to defend & settle implied by contract, courts still said that an insurer still had a of good faith and fair dealing in TORT based upon a “**special ‘trust’ Relationship**”→ Insurer is at complete mercy of insurer to pay it out; stems from the nature of insurance which has “unequal bargaining power. ***Arnold Case*** seemsto suggest it applies to any insurance policy.

**Facts**: Arnold is driving motorcycle; he gets into accident with an uninsured motorist. Arnolds own policy has an **uninsured** **motorist** **protection** for $10,000 = if you can prove that uninsured motorist would have been responsible for your injuries, you can recover it from your own policy). National Insurance lawyer says not to settle with Arnold since they are ONLY responsible if the uninsured was responsible and there was evidence it was his own fault. Arnold sues the responsible party, wins for $18,000; he then sues his own insurance company to satisfy it. **Stowers Duty to Settle does NOT apply (only applies when he is being sued)**. Here, he is the one suing. **Duty to defend** also doesn’t apply for this reason.

**Procedural**: Trial court grants summary judgment to insurance co. saying there is no duty of good faith. **Holding**: Supreme Court reverses says a duty of good faith and dealing does exist.

1. **What is the rationale for this duty?** There is a special relationship between the insured and the insurer based on the party’s unequal bargaining power. **Rationale:** without it, insurers would take advantage of insured.
2. **What is the “special relationship?”** *Aranda**Case* ***=*** special relationship out of “trust.”
3. **Why was it applied to this context?** Unequal Bargaining Contract = Individuals buying insurance have no negotiating power.

**Special “trust” relationship =** You are compelled to trust your insurance company because all your money buys is the potential future legal obligation on their part to cover you. Since the insurer controls the process, you entrust them to execute it in good faith. It’s likely too expensive for you to sue them as well. Or, insured will take a low-ball as a settlement. **Point is that insurance company is in a position to screw you and likely will try since they had little to fear: worst that happens is that they breached a contract, must pay price and interest.**

* Many argue that Arnold is WRONG because there are insurance statutes, etc. that give enough incentive for insurance companies to act in good faith: Arnold court did NOT buy this line of reasoning.

**What is most significant part about this relationship?** Since you don’t call it a breach of contract, it becomes a tort just like the Stowers Duty. **POINT:** Texas’ use of “special relationship” to give rise to duty makes it a tort, allowing awards for mental anguish and punitive damages.

**Why didn’t Texas just follow Crisci’s route by implying a duty of good faith?**

1. Because this might have resulted in the breach of implied covenant of the duty of good faith becoming a tort.
2. Another reason is that Texas simply doesn’t recognize this in Texas (exception: Contracts covered by Article 2 of UCC for goods) but again, this is not applicable to service contracts.

**Why was this case so influential for the next 10 years?** Because the “special relationship” gave rise to this tort, many insured started to sue their insurance companies on notion that they acted in bad faith, contrary to their duty based on this special relationship. In addition, plaintiffs tried to pull this right out of other areas:

1. employer v. employee;
2. franchisor v. franchisee;

**At same time, the same is happening in California, but it is articulated in “implied covenant of good faith and fair dealing” tort language.**

**Contract**: concerned with enforcing the intentions of parties to an agreement. Actions award for breach, not to punish. **Rationale:** encourage **efficient breach.**

**Tort** **law**: designed to vindicate social policy. Actions award for compensation, punishment (social policy reasons). **Rationale:**

**Covenant of good faith and fair dealing:** developed in the contract area, implies duty of good faith (sounds in tort)→ legal fiction used to effectuate the intentions of parties or to promote their reasonable expectations. **Rationale:** aims at making the agreement’s promises effective, thus damages are limited to recovery for loss arising from the breach. ↓ **Exception:** Insurance Contracts; breach of contractual covenant, allows for ***tort*** ***action***. **Rationale:** policy reasons, correct insurers tendency to injure the right of those entitled to receive the benefit of the contract→ if they do, court remedy is in tort, since they breached a duty.

**Aranda v. Insurance Co. of N.A. (Texas SC: 1988) (M1 pp. 307)**

**Facts:** Aranda is employee of two different businesses; each have worker’s compensation insurance. They investigated, agreed that Aranda got injured while working and that the injuries came from his work, but they could not agree who caused it. Both refused to pay him disability and medical benefits. They referred the claim to the IAB (Industrial Accident Board) which is the body setup in Texas to resolve these kinds of disputes. They complied with all their necessary procedural obligations. **Cause of Action:** He sues both companies because they failed to settle the claim promptly, even though they determined he was eligible. **Procedural**: Trial court said there was no duty of good faith and fair dealing (tort) arising from this claim, so they dismissed it.

**Majority** **Opinion**: Reversed. Said there was an insurer/insured relationship, this gave rise to a duty of good faith and fair dealing claim and thus remanded it to the lower courts.

**Justice Philips Dissent**: Says Texas has a statute for employers to comply with, outlines procedures, etc. that give employers all kinds of incentives. He argues that since the legislature created a system to deal with this, the court should NOT extend liability to this case. He is emphasizing what is arguably different about this insurer/insured relationship: that there is an “unfair bargaining power.” He argues that here the statutory framework applies here to resolve that unfair bargaining power. **Counter-Argument to Dissent:** these processes still take time; worker’s compensations schemes give weekly allowances, etc. and the insurance companies can ignore them. Thus there still is a “trust” relationship because you need to be paid quickly for medical bills, no salary. **PROBLEM**: statute says that if there is a dispute, you can refer it to the IAB and that’s what they did. **It is unsure how the case came out at trial but insurers had a good argument that they acted in good faith.**

**Foley Case (California M2: pp. 172) Facts:** Recall that California resolved the insurer/insured relationship using the implied covenant of a duty of good faith (from contract law, but in tort). As a result, someone brought this claim for the employer /employee relationship. In other words, they said that the contractual duty of good faith argument gave rise to a tort claim in the employer/employee relationship.

**Holding**: Employment is different from insurance. It doesn’t apply in the employer/employee context. **Point**: making a breach of contract tortious makes people nauseous.

**What is different about employment from insurance relationship?**

* You can find new employment if you are not happy with your employer.
* Employees have duty to mitigate if fired; get new job
* Generally, Good employees are desirable to employers.
* Unsuccessful cases have emerged in franchisor/ franchisee context
1. **Fiduciary Duty and Shareholder Oppression**
2. **Fiduciary Duty**

**In Texas law, there is NO formal fiduciary duty between shareholders in a corporation as a matter of law:** Must therefore try and establish an informal fiduciary duty.

**How does it relate to business torts?** It is not uncommon for people to bring a claim for shareholder oppression.

**Breach of a fiduciary relationship can constitute fraud:** “because the fiduciary relationship imputes higher duties, such as duties of good faith, candor, and “full disclosure respecting matters affecting the principal's interests and a general prohibition against the fiduciary's using the relationship to benefit his personal interest, except with the full knowledge and consent of the principal.” **[See *Flanary v. Mills*]**

**Fiduciary duty=** Itistheduty to protect the interests of those who you owe the interest too, over your own interests.

**Why do you sue for breach of fiduciary duty?**

* + As a **tort claim, it gives rise to possibility of:**
	+ Punitive damages
	+ Mental anguish damages
	+ Any other equitable relief that the court thinks is fair.
* **These cases are RARELY successful since the TX SC standard is nearly impossible to fill, or even decipher.**
* You should NOT feel comfortable that an informal fiduciary duty claim will survive appeal, but since the jury charge is easy for a layman, it may win at trial-level.
* Thus, if defendant has money to appeal, it seems you may lose (perhaps the only exception is for a family/ like family relationship, *See Flanary v. Mills*).
* Still bring the claim, doesn’t hurt.

