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BUSINESS TORTS

HOW TORT CLAIMS CAN SHAPE
THE NARRATIVE OF A COMMERCIAL DISPUTE

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BUSINESS TORTS

Generally, a tort is a cause of action to recover damages for personal injury or property damage. Under the common law, a person or entity has a property interest in its contracts, its business expectations and its reputation. Thus, where one's wrongful conduct causes damage to any one of these business interests, the injured party may be entitled to damages under one or more common law tort theories. Additionally, states have adopted statutes designed to protect consumers against fraud and/or deceptive practices, which can apply to business-to-business transactions, depending on the state's definition of "consumer" and the nature of the transaction. These tort claims often become the center of a business dispute, shaping the narrative of the litigation, broadening the scope of discovery, and inviting unwanted publicity. Additionally, such claims can increase litigation costs and expose parties to special damage categories such as punitive damages and, sometimes statutorily provided attorney's fees. We will discuss some of the most common business torts and strategies for bringing or defending against business tort claims. Of course, the availability of these torts vary by jurisdiction and clients should always consult with local counsel when evaluating claims and defenses within a specific jurisdiction.

- COMMON LAW FRAUD
  1. General Definition

The Restatement (Second) of Torts provides that "One who fraudulently makes a misrepresentation of fact, opinion, intention or law for the purpose of inducing another to act or to refrain from action in reliance upon it, is subject to liability to the other in deceit for pecuniary loss caused to him by his justifiable reliance upon the misrepresentation." Restatement (Second) of Torts § 525 (1977).

  2. Fraudulent Opinions

In some jurisdictions, fraudulent opinions are not actionable. In such cases, the elements of fraud are as follows: (1) a false statement of *material fact as opposed to opinion*; (2) defendant's knowledge that the statement was false; (3) defendant's intent that the statement induce plaintiff to act; (4) plaintiff's reliance upon the truth of the statement; and (5) plaintiff's damages resulting from reliance on the statement.

A mere expression of opinion, such as statements as to value of property, may not support an action for fraud. However, where the representation is not a mere expression of opinion but is made as a statement of fact for the listener to rely upon, the representation is treated as a statement of fact and the speaker is bound thereby. An opinion may be treated as an expression of fact by implication, as observed by Prosser, in the Handbook of the Law of Torts 4th Ed. s 109, pp. 726, 727 (1971):

> "(I)t has been recognized very often that the expression of an opinion may carry with it an implied assertion, not only that the speaker knows no facts which would preclude such an opinion, but that he does know facts which justify it. There is quite a general agreement that such an assertion is to be implied where the defendant holds himself out or is understood as having special knowledge of the matter which is not available to the plaintiff, so that his opinion becomes in effect an assertion summarizing his knowledge. Thus the ordinary man is free to deal in reliance upon the opinion of an expert jeweler as to the value of a diamond, of an attorney upon a point of law, of a physician upon a matter of health, of a banker upon the validity of a signature, or the owner of land at a distance as to its worth, even though the opinion is that of his antagonist in a bargaining transaction. On the same basis it has been held that statement by a seller as to the capacity of the thing sold, or the condition of land, or other matters, which on the

part of one without special knowledge would be regarded as mere opinion, may be relied on as statements of fact." (footnotes omitted).

Hypothetical 1: Prior to GooseHill's assignment of the purchase contract for TK Apparel to Western Canyon Sports, Western Canyon told GooseHill that their market analysis forecasted the retail sales market to remain stagnant throughout 2021 and potentially continue to plummet. Thus, Western Canyon proposed the discounted purchase price for the assignment of the TK Apparel purchase contract. When the retail sales market began showing signs of recovery in early 2021 as health restrictions eased, GooseHill's management sued Western Canyon for fraudulent inducement alleging that Western Canyon made misrepresentations concerning their market analysis and the value of the TK Apparel purchase contract to induce the sale. Does GooseHill have a claim?

