

4-1-1999

Fraud, Freedom, and Fundamental Fairness: Getting Beyond the Economic Loss Rule

Benjamin England

Follow this and additional works at: <https://repository.law.miami.edu/umlr>

Recommended Citation

Benjamin England, *Fraud, Freedom, and Fundamental Fairness: Getting Beyond the Economic Loss Rule*, 53 U. Miami L. Rev. 505 (2015)

Available at: <https://repository.law.miami.edu/umlr/vol53/iss3/6>

This Comment is brought to you for free and open access by the Journals at University of Miami School of Law Institutional Repository. It has been accepted for inclusion in University of Miami Law Review by an authorized editor of University of Miami School of Law Institutional Repository. For more information, please contact library@law.miami.edu.

COMMENTS

Fraud, Freedom, and Fundamental Fairness: Getting Beyond the Economic Loss Rule

I. INTRODUCTION	505
II. BENEATH THE SURFACE OF THE ECONOMIC LOSS RULE	509
A. <i>Fraud in the Inducement</i>	512
1. "OOPS! I JUST MADE A CONTRACT!"	513
2. "I KNOW YOU THINK YOU KNOW WHAT I PROMISED"	514
B. <i>Fraud in the Performance</i>	515
III. CLEARING THE FIELDS ON FRAUD IN THE INDUCEMENT	518
IV. FREE TO BE STUCK, STUCK WITH YOUR CHOICE, CHOOSING A REMEDY	524
A. <i>A Summary of Florida's Law on Liquidated Damages</i>	526
B. <i>Big Lies and Little Lies</i>	528
C. <i>If This is Freedom, I'll Do Without</i>	529
D. <i>When Tort and Contract Collide</i>	531
E. <i>To Protect or Not to Protect?</i>	537
V. CONCLUSION	537

I. INTRODUCTION

Bob Owner, Chief Executive Officer of privately held company XYZ, was contacted by Jane Acquiror, a young and energetic merger and acquisition entrepreneur who was acquiring new companies to develop for public trading. Based upon Owner's offer to sell XYZ for \$1,250,000, Acquiror's certified public accountant conducted an extensive audit of XYZ's financial records to determine the company's net worth and the potential for a merger with another of its publicly held corporations. After reviewing XYZ's records, Acquiror's accountant estimated XYZ to be worth \$1,500,000.

During subsequent negotiations, XYZ's Chief Operations Officer, John Leaker, expressed concern to Acquiror about her accountant's valuation of XYZ. Leaker warned Acquiror to "watch Owner because he's a snake." When Acquiror confronted Owner about XYZ's current value, Owner reminded her that her own financial advisor's analysis produced the figure upon which they both were relying.

Acquiror continued the negotiations for the purchase of XYZ; however, she began to concentrate on obtaining a warranty that provided a concrete guarantee as to the business' financial condition. Owner was reluctant to do more than orally vouch for XYZ's general condition. Acquiror agreed to an alternative approach when Owner offered to include a liquidated damages clause in the sales contract. The clause

provided that, should the net worth of the business actually be valued at less than \$1,000,000, Owner would pay liquidated damages in the amount of \$50,000 plus 15% of the difference between the business' actual net worth and \$1,000,000. The contract for sale foreclosed all expressed and implied warranties.

Both parties vigorously negotiated the terms of the agreement to sell XYZ and, based partly upon the recommendation of her financial advisor, Acquiror believed she was sufficiently protected from any potential fraud that Owner may have attempted to perpetrate while striking the bargain.

Relying on the negotiations and the written agreement, Acquiror accepted Owner's modified offer to sell XYZ for \$1,150,000. Prior to the sale, Acquiror found it necessary to make adaptations in the operations of another one of her businesses in preparation for enfolding XYZ into her portfolio of corporations. These adjustments cost Acquiror \$75,000 and involved personnel and office relocations.

After the sale, Acquiror began operations at XYZ with minor adaptations and raised additional revenue from the sale of publicly traded stock. She eventually discovered numerous fraudulent transactions in XYZ's financial records. These cleverly concealed transactions were associated with various government contracts. Several of these transactions were outstanding and, if executed, would create potential and severe liabilities for contract fraud against the government to Acquiror and to her new investors. The outstanding transactions, reflected as accounts receivable, were worth \$375,000 and were included in the net worth analysis performed by Acquiror's own accountant.