**PLAINTIFF: Three Ways to Establish a Fiduciary Duty**

1. **Texas Formal** **relationships** that give rise to the duty **[question of law]**
* Attorney/ client relationship
* Partners in partnership [*see # 2*]
* Principal/agent
* Trustee/beneficiary
1. **Establish an Informal Partnership to get a FORMAL FIDUCIARY DUTY Relationship:** Establish **informal** **partnership** (“two or more persons to carry on as Co-owners of a business for profit”) to make **formal fiduciary duty**:Profit-sharing is good evidence. Allegation saying that people were supposed to split profits. BOTH should have some control. This is a factual inquiry as to whether they established legal relationship. [**See *Myers* facts,** Moll says she should have made this argument.]
2. **Informal relationships** based upon “trust and confidence”**→** this gives rise to the duty as a matter of fact → **[this is a question of fact]**

**How easy is it to “manufacture” the informal relationship based upon “trust and confidence”?**

1. **Party’s subjective belief** (trust; rely) [look to the language in the K] [Crim *= “trust alone, not enough”*]
2. **Duration of relationship** (longer usually better, Crim *= “long relationship alone, not enough”*)
3. **Unequal Bargaining power** (Crim *= “power inequality alone, not enough*”­ – allegedly regulated by statute)
4. **Degree of prior trust**: is it *de minimus* or significant?
5. **Relationship between parties**: [Is it a business or family relationship *Crim* = “*must be a relationship existing before the business one being litigated emerged*”…. Make it as close to family as possible – **this is the MOST important factor, *see Flanary v. Mills***]

**EXAM NOTE: EVERYBODY throws in the claim in saying that “there is an informal relationship based upon “trust and confidence.”**

**Defense: Defeat a Fiduciary Duty Claim** [Texas pattern jury charge, handout pp. 1/48]

1. **Try and defeat formal/ informal relationship by attacking law.**

**Formal:** Deny that this case fits that exception, its different

**Informal:** Attack the five factors, using *Crim Truck, Meyers. Flanary will work against you, especially if it looks like there was a family relationship*.

1. **If the duty is established, argue that you still didn’t breach it by showing that:**
2. The transaction in question was fair and equitable to plaintiff;
3. Defendant made reasonable use of the confidence that plaintiff placed in him;
4. Defendant acted in the utmost good faith and exercised the most scrupulous honesty towards plaintiff;
5. Defendant placed the interests of plaintiff before his own, did not use the advantage of his position to gain any benefit for himself at the expense of plaintiff, and did not place himself in any position where his self-interest might conflict with his obligations as a fiduciary; and
6. Defendant fully and fairly disclosed all important information to plaintiff concerning the transaction[s].

**Crim Truck Tractor v. Navistar International (Texas: 1992) {non-formal fiduciary duty} Fiduciary Duty** requires a party to place the interests of the other before his own. **A non-formal fiduciary duty is a relationship of “trust and confidence,”** explores possible factors to establish it:

1. **Party’s subjective belief (trust; rely)** [Crim rejects this factor altogether]
2. **Duration of relationship** [Crim rejects this factor altogether]
3. **Power Equality: Language in K** demonstrating “trust & conf.” [Crim rejects this factor altogether]
4. **Degree of prior trust** [Crim rejects this factor altogether]
5. **Relationship between parties** (Family OR Business, prior to?) [Crim doesn’t seem to explore it]

**\*This case is DEFENSE-friendly; use it to DENY the EXISTENCE of an INFORMAL FIDUCIARY RELATIONSHIP\***

**Facts:** Navistar is franchisor and Crim is franchisee. They start a franchise relationship in 1943. In 1958 they finally make a contract. In 1979 the franchisor says that they can cancel whenever. In 1983 they establish a network between dealers for communication. Crim decides that they don’t want to join it. Navistar then asks all of the franchisees to sign a contract saying they will purchase computer equipment. Crim says they don’t want too; Navistar keeps coming back and warning them, saying that it is mandatory→ Crim must sign, they refuse. On 1 April 1985 Navistar cancels the franchise agreement.

**Cause of Action:** Crim sue for breach of contract, fraud AND breach of fiduciary duty.

**Is the relationship based on a formal or informal fiduciary duty relationship?** Informal, since case law has not yet established this relationship as formal. They thus allege that the relationship was based on “trust and confidence.”

**Holding**:

* **Factors 1/4:** Mere trust alone is not enough to transform an arms-length relationship into a fiduciary relationship;
* **Factor 2:** 49 year relationship: court doesn’t take it as evidence of a relationship of trust.
* **Factor 3:**Contractual provision saying that the relationship was one of “trust and confidence” was not enough (was merely an anti-assignment clause);

**Point:** Majority doesn’t allow subjective belief; contract language OR duration of relationship to evidence the relationship. **It seems to mean that ONLY**

**Dissent:** Takes issue with Court on Factor 3: **Language of K:** says that if the K was un-assignable based on “confidence and trust” it means that the clause reflected that you were comfortable with the part you dealt with, but not another, thus proving “trust and confidence.”

**MOLL’s Opinion→** Moll thinks that the outcome of the case is correct, but that the reasoning behind the case might not be. **Why does he feel this way?** Because it seems that (1) The contract does allow them to breach the relationship; and (2) They also gave every opportunity to the franchisee to remedy their breach.

**Meyer v. Cathey (SC TX: 2005) [Insufficient evidence to prove an informal fiduciary duty]**

**Defendant-friendly. Rule**: “Prior arms-length transactions entered for the parties’ mutual benefits do not count as prior-existing relationships based upon trust and confidence. **Factors 1-4 have largely been disregarded.** as factors to establish “trust and confidence” to establish an informal fiduciary duty. The only route it seems the court MIGHT buy is that there was a family or “like family” relationship but we still aren’t certain.

**Factor 5 may still be in play:** an informal fiduciary relationship based upon “trust and confidence” may arise where one person trusts in and relies on another, whether the relationship is moral, social, domestic or purely personal.

**Facts:** Cathey sues Meyer saying that they engaged in several real estate transactions, that Meyer did not pay him for. The relationship had been ongoing for a long time. Cathey relied on Meyer, he controlled the books and made all the final decisions (suggesting less of a partnership, more of a loan/loanee relationship).