3. Promissory Fraud

Promissory fraud occurs when a party enters into a contract with no intention to perform. The Restatement (Second) of Torts, § 525, provides that misrepresentations of intent are actionable. The Restatement formulates the rule for promissory fraud accordingly: "Since a promise necessarily carries with it the implied assertion of an intention to perform it follows that a promise made without such an intention is fraudulent and actionable in deceit . . . ." Restatement (Second) of Torts, §530 cmt. C (1977).

Of course not every broken promise supports a claim for fraud. Breach of contract is not fraud. Jurisdictions that recognize promissory fraud distinguish such claims from breach of contract with the following qualification: only when the breaching party never intended to perform in the first place is the promise fraudulent.

In litigation, the distinction is not always so clear. Additionally, concerns over proof of the promissor's intent and the prospect that every action for run-of-the-mill breach of contract could be transformed into a fraud case has led some jurisdictions to disallow promissory fraud claims as a general rule with narrow exceptions and/or subject to heightened proof requirements. *See Roda v. Berko,* 401 Ill. 335, 340 (1948) ("It is also the rule that a promise to perform an act, though accompanied at the time with an intention not to perform it, is not such a false representation as will constitute fraud sufficient to predicate thereon a cause of action. However, in cases where the false promises or representation of intention or of future conduct is the scheme or device to accomplish the fraud and thereby cheat and defraud another of his property, equity will right the wrong by restoring the parties to the positions they occupied before the fraud was committed.")(internal citations omitted); *Advent Elecs. v. Buckman,* 918 F.Supp. 260, 265-65 (N.D. Ill. 1996) (requiring proof of a scheme or device to defraud); *Jim-Bob, Inc. v. Mehling,* 443 N.W. 2d 451, 460 (Mich. Ct. App. 1989) (holding that "the evidence of fraudulent intent must relate to conduct by the actor at the time the representations are made or almost immediately thereafter); *Sanders v. First Nat'l Bank,* 114 B.R. 507, 516 (M.D. Tenn. 1990)(requiring "direct proof of a misrepresentation of actual present intention").

4. Heightened Pleading and Evidentiary Considerations

Expect to litigate the pleadings when fraud is alleged. Federal Rule of Civil Procedure 9(b) provides that "In alleging fraud or mistake, a party must state with particularity the circumstances constituting fraud or mistake. Malice, intent, knowledge, and other conditions of a person's mind may be alleged generally." Most states have adopted a heightened pleading requirement similar to Rule 9(b). Additionally, several of the country's busiest jurisdictions, including California, New York, Pennsylvania, Florida, Texas, Missouri, Illinois, New Jersey, Connecticut and Louisiana, require some form of fact pleading that is more exacting than the notice pleading standard employed by the federal courts.

Also, most states require clear and convincing evidence to prove fraud, particularly where punitive damages are sought. During investigation and discovery, and in particular for cases alleging promissory fraud, focus on evidence of intent at the time that the representation was made. If litigating a claim for promissory fraud, consider evidence of intent to perform such as partial performance or changes in circumstances that necessitated the breach.

- TORTIOUS INTERFERENCE WITH EXISTING OR PROSPECTIVE CONTRACTUAL RELATIONS

"One who intentionally and improperly interferes with the performance of a contract (except a contract to marry) between another and a third person by inducing or otherwise causing the third person not to perform the contract, is subject to liability to the other for the pecuniary loss resulting to the other from the failure of the third person to perform the contract." Restatement (Second) of Torts, § 766 (1979). Improper interference with another's prospective contractual relation is also actionable "whether the interference consists of (a) inducing or otherwise causing a third person not to enter into or continue the prospective relation or (b) preventing the other from acquiring or continuing the prospective relation." Restatement (Second) of Torts §766(B) (1979).

When litigating a claim for tortious interference, the central question is the propriety of the defendant's conduct as business competition is not itself actionable and proper free market activity should not be deterred. The Restatement sets out the following factors to consider in determining whether interference is improper:

(a) The nature of the actor's conduct,
(b) The actor's motive,
(c) The interests of the other with which the actor's conduct interferes,
(d) The interests sought to be advanced by the actor,
(e) The social interests in protecting the freedom of action of the actor and the contractual interests of the other,
(f) The proximity or remoteness of the actor's conduct to the interference and;
(g) The relations between the parties.