Acquiror sued Owner in contract under the liquidated damages clause and in tort pleading fraud in the inducement of the contract. In her tort claim, she sought the difference between her recoverable amount under the liquidated damages clause and the contract price. She also prayed for relief for the \$75,000 spent in adjustments to her other businesses and for punitive damages. Owner moved to dismiss Acquiror's claim of fraud in the inducement of a contract arguing that it violated Florida's economic loss rule. Owner contended that Acquiror bargained for a remedy, the liquidated damages clause, which specifically addressed the value of the business. Therefore, he argued, her remedy should be restricted to the terms of the sales contract. Additionally, he argued that absent reliance, contract law precluded recovery for preparation to perform a contract, so he should not be liable for the \$75,000 Acquiror spent to make her business adjustments.

The above scenario presents several problems, some of which Florida courts have been wrestling with for many years, others of which are

sure to follow. Florida's economic loss rule is arguably one of the last bulwarks that separates tort law from contract law. Of the various theories advanced for its operation, each posits that the economic loss rule precludes recovery for mere pecuniary loss if no personal injury or property damage has been sustained. From this common ground, the theories have diverged, both in the literature and from the bench. As a result, Judge Lazzara of the Second District Court of Appeal recently lamented that "the economic loss rule is stated with ease but applied with great difficulty."¹

Florida's economic loss rule finds its doctrinal origins in a California Supreme Court case, *Seely v. White Motor Co.*² In *Seeley*, Justice Traynor denied the plaintiff's strict liability claim where a defectively manufactured pickup truck overturned but caused no physical injury to the plaintiff or his property.³ Justice Traynor limited the plaintiff's claim to contract and held that if no physical injury resulted from the defective product, the manufacturer should not "be held liable to the level of performance of his products in the consumer's business unless he agrees that the product was designed to meet the consumer's demand."⁴

Following Justice Traynor's reasoning, the Florida Supreme Court first used the economic loss rule to preclude tort liability in *Florida Power & Light Co. v. Westinghouse Electric Corp.*⁵ Since that case, the economic loss rule has been used by Florida courts to bar recovery for actions brought in tort for negligence,⁶ fraud,⁷ conversion,⁸ civil theft,⁹ Florida RICO,¹⁰ and breach of fiduciary duty¹¹.

This progressive degeneration of tort liability in Florida eventually came to a halt in 1996. In *Woodson v. Martin*,¹² the Florida Supreme Court held that a separate tort action could co-exist with a breach of contract claim even though both allegations resulted in economic loss. The case involved a claim of fraud in the inducement of a contract.¹³

1. *Delgado v. J.W. Courtesy Pontiac GMC Truck, Inc.*, 693 So. 2d 602, 606 (Fla. 2d DCA 1997).

2. 403 P.2d 145 (Cal. 1965).

3. *Id.* at 151.

4. *Id.*

5. 510 So. 2d 899 (Fla. 1987).

6. *See Moransais v. Heathman*, 702 So. 2d 601 (Fla. 2d DCA 1997).

7. *See CWoodson v. Martin*, 663 So. 2d 1327 (Fla. 2d DCA 1995).

8. *See Airlines Reporting Corp. v. Atlantic Travel Serv.*, 841 F. Supp. 1166 (S.D. Fla. 1993).

9. *See Sarkis v. Pafford Oil Co., Inc.*, 697 So. 2d 524 (Fla. 1st DCA 1997).

10. *See Ginsberg v. Lennar Florida Holdings, Inc.*, 645 So. 2d 490 (Fla. 3d DCA 1994).

11. *See Karn v. Caldwell Banker Residential Real Estate, Inc.*, 23 Fla. L. Weekly D339 (Fla. 4th DCA Jan. 28, 1998).

12. 685 So. 2d 1240, 1241 (Fla. 1996).

13. *See id.*

This case turned the tide on the previous tendencies of Florida courts to prevent separate independent tort theories for recovery of pecuniary losses when there was a contract between the parties.