 **Procedural**: won on issue of fiduciary in trial and appeal; loses here in the supreme court.

**Issue**: Did Meyer owe fiduciary duty w/ respect to projects.

**Holding:** NO. There is insufficient evidence that there was a fiduciary duty. **Possible Factors**

* Worked together on prior projects,
* three years
* Meyer controlled the books, co-signed for a loan before
* They were, prior, in a fiduciary relationship
* They ate lunch together, consider each other friends (who cares)

\*\*\*\*\*\*\*\*\*\*

**Flanary v. Mills (TX App. 2004)** {Plaintiff friendly: Family relationship + other factors MAY est. inf. fiduciary duty}

**Rule:** Gives heavy weight to Factor 5 [FAMILY relationship] + by saying **“A confidential relationship exists where influence has been acquired and confidence has been justifiably reposed” → Suggests other factors are BACK in play. Factor 5: Evidence that is considered favorably,** but other Factors also considered:

**Evidence Law**

* Flanary is Mills uncle; grew up close like brothers {Factor 5}
* Mills trusted and had faith in Flanary; {“Trust and confidence lang.”}
* Previously worked in oil, on other businesses {Factors 2 & 4}

(prior fiduciary duties now seem recognized as good evidence, as opposed to arms-length transactions);

* Flanary was in charge of finance {Factor 3→ power inequality}
* Told him not to worry about the profitability of the business. {Factor 3→ power inequality}

**Facts:** Flanary is Mills uncle, but only 7 yrs. older than Mills – so they grew up like brothers [lots of evidence]. Mills & Flanary started two businesses together prior to this one: a house building corporation, which they ran for years. No stock certificates were issued, nor were any minutes/resolutions kept. Flanary and wife control all the finances for the business. Mills invested $15,000 at start, receives very little return over years. Mills finally asks to get money out. Flanary says there is no money. Later, Flanary offers him $7,000 as “all that is left.” Mills insists on seeing the books, Flanary said “you’ll never see the books.” Mills sues for Breach of Fiduciary Duty, during which time the corporation is dissolved. Flanary even denied at one point that Mills was a stockholder, but **tax** **returns** proved otherwise.

**Mill’s Arg:**  I didn’t get my fair share of ownership in the company.

**Holding:** Held that there was indeed an informal fiduciary relationship and thus allowed Mills to recover. Flanary was converting the company funds for his own personal use. **Damages awarded→** The undistributed net profits described that belonged to Mills. + reimbursement for investment and loans to the company.

**EVIDENCE Establishing Fiduciary Duty:**

**Language of Court:** “Ample evidence supports the finding that a fiduciary relationship existed.   Flanary is Mills’ uncle [**factor 5: family relationship**]. Flanary is only six or seven years older than Mills;  as they grew up, Flanary was more like a big brother than an uncle[**factor 5: close relationship**]. Mills testified that he had always had faith in Flanary, looked up to him, and trusted him [**Factor 1 (subjective belief); “trust and confidence” language**]. Mills worked for Flanary in the oil fields in the 1980s **[Factor 2: duration of relationship]**. They were partners in a roofing business before they formed Easyliving Homes **[Factor 4: degree of prior trust]**. Mills depended on Flanary to handle the finances of the roofing company and, later, Easyliving Homes **[Factor 3: power equality]**. The evidence shows the requisite personal AND professional relationships **[Factor 5: suggests that both a prior family relationship AND existing business relationship together, are req’d]**. Flanary told him not to worry about the profitability of the business **[Factors 3 /4: power equality/trust]**. This evidence provides factually and legally sufficient evidence to show a confidential relationship.”

**Evidence Establishing Breach of Fiduciary Duty:**

**“The record also contains sufficient evidence that Flanary breached that fiduciary relationship**. Mills and Flanary agreed to share the profits of the business equally (the most unequal division alleged was the 51-49 split Flanary mentioned), and Mills entrusted Flanary with the finances of the company. Although the Flanary's testified that Mills was only part of the business for the first house, there was competing evidence from Mills, other builders, and some documents that Mills remained an equal shareholder for the corporation's four-year existence. Flanary spent thousands of dollars from Easyliving's account;  some witnesses argued that these were business expenses, but other witnesses contended that these expenditures were for personal expenses that were not authorized. Although evidence showed that the company had an after-tax profit of more than $300,000, Flanary told Mills that the business was not profitable and wrote him a check for $7254.86, alleging that the amount was Mills’ $15,000 investment, less expenses Mills owed. **Legally and factually sufficient evidence supports the court's finding that Flanary violated the fiduciary duty arising from the confidential relationship he had with Mills.”**

**Evidence Used to Establish Damages:**

* Bank statements
* Deposit slips
* Checks and check stubs
* Tax returns of the individuals and Easyliving
* The company's general ledgers and financial statements
* The articles of incorporation and related documentation
* **Depositions**
* **Expert** **Testimony**
1. **Shareholder Oppression**

**What is “oppressive conduct”?** → Majority conduct that frustrates the reasonable expectations of the minority shareholder.

**Shareholders are vulnerable to a freeze-out situation:** Majority shareholder can freeze out the minority, by stacking the board, taking over and firing minority, then kicking him off the board not paying dividends and then offering him nothing for his stock. Who will buy when guy has shown track record of screwing over the minority? He now has stock that he gets nothing out of and cant evens ell. The shareholder oppression statute affords him a remedy.

**Remedies for shareholder oppression:**

Jurisdictions have responded to the free-out through [1] Traditional corporate law and [2] these **Supplemental Oppression Doctrines:**

Freeze-out

/ \

Special c/l rules No special c/l rules

/ \

Fiduciary Diss. for oppression (statute)

 /\

Formal Informal

**Other** **States** [Depends, MA for example goes left, to special c/l]

* Shareholders in a CHC may have fiduciary duties to other shareholders.
* Texas however, does not give it to them.

**Texas** [right side of diagram]

* **Common Law:** In Texas, you must establish an informal fiduciary duty **[Crim Truck, etc.]**→ which we have discussed, is very weak, OR
* **Statute:** Bring a claim under the Texas Shareholder Oppression Statute→ allows a shareholder to bring a disillusion for oppression claim asking the court to dissolve on grounds of oppressive conduct. Dissolution helps you because it helps you derive money out of the company.

**Texas Shareholder Oppression Statute [Texas Business Org. Code § 7.05]:**

**→ A. If all other requirements of law are fulfilled AND all other remedies (law and equity) are determined to be inadequate, you get a receiver appointed, “who has the power to dissolve the company ….”**

**(1) In an action by a shareholder, when it is established (c) that the acts of the directors or those in control of the corporation are illegal, oppressive or fraudulent.**

↓

**Oppressive** **conduct** = majority conduct that frustrates the unreasonable expectations of the minority shareholder (*Davis v. Sheerin*).

**POINT**: “**Reasonable** **Expectations**” give much leeway, could be:

* Denial of employment;
* Discrimination in distribution of dividends, etc.
* Denying access to the books
* Participation in company
* Would be recognized as shareholder
* Would receive formal/informal dividends
1. **Remedies For Shareholder Oppression**

**Davis v. Sheerin (TX SC: 1988) [Remedies for Shareholder Oppression]**

**Rule → See Majority Rule Below**

**Facts**: Sheerin is minority owner of 45%; Davis’ are majority, own 55% of corporation. The majority pretends like Sheerin’s 45% interest doesn’t exist.

**Evidence:** The tax returns show Sheerin of 4% ownership, Davis even tried to buy his stock.

**Legal** **Action**: Sheerin sues under the Texas Shareholder Oppression Statute

*What reasonable expectations of Sheerin were frustrated?*

* **Reasonable** **expectation** of participation in company (here “Sheerin’s opinions or actions would have no effect on the Board’s deliberations”);
* **Reasonable** **expectation** that he would be recognized as a shareholder (important because this gives you rights to inspect books & records w/ proper purpose; to receive dividends; to vote as shareholder, etc.)
* **Reasonable** **Expectation** to inspect books & records – he did try (similar to top, could be different);
* **Reasonable** **Expectation** to receive informal dividends – Davis were paying themselves contributions to their 401K accounts.

**Holding?** Since statute gives us power to appoint a receiver to dissolve the company (“kill it”); equity principles allow us to give a lesser remedy.Note that a Virginia statute reads just like TX but is interpreted differently. Virginia Supreme Court did NOT allow dissolution since the legislature did NOT specifically authorize.

