

Proving Damages Suffered in a Fraud Case

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Legal Principles

- Proximate Cause
- Transaction and Loss Causation
- Foreseeability
- Reasonable Certainty
- Economic Loss Rule

Proximate Cause

- **Defined as:** Causal connection between the fraud and the harm claimed
- **Principle:** Recoverable damages limited to those caused by the wrong
- **Test:** Fraud must be a direct and proximate cause of the loss
- **Two-Part Analysis – Restatement of Torts:**
 - I. Is reliance on the fraudulent misrepresentation a substantial factor in the loss?
 - II. Is loss reasonably expected to result from reliance on the fraudulent misrepresentation?

Transaction and Loss Causation

- **Transaction Causation**
 - “But for” causation
 - “But for” the fraud or misrepresentation, the person would have never entered into the transaction and suffered loss
- **Loss Causation**
 - Present when the defrauded person suffers loss and the loss can be tied to the fraud
 - Uncertainty as to the amount of damages does not bar recovery
- **Federal courts**
 - **Most** require both Transaction and Loss Causation
 - Not all states require – most do not

Foreseeability

- Recovery of damages limited to
 - Foreseeable or
 - Within contemplation of parties at time of misrepresentation
- Proximate cause almost always = foreseeable damages
- Some cases expressly do not make foreseeability a limitation on recoverable consequential damages

Reasonable Certainty

- Reasonable Certainty:
 - i. Degree of certainty expected to be held by the average person
 - ii. Having sound judgment, fair and sensible
 - iii. Moderate expectations
- Multiple cases establish –
 - Damages for fraud (like other tort damages)
 - Must be proven with reasonable certainty

Economic Loss Rule

- Loss unaccompanied by property damage or personal injury
 - Not recoverable in an action alleging negligence or strict liability in the manufacture of a product
- Some cases have held ELR bars recovery of damages for fraud or misrepresentation

Measure of Damages for Fraud

“Benefit of the Bargain” (“BoB”)

Defrauded purchaser of property recovers difference in actual value and represented value

Majority of states follow this rule

“Out-of-Pocket Loss”

Defrauded purchaser limited to the difference between the value of what was given and the value of what was received

Applied consistently in CA, DC, MN, MT, NY, PA (HI has no rule)

Benefit of the Bargain (“BoB”) *Case Example*

Damon v. Sun Co., 87 F.3d 1467 (1st Cir. 1996)

- Sale contaminated gasoline service station
- Plaintiff alleged fraudulent representations that service station was clean - not contaminated
- Court held that:

Value of Uncontaminated Service Station
Less: (-) Actual Value of Contaminated Service Station
Fraud Damages



Benefit of the Bargain (“BoB”)

Sunshine Mills, Inc. v. Ross Systems *Alabama Circuit Court Case*

- Sunshine Mills purchased new accounting and management software system from Ross Systems
- System problems
 - Bugs
 - Not work properly
 - Brought to knees
- Court awarded value of what was promised less value of what was received
- Compensatory \$15MM – Punitive \$45MM



“Out-of-Pocket Loss”

Case Example

Strouth v. Wilkinson, 224 N.W. 2d 511 (Minn. 1974)

- Plaintiffs hired contractor to build house
- Contractor abandoned project
- Second contractor finished house
- House worth less than cost
- Court held :



Amount Expended by Plaintiffs
Less Reasonable Value of the House
Fraud Damages

Consequential Damages

- Recoverable damages caused by reliance on a misrepresentation
- Include damages and/or expenditures proximately caused by reliance on misrepresentation which would not otherwise have been incurred
- In most states allowed in addition to BoB and out-of-pocket damages (*generally*)

Examples

Consequential Damages

- Lost Earnings
- Lost Profits
- Operating Losses and Expenses
- Emotional Distress
- Expense of Investigation
- Attorney's Fees and Litigation Expenses
- Damage to Reputation

Lost Earnings

- *Generally* considered compensable element of consequential damages
- Recoverable in both
 - BoB
 - Out-of-pocket jurisdictions

Lost Profits

- Generally recoverable in BoB states
- Generally not recoverable in out-of-pocket states
 - ***AFA Protective Systems, Inc. v. American Telephone & Telegraph Co., 57 N.Y.2d 912 (NY 1982)***

Lost Profits

- Some out-of-pocket states allow lost profits based on Restatement (Second) of Torts §552B (1976) where the Plaintiff can:
 1. Show justifiable reliance on the negligent misrepresentation
 2. Prove with reasonable certainty

Operating Losses and Expenses

- Recoverable variety of circumstances in action for damages for fraud:
 - Damages to property as a result of the fraud
 - Operating losses from the sale of a business involving a defrauded buyer
 - Expenses incurred by a plaintiff such as the purchase of inventory/equipment, rent, and compensation for time and effort