One difference in cash value between contract and tort claims is the availability of punitive damages.¹⁴ As in the above hypothetical scenario, the question arises whether Bob Owner should be subject to punitive damages for fraud in the inducement of the contract to sell XYZ. Recall that Jane Acquiror sought a warranty guaranteeing the financial condition of XYZ Corporation. In the contract for sale of XYZ, Owner and Acquiror specifically negotiated a liquidated damages clause that addressed the corporation's value, the very factor upon which Acquiror later alleged Owner defrauded her. It is not difficult to conclude that Acquiror bargained for and obtained her remedy under the contract and should be limited to it. So, whether she will recover more than the amount provided for under the liquidated damages clause depends upon whether the clause is valid under Florida law. If it is valid, then it must be determined whether the public policy considerations underlying the validity of such remedial clauses would be undercut by permitting Acquiror to claim tort damages for the very conduct which the liquidated damages clause was intended to remedy.

An elementary principle in construing the validity of a liquidated damages clause is whether it can be fairly characterized as a penalty clause.¹⁵ Contract law traditionally has had a particular distaste for penalties and promotes the efficient breach of contract for the benefit of the public economy in which contracts usually arise.¹⁶

This article addresses these issues at length and argues that, given the recent fall of the economic loss rule in regards to fraud in the inducement, it is not sound to permit a liquidated damages clause (or any other remedial clause) to drag the tort claim into the contract claim and preclude traditional tort remedies. Part II deals with the line of cases that developed prior to the Florida Supreme Court's ruling in *Woodson v. Martin*¹⁷ and examines the self-contradictory language in an earlier principal case which created the conflict in the district courts of appeal. Part III addresses the Florida Supreme Court's reversal of the trend to preclude fraud in the inducement based upon the economic loss rule. Part IV examines Florida's policies on liquidated damages clauses and how they conflict with tort law policies in general. This section also offers a potential solution to resolving the choice of law problem by borrowing

14. See *Williams v. Peak Resorts Int'l. Inc.*, 676 So. 2d 513, 521 (Fla. 5th DCA 1996).

15. See *Humana Medical Plan, Inc. v. Jacobson*, 685 So. 2d 904 (Fla. 4th DCA 1996).

16. See E. ALLAN FARNSWORTH, *CONTRACTS*, § 12.3 at 847 n.3 (2d ed. 1990).

17. 685 So. 2d 1240 (Fla. 1996).

principles from Florida's conflict of law rules. Part V draws conclusions from the analysis and argues that a tort claim should not be barred in a case where a liquidated damages clause purports to deal with the subject matter that is also the basis for a fraud.

Contract law is designed to regulate reciprocal promises between parties who stand in some relation to one another.¹⁸ Conversely, tort law predominantly addresses general breaches of duties owed to the public.¹⁹ This article argues that permitting a party to intentionally defraud another while punishing the defrauded party for attempting to protect herself from pecuniary loss naturally resulting from a potential fraud, is contrary to both contract and tort law policy principles.

Notwithstanding a liquidated damages clause in a contract to cover the very factor which is the subject of a fraud inducing the contract, the fraud should remain a viable independent action permitting recovery for damages above and beyond those remedied by the liquidated damages clause. A contrary conclusion would turn both contract law and tort law on their respective heads. Nevertheless, for a period of several years, Florida courts were precluding fraud in the inducement claims in cases where the plaintiff could only plead economic losses.

II. BENEATH THE SURFACE OF THE ECONOMIC LOSS RULE

The economic loss rule is a creature of tort law and represents one of the most significant common law limits on tort liability.²⁰ Stated in its simplest terms, the economic loss rule operates as a common law denial of tort remedies when, in the context of a contractual relationship, the only losses sustained by a party are pecuniary.²¹ The Florida Supreme Court has determined that such pecuniary interests are more appropriately protected by contract principles than by tort principles.²² In this sense, the rule acts as a contract-law limit on a tort-law claim.²³ The Florida Supreme Court in *Casa Clara* acknowledged the role that

18. See FARNSWORTH *supra* note 16, § 1.1, at 4.

19. See JOHN W. WADE ET AL., PROSSER, WADE AND SCHWARTZ'S CASES AND MATERIALS ON TORTS, 1 (9th ed. 1994).

20. See *id.* at 459 n.2.

21. In commercial settings, the majority rule defines "economic loss" or "damage" as the loss of the benefit of a buyer's bargain. 63B AM. JUR. 2D § 1909 (1996).