**[TX/ Majority Rule]**

**Majority Rule (TX):** Since statute gives us power to appoint a receiver to dissolve the company (“kill it”); equity principles allow us to give a lesser remedy.

**→ TX & Majority is better (argument):** it gives more remedies which probably will be tailored better to each situation; they put dissolution in because it seemed only way to solve, but lesser remedies are better.

**Problem w/ Texas→** Moll says “who cares” how bad he was, it won’t change the valuation and that’s the real issue: whether majority was jerk or not, it shouldn’t change the valuation (**BUT MOLL says that it does anyways since we are dealing with juries. Thus, strategically, most parties want to litigate the “fault issue”→ if jury agrees, they will probably benefit in the valuation area**).

**[VA/ Minority Rule]**

**Minority Rule (VA) :** Court must dissolve, since that is what the state legislature said. If they wanted lesser remedies, they would have specifically granted them.

**→ VA Legislature is better (argument):** Don’t legislate from bench; if Legislature wanted to allow courts to provide lesser remedies, hey would have.

**[NY/ Election Statute]**

**Minority Rule (VA) :** Court must dissolve, since that is what the state legislature said. If they wanted lesser remedies, they would have specifically granted them.

**→ NY Election Statute is better (argument), but different from Texas:** An Election statute supplements a dissolution statute, allow a defendant who has a pending shareholder oppression action, to buyout the minorities share at “fair value,” right then and there. Thus, once “election” occurs, parties skip litigation on fault and go directly to the valuation issue, which is usually the major issue (saves money on issue of liability for oppression). **By contrast,** in **Texas** a trial is required to get a buyout (if negotiations don’t succeed). Plus, even if you get to trial, the court might do whatever it thinks is equitable. **Rationale for TX:** they want jury to see what a bad the controlling shareholder was. **Problem w/ NY→** **Minority Oppression/hold-up:** Moll says sometimes people file to threaten so that they get better treatment. If NY, plaintiff files and defendant “elects” to buy him out, plaintiff is out, whether he wanted to be or not.

**MOLL SUGGESTION→** States should have a statute that mandates a buyout whenever minority shareholder wants it. **Problem:** Minority has less bargaining leverage; corporation may not have the cash to effectuate a buyout.

* **If Minority is “brains,” some courts allow them to buyout.**

**50-50 split:** usually happens when directors are equal, but one shareholder is President and CEO thus giving him more authority. Also, someone might have “negative control” – doesn’t agree in a vote, thus without a majority vote, they never allow any changes to the company. Statute says you can bring action against “directors” OR “those in control.” So if a director is oppressing, just sue him. **To establish oppression, you must establish that you don’t have the power to stop oppression.**

**Court Ordered Remedies for Oppression:**

1. **Dissolution**: Creates a market, but it destroys the Company. Majority Rule states thus allows any lesser action; Minority Rule states go by direct wording of statute – if it only allows dissolution, that/s all you get.

**Lesser Statutory Remedies [Majority States allow regardless]**

1. **“Buy-out”:** Majority shareholder(s) OR Corporation buys out the minority. It solves the freeze-out problem because the minority can get out of the bind. This creates an “artificial market” that allows the minority to get out. **Why is “buy-out” seen as better remedy?**

(a) It benefits oppressed, by letting him get out;

(b) majority gets to keep business and run it in his way

(c) it doesn’t kill the business and preserves employment, etc.

(d) may produce better price since business sold together is usually worth more than being liquidated (sold off in pieces).

**Problem(s):**

Valuation is tough: since this is not being sold on open-market, it’s tough to know what the minority stake is worth.

Majority may not have the liquid assets to buy-out the minority – to do so business might have to sell off assets, so effect is to destroy the business.

1. **Alternative: Election Statutes:** Defendant elects to buy shares; litigation is done on valuation issue.
2. **Determining Valuation**

**→Discounts based on [1] minority share being worth less than controlling, OR [2] Stock is NOT public, so worth less.**

**How to calculate a Valuation**

1. First, the appraiser values the company\* **[e.g. 100% of company is worth $1,000,000]**
2. Then they value the shares **[Minority Share of 25% of $1,000,000 = $250,000]**
3. Apply discounts [i.e. FMV] **[*See* NEXT box]**

**\*Discounts used by appraiser here are not our concern; done by professional accounting standards].**

**What does “fair value” for the buyout of the oppressed shareholders shares mean:**

1. **Enterprise value**: Valuation of business as a whole, at whatever % is being bought out; **e.g. $1 million, minority owns 25% share, so minority gets = $250,000.**
2. **\*Fair market-value:** What a willing buyer would pay a willing seller. Buyer will discount the price to buyer for. Involves discounts:
3. **Minority** **discount**: Buyer will not pay full $250,000 because a 25% share in company lacks control; when you buy something with no control and you are at mercy of majority, they will discount the value to account for lack of control. **[~25% of Enterprise value]**
4. **Marketability Discount:** you will pay more for public stocks than private, because it can be equally liquidated. If you buy into a CHC, it is not liquid; there is no “quick-sell.” **[ + ~25% of enterprise value]**

**\*NOTE: Most courts only allow variations of these discounts. Texas:** Thisissue is still wide-open

E.g. NY allows a marketability discount, but not a minority discount.

**Applying discounts for calculation of Type 2 valuation (“fair market-value”)**:

You don’t take 50% off immediately; you take 25% off, then another 25% off.

**Minorities shares are valued at $250,000 =** $250,000

Minority Discount = [~25%][x.75]

 = 187,500

 **$**187,500

 Marketability Discount: [~25%] [x.75] **[Cali did not allow for election statute]**

 **$140,625**

**FMV = $140,625**

**Brown v. Allied Corrugated Box Co. (Cali) [Election Statute mandated FMV, not fully honored]**

**Rule:** A minority share discount does not apply in CA Election Statute proceedings, since the alternative (dissolution) would result in a distribution of “the exact same amount per share.” It wasn’t fair to penalize the minority as the “moving party” for the buyout. [“Fair value” buyout is the usual (MAJORITY?) remedy for oppression. Cali court recognizes this as in its statute, but does NOT allow a minority discount].

**Facts**: Of three brothers; two own 49% together; and mean brother owns 51%. Mean brother has all the power; he has control of the BofD, etc. California operates like NY: it has a shareholder oppression statute and an election statute. Mean brother swoops in and elects to buy-out because he doesn’t want to risk dissolution. The Court ordered each party to get their own valuation experts. Once there was disagreement, the experts would both pick a third expert to set price. **Valuation Used:** TheCalifornia **statute requires buy-out at fair-market value** (this is the usual standard)**.** Liability is thus not at issue. **Discrepancy:** Plaintiff’s valued @ $148,000**;** Defendant’s valued@ ~$28,000 after applying a minority discount.

**Issue**: What is “fair-value?”

**Held**: The court refused to permit the minority discount. Said that the rule justifying the devaluation of minority shares in closely held corporations for their lack of control has little validity when the shares are to be purchased by someone who is already in control of the corporation. Also said that “a minority shareholder who brings an action for the involuntary dissolution of a corporation should not, by virtue of the controlling shareholder's invocation of the buy-out remedy, receive less than he would have received had the dissolution been allowed to proceed.”

**Discussion The holding implicitly** **suggests** that “fair-market value” is the wrong valuation standard. Since it does not allow a minority discount, it demonstrates that valuation of the **entire business** that would be subject to sale in a dissolution sale is correct. The court thus does denies the minority→ When a corporation buys back its own stock, it cancels them, so other shares are more valuable because they represent more ownership share. So it would not make sense to apply a discount in CHC.