Hypothetical 2: As public health restrictions eased and the retail sales market began to improve, TK Apparel resolved all of its disputes with its suppliers and vendors amicably based on a mutual desire to continue their business relationship. However, when Northwest Ravine, a competitor of Western Canyon learned that Western Canyon was purchasing a major stake in TK Apparel, and that TK Apparel's business relationship with its suppliers and vendors was nearly compromised, Northwest Ravine successfully convinced TK Apparel's biggest suppliers to enter into exclusive supplier agreements with Northwest Ravine and its subsidiaries, thereby causing the suppliers to terminate all outstanding orders and any future business plans with TK Apparel. Does TK Apparel have an action against Northwest Ravine for tortious interference?

Hypothetical 3: TK Apparel managed to procure a new supplier to replace the vendors lost to Northwest Ravine, and even secured more favorable terms. Northwest Ravine could not use the same exclusive sales terms to entice TK Apparel's new supplier, but did learn that the new vendor's biggest manufacturing facility was operating under a lease set to expire and Northwest Ravine's founder was golfing buddies with the landlord. After making wagers and horse trades over a weekend of golf, Northwest Ravine's founder convinced the landlord to include in the renewed lease a provision that prohibited the supplier from dealing with TK Apparel, which the supplier accepted thereafter terminating its business with TK Apparel. Does TK Apparel have an action against Northwest Ravine and/or its founder for tortious interference?

- BREACH OF FIDUCIARY DUTY/JOINT VENTURE

The duties owed by a fiduciary are far greater than those typically imposed by a contract. As Judge Cardozo put it, the standard owed by a fiduciary is "[n]ot honesty alone, but the punctilio of an honor the most sensitive." *Meinhard v. Salmon,* 154 N.E. 545, 546 (N.Y.1928). Additionally, a fiduciary who breaches his duties can be subjected to additional categories of damages, including punitive damages and disgorgement. Thus, parties to business disputes must give careful attention to the circumstances that could give rise to a fiduciary duty.

Generally, directors are fiduciaries to their corporations. Partners are fiduciaries to the partnership. Additionally, courts in practically all jurisdictions have held that the default duties in partnership (undivided loyalty) also apply to joint ventures. However, whether a joint venture exists is not always clear and can be the subject of litigation. This is particularly true in the context of joint ventures formed between corporations. Indeed, early corporate law prohibited corporations from forming joint ventures, however, these prohibitions were eventually swallowed by judicially created exceptions and legislation. Regardless, the question of whether a joint venture was formed is often the center of a business dispute where a party seeks to impose damages against another entity for some form of violation.

A joint venture is an association of two or more persons or entities to carry out a single, specific enterprise. To prove a joint venture, a plaintiff must establish (1) an express or implied agreement to carry on an enterprise; (2) a manifestation of intent by the parties to be associated as joint venturers; (3) joint interest as shown by the contribution of property, money or knowledge by each joint venturer; (4) joint control or ownership over the enterprise; and (5) the joint sharing of profits and losses.

Whether a joint venture exists is often a factual inquiry, particularly when there is not an express written agreement and a party alleges the existence of an implied agreement to form a joint venture. In evaluating the parties' intent to form a joint venture, emphasis is placed on whether the parties agreed to share profits and losses.

CLOSING

"Never stir up litigation. A worse man can scarcely be found than one who does this."[1] Yet, President Lincoln's advice seems often ignored. Run-of-the-mill contract disputes can evolve into complex cases involving allegations of fraud, betrayal and interference. It is important to understand the nuances of business torts and stay current on developments in the law as there may lie opportunity to narrow the issues in a dispute by separating the pertinent wheat from the colorful, though often irrelevant chaff.

[1] Abraham Lincoln's Notes for a Law Lecture, Collected Works of Abraham Lincoln. Volume 2, p. 81, edited by Roy P. Basler et al., New Brunswick, N.J: Rutgers University Press, 1953.