Emotional Distress

- Sharply divided in courts
 - Courts deny – state that it is a result of the “black letter law”
 - Courts allow – without analysis (terminated employee recovers emotional distress damages for fraud)

Expense of Investigation

- Investigation of opportunity to purchase a property or business, later found to be tainted by misrepresentations of the seller
- Recovered as consequential damages

Attorney Fees, Litigation & Other

- General rule (American Rule) not recoverable in action for fraud with following exceptions
 - i. Tort of another
 - ii. Other (cost to collect & PIB) see 186
 - ***Advantor Capital Corp. v Yeary, 136 F.3d 1259 (10th Cir. 1998)***
 - ***Wilko of Nashua, Inc. v. TAP Realty, Inc., 379 A.2d 798 (N.H. 1977)***
 - iii. Costs of settlement
 - iv. Attorney fees and costs (without litigation)
 - v. Damage to Reputation
- Interest and financing charges generally recoverable

Computation of Damages

- Offsets
- Date measured
- Tax Treatment
- Who Pays
- Evidence
- Expert Testimony
- Price Paid as Evidence of Value
- Owner's Testimony
- Cut-Off Date
- No Double Recovery

Offsets – 2 Options

1. Affirm contract
 1. Retain property
 2. Recover BoB or out of pocket
 2. Rescind contract
 1. Return property
 2. Recover consideration
- If affirm must pay amounts due and if they are unpaid, are offset against the fraud damages

Baeza v. Robert E. Lee Chrysler, Plymouth, Dodge, Inc., 309 S.E.2d 763 (S.C. App. 1983)

Date Measured

- Valuation at date of sale
- Occasionally, valuation near the date of sale is adequate
- Damage rarely measured at the date of discovery of the fraud

Tax Treatment

- Most cases hold that tax benefits or adverse tax consequences are irrelevant to computation of damages on fraud claims
- However, the U.S. Supreme Court has considered the issue of tax offsets in a securities fraud case

Randall v. Lofstgaarden, 478 U.S. 647 (1986)

Who Pays

- Corporate principal
 - An individual or entity acting on behalf of another which give rise to a relationship of trust and confidence
- A corporate agent
 - Personally involved in the commission of the fraud
 - Can be liable for compensatory and punitive damages
 - Agent acting on behalf of the corporation and corporation is also liable

Evidence

- BoB States

Plaintiff must offer evidence of the value of the property received in comparison to the value as represented

- Out-of-Pocket States

Plaintiff must offer evidence of the value of the property received in comparison to the price paid

Expert Testimony

- Expert witness
 - By virtue of education, training, skill, or experience
 - Is believed to have expertise and specialized knowledge in a particular subject beyond that of the average person
 - Will aid the jury
- Testimony in Out of Pocket and BoB is universally held admissible on the question of valuation of property in fraud cases

Price Paid as Evidence of Value

- Occasionally, in BoB jurisdictions, a purchaser will put in evidence as to the purchase price and no other evidence as to the value as represented
- Most courts hold that evidence of the purchase price is sufficient to establish the value of property

Owner's Testimony

- Owner may be qualified to testify as an expert to the value of property in a fraud case
- For example, a business owner can testify to past profits based on their own personal knowledge of his/her business

Cut-Off Date

- Generally – date fraud is discovered
- Once fraud discovered, continued reliance is usually not reasonable
- Continuing a commercial relationship can extend the fraud damages period for “reasonable period”

Clements Auto Co. v. Service Bureau Corp., 444 F.2d 169 (8th Cir. 1971)

No Double Recovery

Significant, complex analysis required to determine double recovery

Ostanzo Commerzanstalt v. Telewide Systems, Inc., 880 F.2d 642 (2nd Cir. 1989)

Plaintiff cannot recover both benefit of bargain damages for breach of contract and warranty and out-of-pocket expenses for fraud

Brown v. Richards, 840 P.2d 143 (Utah App. 1992)

Purchaser cannot retain ownership of stock for the amount paid and receive fraud damages

Nominal Damages

- An award of a trifling sum
 - Usually where evidence fails to show the amount of loss (absence of proof of compensatory damages)
- Split in authority
- Nominal damages show wrong has occurred even though no compensatory damages are awarded
 - In most jurisdictions, nominal damages support award of punitive damages even in absence of compensatory damages

Punitive Damages

- Recoverable in most states
 - Level of culpability required varies significantly from state to state
 - Same Standard as Fraud
 - If a fraud is proven, then punitive damages may be awarded*
 - Lesser Standard than Fraud
 - “Fraudulent breach of contract”*
 - Higher Standard than Fraud
 - A higher standard of culpability is required than simply proof of fraud*
- Sessums v. Northtown Limousines, Inc., 664 So. 2d 164 (Miss. 1995)*
- Jugan v. Friedman, 646 A.2d 1112 (N.J. 1994)*

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