**Point→ Dissolution** **sucks**: it’s a fire sale. The notion that a buyout should not bring less-than dissolution makes sense, except that it always happens→ dissolution provides terrible value and thus, theoretically it’s not so clear that if you did an enterprise value and then discounted the shares, it would be less than a FMV analysis.

**What is the problem with the “market-discount” application in a buy-out of minority shares in CHC?** It works for the minority, but not marketability. All shares of CHC are illiquid, even the majority.

**ACD, Inc. v. Follett (2000: Minn)**

**Rule**: Absent extraordinary circumstances, “fair value” in a court-ordered buy-out means a pro rata share of the value of the corporation as a going concern without discount for lack of marketability.

Extraordinary circumstances means circumstances where not applying a marketability discount would result in “an unfair wealth transfer from the remaining shareholders to the dissenting shareholder.”

**Facts:** The three shareholders eventually entered into a Buy-sell agreement which had a provision that said that if a shareholders employment is terminated for reasons other than death/disability, the corporation could exercise an option to purchase the terminating shareholder's shares within 90 days. If valuation could not be agreed upon, it would be determined by appraiser EBVF. Other employee quit, was paid $50,000 for his 1500 shares AND another $45,000 in severance pay + for a non-compete agreement. President Scibora never told Follett that he paid the severance/non-compete fee. President’s wife was eventually employed as Follett’s boss and was also given benefits that were undisclosed to him. Follett and presidents relation deteriorated, Follett was demoted, given reduced salary and as a result, he served President Scibora with a proposal for a severance package. No agreement was reached and Follett resigned immediately, retaining his stock.

**Procedural:** Plaintiff Corporation brought suit against Follett for minority shareholder breach of fiduciary duty to company, other shareholders. Follett responded with counter-claim against corporation and the President, requesting dissolution of the company.

**Negotiations:** President Scibora then offered to buy his stock pursuant to agreement for $24,646 but Follett declined. ACD Corporation sought audit from Chartwell since EBVF was no longer in business: they estimated his stock at $30,000. Amended complaint, asking court to make Follett sell his shares back at $30,000.

**Valuation:** The parties finally negotiated for a new valuation by three-member panel: The Majority Appraiser (Follett’s+ courts) valued ACD at $1,426,143; Follett’s 1/3 interest at $475,381 + a **market-discount** of 55% = $213,921. Minority’s appraiser (ACD/Sciboda) valued the company at $875,000; on Follett’s share, they applied [1] a %75 minority discount; and [2] a 35% market-discount valuing his total stock at $46,665.

**Procedural:** Trial Court found for Follett and asked the corporation to re-buy his stocks at the majority appraisers price, without the market-discount. It also ruled that Follett, as a minority shareholder, did not owe the corporation a fiduciary duty and that Scibora acted in bad-faith towards him since he failed to disclose the terms with other employee, and new employee (wife). Court of Appeals affirmed. *The trial court concluded that applying a discount would interfere with the statutory purposes of protecting minority shareholders and ensuring that court-ordered buy-outs are fair and equitable to all parties* citing a **NJ Case [Balsamides,** upheld the application of a marketability discount when oppressed shareholder had the right to purchase the shares of the oppressing shareholder **like a penalty.]***.*

**Issue:**; [1] whether [in Minnesota] a minority shareholder in nonvoting stocks owes fiduciary duties to the corporation or other shareholders; [2] Whether a market-discount should be applied to the value of shares

**Held**: The court held that a minority shareholder did NOT owe fiduciary duties, particularly here since he had no voting shares, therefore lacked any control whatsoever. They reversed lower court however when it refused to apply the market-discount. They said that allowing Follett to recover $475,381 dollars for a 1/3 interest in a corporation worth $1,426,143 nearly 5x net worth of corporation when he quit; would hinder corporations ability to inject cash to grow business, was thus unfair. Court was saying that the corporation as not going to grow that much in future, so if they sustained that price, those currently holding stock would be crippled. Remanded to trial court to strike an in between market-discount of 35-55% of price. ↓ **What date should be appropriate for valuation?** Also is contentious? Current date or date that most oppression occurred? ↓ **Balsamides Case[NJ]:** To secure “fair value,” for Parle’s stock, a marketability discount should be applied. To do otherwise would be unfair, particularly since Perle was the oppressor and Balsamides was the oppressed shareholder. **[*Balsamides v. Protameen Chemicals, Inc.* 734 A.2d 721(N.J. 1999).** ↓ **Point of CASE: MOLL** believes that the market-value discount should ONLY be applied for CHC v. Public company; it should NOT be applied because the other guys acted terribly. ↓

**Texas law is unsettled: Texas precedent** does say that a buyout is an authorized remedy – it could be given in a breach of fiduciary duty claim, because it is equitable but there is no precedent on this point.

**POINT:** there is no standing issue when dealing with “oppression.” Any business person can bring it without going to Crim. Truck, etc. based upon statute.

**Oppression (easy to bring, based upon statute) v. breach of fiduciary duty (impossible to bring in TX)**

* Is this stupid – they both police the same thing?
* Both are relevant when it appears that the majority is abusing control, but “oppression” is easier to bring; breach of fiduciary duty suit for minority shareholder, not supported by case law in Texas; but people bring it because it’s clearly a tort.
* **Is oppression clearly a tort?** Other jurisdictions treat it as one, but we don’t necessarily have the case law there for it.

↓

**What is an appraisal statute?** A statute that says when certain fundamental corporate events occur [mergers, changing internal- documents, etc.], you have a statutory right to say that you do not want to participate in it and thus want out at “fair value.” **Why does it matter?** Texas appraisal statute kicks in whether there is fault or not. So if discounts are inappropriate there [as is law], wouldn’t it be perverse to say that in the fault context, discounts somehow now apply. **Argument Against Marketability Discount:** Marketability discount doesn’t make sense if corporation is buying stock back, because it doesn’t have to sell that stock later, the stocks are retired.

**What date should be appropriate for valuation?** Also is contentious? Current date or date that most oppression occurred?

**LLCs**

**What if a plaintiff is not a minority shareholder in a corporation but a member of an LLC?** You might still need the informal oppression action instead of the shareholder one; Supreme Court suggests it will not prevail. But we do have a statute that extends protection to all; LLCs, etc.

* Minority member in LLC can use it.

**Could you bring a fiduciary duty breach here?** In other states the precedence exists to draw parallel …here however, Texas held that in minority shareholder context, do not necessarily own fiduciary duties…so they would probably do the same for LLC. But you can still use the statute.

1. **DTPA**

**Overview**

DTPA still fits into business tort; you want to use it since it covers both.

* Legislature changed a lot but did not touch:
* Broad definition of consumer (included consumers), which had a lot of case law behind it;
* It’s still a no-fault liability statute;
* 30+ claims available, ~ 4 only, deal with mental intent.
* \* Lowest causation standard in Texas:
* \* Proximate cause, w/out foreseeability standard (statute says “a producing cause,” so you don’t have to show all or any causes, but just one)
* Economic damages & damages for mental anguish;
* Court has said that you can never have mental anguish out of Economic Loss in Business Torts; DTPA gives you more;
* Lowest standard for punitive damages: “knowingly” (knew/should have known), as opposed to “actual malice.”

**History**

* The 1950s and 1960s ushered in the great necessity for credit – also, people were getting ripped off more easily. The system needed to deal with these problems;
* In the early 1970s: every jurisdiction needed to alter the common law to better deal better with new economy;
* US never wanted to regulate; private civil justice system was supposed to regulate.

**Traditional Problems:**

**Contract issues Tort** **Issues**

* **Privity**, if someone was out of privity, they could not recover; - Must prove “duty”
* **Waiver** – was now becoming an issue - Must prove “fault”
* **Contractual limitations -** Must prove “proximate cause ”

(foreseeability was for juries)

**Damages Damages**

* no punitive damages - No economic damages
* no attorney’s fees (TX was exception for breach of K) - No attorney’s fees
* no punitive damages

**How good was a cause of action for contract & for tort when the DTPA was passed in 1973?**

* Contract was okay
* Tort was much better: mental anguish, attorney’s fees, etc.
* DTPA was above all of them (combined the best of both tort and K).

**1985**: Texas Supreme Court started to get more conservative; Legislature became conservative, reformed almost ALL tort, DTPA.

**How to use the DTPA**

**Interpretation of the DTPA**

* Statute says “the subchapters shall be liberally construed and applied to promote its underlying purpose, which is to protect consumers…**”.** Means that if there are two possible interpretations, court must go for the one that most protects consumers;

**Disclaimers & Limitations (waivers)**

* Not Waivable, against public policy and thus unenforceable. **Exception: (1)** inwriting **(2)** consumernotindisparatebargainingposition **(3)** consumerrepresentedbylegalcounselinseeking**/**acquiringgoods**.**

**Who is a “consumer”?**

* Means somebody who goes out and buys stuff – can be an:
1. Individual person
2. Business (corporation, partnership)
3. Agency
4. State or agency of this state.
* They came up with this definition because people sometimes bought goods for their businesses, and legislature wanted it to apply to those instances as well.

**Is a “trust” a consumer?** A trust is not an individual, partnership, corporation or agency. Beneficiaries of a trust AND the trustee are consumers. **Are the services for trust or trustee?** You need to find a way in.

**Who does it apply to?**

* **Accountants**
* **Lawyers**
* **Construction workers/ contracts**
* Applies to businesses with: less than $25 million in assets (does not need to be proved, defendant can raise it as an affirmative defense).

→ Purchasing inventory, parts, supplies, etc.

**What is a “good”?**

* Everything is a good except intangibles

**What is the requisite relationship to use the statute?**

Person must simply:

1. “seek OR acquire” by
2. “purchase OR lease” any
3. “goods OR services.”

**Businesses became scared of the DTPA:** good chance the lawsuit would win. People (mostly attorneys) were threatening to sue when they shouldn’t (for minor misrepresentations). Since all you have to do is seek the purpose, it was *carte blanche* to sue, even though it was often obvious they didn’t mean what was said.

**Early DTPA cases**

**Latham v. Castillo→ What are “legal services:** Often lawyers are sued for malpractice. Problem is you must prove a suit within a suit (not only that attorney screwed up, but that if he didn’t, you would have recovered. So you must try to lawsuits). If you sue under the DTPA, you don’t need too. You can recover simply because the lawyer did not file your lawsuit and give person a chance to tell their story. Since they lost opportunity to be heard, they were damaged under the DTPA.

***Wellborn v. Sears Roebuck & Co:***Kid played on skateboard, mother bought electronic garage door. Kid would try and go under door on skateboard before it would close. Kid hits defective door. Family sues on his behalf under DTPA.

**Issue**: **Is kid a consumer (always first issue)?:** Sears says he wasn’t since the mother bought the garage, put it in her house, her garage, Bobby had nothing to do with it. **Court** **said**: Statute doesn’t say you must own it, it says you must acquire it; since mother bought the door for her son’s benefit, he acquired it because he was an **(1)** intended beneficiary, and **(2)** she acquired it for him.

* Now, if you don’t pay for legal services, but you are a business benefitting from it, you are still protected;
* If a kid buys a baseball bat, but the bat is used by a team, they are covered because bat was bought with team as “intended beneficiary;”

***Birchfield v. Texarkana Memorial Hospital:*** Birchfield was unborn child. Woman knew there would be complications at birth, asked them if they had a machine. Hospital misrepresented that they did. When hospital didn’t, they sued on her behalf and won (**Point:** when looking at these problems, throw out all notions of contract, privity).

**Holeman v. Landmark Chevrolet:** The dealership said “no offer will be beat.” Lawyer got his family to buy Chevrolet’s offer something like “$50 each.” Dealer would say “we will not do that.” People testified that they “relied on the ad” and lawyer says “you thus violated the DTPA.” **Court said:** To be a consumer, all you have to do is be seeking, but what the court did was say that you must be seeking in good faith.

**Exxon v. Dunn:** Free goods or services: if someone buys something through purchase and then gives it away, the recipient has “acquired.” As long as person who acquires it after someone was misled, still has the action.

**Kennedy v. Sale:** Employer buys car insurance for employee. Insurance agent lies to them. If one party paid for service benefitting both, both were “consumers” because both acquired the service through purchases.

 **“Banking Services”**

***Riverside National Bank Case*** – Facts: person went into bank, said he wanted to borrow money. Manager asked “how much?” that was it. **Defendant** **won**, said that “merely lending money” is not a service.

***Flenniken Case:***there was a consumer, a builder and a bank. Consumer wanted to buy house, gets loan. Court says the loan form bank is means of paying for the house. Therefore, the whole transaction is subject to the DTPA -  **so long as the loan is being used for a purpose, DTPA applies.** Plaintiff must make the transaction, defendant wants to split the transaction into different pieces.

Buying motors for boats under UCC, lender was in TN, motors were in KS, consumer in Texas. Depositions, not once does consumer say “I was buying motors.” **They settled:** problem? Defendant was able to “split” into “two” transactions, since it did not link buying motors AND the loan. **Bottom line:** usually, **DTPA does NOT usually apply to loans.**

**Shell v. US Brass**: US Brass manufactures polyurethane pipe (which cannot be sealed). They advertise it because it is so cheap. Almost every mobile home for 5-6 yrs. buys it. ALL of the pipe leaks. Advertisements said “polyurethane pipe – best you can get .. etc.” US Brass sells it to General Homes, etc. General Homes put it in the house that the consumer buys. Consumer sues US Brass. Court says you cannot sue the manufacturer (tort – must sue General Homes, etc.). Everything US Brass did was a misrepresentation, but the court said it did not occur in relation to the consumers purchase. Court only say that “if misrepresentation was made directly to consumer” then it would have happened. **Problem:** General Homes did not do anything wrong (and they were also in bankruptcy).

**POINT:** if you get involved with ANYTHING about manufacturers it’s a mess (laws conflict – some say you must sue middle-man, but law won’t allow).

1. **The Boundary Between Tort and Contract**

**Should it matter that a lot of torts fall at the edge of contract? That one action may give rise to Tort and Contract?**

* There is mass confusion surrounding what type of cause of action was brought;
* Known as the **“Contort**” **problem**:
	+ What are boundaries
	+ What are policy justifications.
* Fall back to the basics

**What is purpose of contract?** **Upholding intent of parties.** Contracts are meant to effectuate the intent of the parties: put ppl in position they would have been if bargain had been met. Breaching a K is not considered immoral. **Derives** **from** **common law notion of Nonfeasance:** failure to do something (omission) = contract

**What is the purpose of Tort? Vindicating social policy.** Tort picks out activities that society deems undesirable. Intent can have less standing; idea is to deter not to punish. That is where punitive come in. Being tortious is considered poor, immoral behavior. **Derives** **from** **common law notion of Misfeasance**: affirmative acts that were done wrongly (commission) = Tort.

**SUMMARY**

**DAMAGES**

**Breach of contract** = expectation damages (BOB)

**Negligent misrepresentation**= out-of-pocket damages

* **Montgomery Ward v. Scharrenbek (1947)**→Every K contains implied duty to perform the K with care→ made every breach of K a potential negligence claim.
* **Jim Walter Homes v. Reid (1986)** → Now the major inquiry is on the nature of the injury→ can bring tort w/ contract if there is a specific tort injury (personal or property) separate from contract;
* **Southwestern Bell v. Delanney (1991)** → To bring both claims requires [1] An independent tort duty (one that does not arise in a contract), and [2] The nature of the injury is “instructive”→ injuries that are pure economic loss probably don’t count

**Application of New Test:**

1. **Is there a tort that has been committed independent of the breach of the contract?** Yes→ Duty not to commit fraud. **Evidence:** Court said there was plenty of evidence of Scienter (that at time they signed, Formosa knew they didn’t mean it)
2. **What is the “nature of the injury [since its ‘instructive’]?”** if it is property damage or personal injury, will be able to bring both.
* **Formosa Plastic Corp. v. Presidio (1996)** → Establishes a Fraud Exception: for fraud, you only determine whether the duty arises independent of the contract. You don’t look at prong 2, nature of injury.
* **DSA v. Hillsboro Independent School (T1998: TX SC)** → Negligent Misrepresentation is not an exception. Must pass the two-pronged test.

MOLL’s OPINION: Since tort focuses on discouraging conduct, then the inquiry should focus on duty as Formosa did→ that goes with basic tort idea of vindication public policy. Thus, he likes first prong, not crazy about second [particularly in Formosa Case].

**Fact patterns where question of tort and contract arise: Bring BOTH claims?**

**Montgomery Ward v. Scharrenbeck (1947 SC Texas) [The Early Distinction]**

**Facts**: Scharrenbeck’s buy hot water heater from Montgomery. It doesn’t work well. They call the company to fix it – they agree (= contract). Montgomery comes to fix it, asks Scharrenbeck to turn it on. House catches fire.

**Procedural**: Scharrenbeck’s bring a negligence cause of action: say worker was negligent in repairing the water heater.

**What words ensure “tort language”? What words ensure “contract language”?**

* He repaired in a faulty matter - Failed to adequately repair;
* “Defectively” - Failed to ensure proper repair
* Generally uses active verbs that demonstrate - Generally uses passive words that suggest failing

committing an affirmative act. to do something.

**How are these distinctions collapsed?**

* Can say they did something but did it wrong
* Or did something, but didn’t do it right.
* Scharrenbeck thus refutes the traditional common law distinction.

**Issue**: Did company have duty to repair heater in a diligent way? Yes.

**Where did it come from?** It comes from the “general duty” stemming from the contract.

**Held**: “Accompanying every contract is a common-law duty to perform with care, skill, reasonable expedience and faithfulness the thing agreed to be done, and a negligent failure to observe any of these conditions is a tort, as well as a breach of the contract.”

* Meant to say that a Contract can create the relation out of which the duty emerges;
* This is a broad holding because the contract doesn’t specifically create a duty, it just generally creates one which court says is a tort AND a breach of K.
* **This statement resulted in 70 years of Texas cases trying to spell this out and narrow it more.**
* This holding basically makes ANY plaintiff able to bring both a contract AND a tort claim.

**Why is ability to bring both a tort and contract claim against defendant an advantage for plaintiff?**

* **Indefiniteness** + **price**
* Remember here that ordinary negligence, but if the jury finds gross negligence (extreme, willful, etc.) than it may result in punitive damages.
* May initiate insurance coverage;
* Would not be burdened by doctrinal issues in contract (statute of frauds, etc.)

**What does this language sound like?** Duty of good faith = in carrying out your contract, must make reasonable effort (TX has rejected covenant of good faith and fair-dealing).

**Jim Walter Homes v. Reed (1986: SC Texas) {Focus on Injury: economic = contract}**

**Rule: Changed rule so that instead of earlier ruling (all contracts can give rise to tort), instead you must have a breach of contract and a tort injury to recover for both.**

* Done to reverse earlier problem that any breach of k could be a tort; if there was intention, as contract allows but tort discourages, then all breaches of contract could result in punitive damages.

**Facts**: Reeds bought a house from defendant. It was defective. They sued.

**Procedural:** Sued for “damages arising out of sale and construction of the house” = tort. Trial court ended up awarding them punitive damages.

**Holding**: Reverses **Scherrenbeck** standard that the inquiry surrounds the nature of injury most often determines which duty or duties are breached;

* **When injury is only economic loss, it sounds in contract alone**; court derived this ruling by citing products liability cases where only damage was to product itself, not someone else: “when no physical injury has occurred to persons or other property, injury to the product itself is an economic loss governed by contract.”
* To bring tort, must show injury to property or person other than subject-matter of the contract.
* Nothing in **Scherrenbeck** suggests that the nature of the injury must be considered, so this is a major surprise, decision for court to curtail **Scherrenbeck Case**.

**If an injury occurs as a result of the contract, why should it make a decision?**

* Suppose as house is sinking for defect, couple runs out and he gets a mere splinter: why should they all of a sudden get punitive.
* Suppose you enter termite agreement, K gives duty of care “reasonably perform inspection;” he doesn’t. while suing him, you find a smoking gun memo which shows that he had absolutely no intention to even check for termites: **you could bring a fraud action = he intentionally misrepresented that he would perform something, but did not. Fraud is an intentional tort = punitive damages, etc.**
* Remember that when you sign a contract, you are at least saying that when you signed a contract, you intended on performing it;
* If you sign it and then 5 seconds alter your financial situation changes and you can’t then it’s different.

Restatement s 350 – can’t bring tort claim if there is no damage to something other than the product under the contract itself.

**Southwestern Bell v. Delanney (TX Supreme Court: 1991) [tort needs ind. duty sounding in tort]**

**Rule**: To bring a tort claim, you need to find an independent duty that sounds in tort. Bell’s obligation to publish an ad was NOT independent since it was based on a contract, so no claim emerges. It’s instructive to look at

**Facts**: A small business cancels there phone line with telephone company, but does NOT cancel a contract to have their business advertisement placed in the yellow pages. Southwestern Bell cancels their advertisement as well. Small business sues.

**Procedural**: Delanney brings a negligence action and a DTPA. **Delanney does NOT bring a breach of contract claim** perhaps this was to mask the fact that this is a “contort” problem. He may also not have brought the contract claim because of a damages problem: couldn’t get around the limitation of liability clause in contract, so they left it out altogether.

**Concurrences:** Discusses a Duty of Public Policy which would help DeLanney because if the telephone company has such a duty, DeLanney could bring a tort claim.

**Why doesn’t this help here?**  Because the duty of public service is limited; applies to phone service, NOT to publishing an ad.

↓

**Holding:** Contort problem terms on whether there is a common law duty (don’t look at contract or injury) – the question has re-shifted back to duty, but not in same way of Montgomery. DeLanney still has NOT abandoned the Jim Walter Homes theory: says it’s “instructive” to look at the nature of the injury.

**TODAY**:

* Duty inquiry is relevant
* Jim Walter Homes test is “instructive” (what does that mean?)
* In Delanney, court says that since there is no tort duty, then the claim doesn’t come in.
* **THUS:** DeLanney’s claim goes away→ since DeLanney’s lawyer was crafty in trying to keep contract claim out. It backfired since all that was submitted to the jury was the contract question.
* **DeLanney** **lesson**: Submit claims on both. **Problem**: Trial courts have MSJ which attempt to weed out claims, so if they weed out your tort claim, whole case must be remanded for new trial.

**R2D § 530 =** Agreeing to contract when you don’t intend to honor it is fraud→ can you bring fraud claims after Delanney, since the Jim Walter Holmes inquiry was “instructive.”

**Formosa Plastic Corp. v. Presidio (1996: TX SC) [Fraud Exception]**

**Rule: Fraud is an exception whereby you do not look to the nature of the injury for “instruction**.”

***Southwest Bell v.* Delanney ANALYSIS:**

1. **Is there a tort that has been committed independent of the breach of the contract?** Yes→ Duty not to commit fraud. **Evidence:** Court said there was plenty of evidence of Scienter (that at time they signed, Formosa knew they didn’t mean it)
2. **What is the “nature of the injury [since its ‘instructive’]?”**→ Overspending from underbidding induced by a misrepresentation is ALL economic damages.

**Facts**: Formosa is large company that wants a facility built. They receive bids for it using certain provisions contained in a bid pamphlet. In doing so, they intentionally made misrepresentations including that they would be able to schedule their own work. If subcontractors complained, they would use their large pressure. Presidion couldn’t complete work on time.

**Cause of Action:** Presidio sues Formosa for fraud; breach of contract breach of good faith and fiduciary duty.

**Trial**: Jury awards win on all claims: frau; breach of good faith & fair-dealing; and breach of contract. By time this gets appealed, Presidio is fighting for a $10 million punitive claim which must basically come from the survival of the fraud claim (tort). **The same underlying facts thus give a claim under both tort (comments in k were knowingly not true) AND contract (breach of contract).**

↓

**PROBLEM: After Formosa, lawyers are now going to handle Contort by trying to bring a tort action through a suit for fraud?**→ NOT only are economic damages available for fraud, but you can also get punitives (Fraud involves an independent duty). This makes sense and it seems to resolve the “instructive” language from Delanney, by burying that analysis.

**DUTY USED TO BE MAIN FOCUS, WALTER HOME IS NOW COMPLETELY DEAD**

**DSA v. Hillsboro Independent School (1998: TX SC)** [Is Negligent Misrepresentation an Exception?]

**Rule: For Negligent misrepresentation, the inquiry includes both the first prong [independent tort] and the second prong,** nature of the injury. Here, the negligent misrepresentation does not meet that standard since the claim arises out of a contract and the nature of the injury is economic loss. Thus, the plaintiff can only bring the breach of K claim.

**Facts:** DSA is hired to build an elementary school; they enter a contract agreeing to build it. In the end they build it to the wrong specs.

**Procedural:** They are sued for breach of contract and negligent misrepresentation because the building has several defects. They also had a DTPA lawsuit that was thrown out.

**Issue**: Can you bring a tort claim for negligent misrepresentation along with the contract.

**Procedural**: School district got an award for negligent misrepresentation; the jury was then asked whether it rose to a level of gross negligence, as a basis for awarding punitive damages in tort.

**HOLDING**: You cannot bring a claim for negligent misrepresentation AND breach of K here, since the duty arose in contract AND the losses were simply economic.

**Could you usually bring a negligent misrepresentation claim in this fact context?** Usually the NR claims cases come from professional services such as lawyers, accountants; this involves plain-old, arms-length parties, so you would think no. But according to **R2d § 552**, yes you can, so long as it involves a pecuniary interest. Here they have one since the transaction is to make money.

↓

**Damages claimed here were wrong: sought expectation damages usually reserved for Breach of K, for a negligence case where out-of-pocket expenses are usually the recovery.** The Case can be resolved in two ways:

**First Interpretation**

For negligent misrepresentation however, proving carelessness is easier than Scienter for fraud; it’s easier to prove that someone misrepresented than that they had intent to deceive, so it seems like what court is saying is that since it is easier to recover for negligent misrepresentation, they will make it pass the second prong since they don’t want each breach of k to also become a negligent misrepresentation claim.

OR

**Second interpretation**

Court purposely made this NOT be a contort problem: the school district made an error when it sought expectation damages (BOB) when negligent misrepresentation is supposed to get you out-of-pocket damages; since only a breach of K gets **ED** & negligent misrepresentation does not, the court struck it down.

**Moll likes second opinion, so it avoids confusing first**

MOLL’s OPINION: Since tort focuses on discouraging conduct, then the inquiry should focus on duty as Formosa did→ that goes with basic tort idea of vindication public policy.

**Seaman’s v Standard Oil of Cali**

**Facts**: Seaman’s performs various harbor services, have service station at marina type setup. Seaman’s has K with Standard oil to get gasoline. After time passes, Arab oil embargo, massive drop in gasoline happens. Seaman’s went and got a government waiver that allowed standard oil to give Seaman’s oil, all they needed was an affidavit saying the K was signed. Standard Oil representative did NOT do it.

**Tort of bad Faith Denial of an Existing Contract** emerges.

**What is the problem with this kind of tort?** What does it mean. If you say that you didn’t have a K, they can look into your motive for asking it. If they don’t like it, they can hit you with torts.

If you think you enter a K and defendant thinks there was no consideration, can that be considered (or any other defenses→ can all be judged)? Questioning a contract may be denying it OR it may be saying it was made, but it is not legally binding (semantic games can be played to avoid saying you are denying a K, but court will see through it.)

**Point→ “bad faith” defense can get you**

* **Admitting breach but denying any liability – is that bad faith?**
* **Generally, breaching a K is not considered morally wrong (efficient breach)**
* **Ks are about predictability, knowing your obligations, but this case brings that out the window if they think you have a bad faith motive.**

**Freeman Case [M1 pp. 395]**

**Facts:** Belcher oil breaches K; sued for breach of K; plaintiff threw in bad faith for denial of K claim.

**Procedural**: Jury Instruction on bad faith of denial claim

**Issue 1:** whether d acted with malice.. etc.

**Issue 2**: Should we allow this lawsuit to stand.

**Holding:** the purpose of contract damages is to compensate the injured party, NOT to punish them; assigning fault is anathema to contract.

**Contract is obsessed with compensation, not punishment because:**

1. T promotes contract formation by limiting damage to compensation for breaching it; this can be budgeted and this predictability is good.
2. We think efficient breach is a GOOD thing; don’t want to deter them and want to facilitate them→ to do so we must make sure people can quantify potential damages to ensure nobody is worse off, somebody may be better off.
3. We don’t want every potential breach of k to be a tort→ can’t erode the line between tort and K, parties MUST be able to predict getting in and out of a k.

**Mosk Concurrence**

Is there some middle-ground where we should say that some breaches of contract are tort?

* Says it’s okay Seaman’s was overruled, but isn’t sure that it should have been completely overruled.
1. The breach is accompanied by a traditional common law tort, such as fraud or conversion;
2. The means used to breach the K is tortious;
3. One party intentionally breaches the k will cause severe immitigable harm in the form of mental personal hardship, or substantial consequential damages.
1. Establishes an independent reason why plaintiff should not recover, rather than by denying the plaintiff’s claim. [↑](#footnote-ref-1)
2. **Indemnify:** Technically means you pay and they reimburse you. [↑](#footnote-ref-2)