22. See *Casa Clara Condominium Assn v. Charley Toppino & Sons, Inc.*, 620 So. 2d 1244, 1246 (Fla. 1993).

23. The *Casa Clara* court characterized the issue in the following statement: "When only economic harm is involved, the question becomes 'whether the consuming public as a whole should bear the cost of economic losses sustained by those who failed to bargain for adequate contract remedies.'" 620 So. 2d at 1247 (quoting Sidney R. Barrett, Jr., *Recovery of Economic Loss in Tort for Construction Defects: A Critical Analysis*, 40 S.C. L. REV. 891, 933 (1989)). The consuming public is protected by tort duties where as interests of parties to a contract are protected by the terms of the contract itself.

the economic loss rule plays in separating two distinct bodies of Florida law stating, "[t]he rule is 'the fundamental boundary between contract law, which is designed to enforce the expectancy interests of the parties, and tort law, which imposes a duty of reasonable care and thereby encourages citizens to avoid causing physical harm to others.'"²⁴

Although the supreme court in *Casa Clara* established a reasonable and necessary distinction between legal theories, and the economic rule may assist courts in keeping basic fundamental principles in their proper legal perspectives, it did not play out so neatly for the *Casa Clara* plaintiffs. *Casa Clara* was framed as a breach of implied warranty, negligence, and product liability case, where the defendant allegedly manufactured concrete which was too high in salt content for use in reinforced concrete block building construction.²⁵ The high salinity caused the steel reinforcement bars to rust over time.²⁶ The concrete was sold to and used by a general contractor in the construction of the plaintiffs' condominiums and the expanding re-bar produced progressive cracks which ultimately led to the concrete breaking off and falling to the ground.²⁷ In its ruling, the Supreme Court essentially told the plaintiffs that they should strike better bargains in their home-buying negotiations.²⁸ The Court thereby lowered the economic-loss-rule boom on the plaintiffs' claims.

The unnerving aspect of this landmark case²⁹ is that the plaintiffs were not in privity with the concrete manufacturer's contract with the general contractor.³⁰ Therefore, the plaintiffs could not have bargained for the salinity content in the concrete. They were without a remedy — whether in contract³¹ or tort³² — because they should have bartered better in their home buying.³³

Justice Barkett dissented, acknowledging this catch-22. She argued that the plaintiffs' lack of privity with the concrete manufacturer was a fact which should have permitted them to circumvent the economic loss rule because the rule's purpose would not be furthered by its application

24. *Casa Clara*, 620 So. 2d at 1246 (quoting Barrett, *supra* note 23) (citations omitted).

25. *See id.* at 1245.

26. *See id.*

27. *See id.*

28. *See id.* at 1247.

29. *See* Geri Lynn Mankoff, *Florida's Economic Loss Rule: Will it Devour Fraud in the Inducement Claims When Only Economic Damages Are at Stake?* 21 NOVA L. REV. 467, 469, 473 (1996); Paul J. Schweip, *The Economic Loss Rule Outbreak: The Monster That Ate Commercial Torts*, 69 FLA. B.J. 34, 38 (1995).

30. *See Casa Clara*, 620 So. 2d at 1245.

31. The plaintiffs' breach of warranty claims were dismissed for lack of privity. *See id.* at 1248 (Barkett, C.J., dissenting).

32. The court barred their tort claim based upon the economic loss rule. *See id.* at 1248.

33. *See id.* at 1247.

in this case.³⁴ In Barkett's analysis, the economic loss rule's underlying principle was that parties in a business context have the ability to allocate economic risks and remedies as part of their contractual negotiations.³⁵ Based upon their lack of privity with the manufacturer, the plaintiffs did not possess this ability.³⁶

Justice Shaw also dissented, but on a different theory.³⁷ Granting that "under a negligence theory, purely economic loss cannot be recovered by parties to a contract when the loss is to the property that is the subject of the contract,"³⁸ Justice Shaw did not see the necessary basis in *Casa Clara* for applying the doctrine. His argument was that the plaintiffs' injuries were reasonably foreseeable to the defendant concrete manufacturer and, notwithstanding privity, they should have been permitted to recover from the defendant's defective product as "innocent third parties," having been injured by a defective product.³⁹

Consequently, the majority's catch-22 leached into the two dissenting opinions, one arguing that the rule's purpose would not be furthered by such an application, the other arguing that reasonable foreseeability should have permitted the imposition of liability on the defendant for injuries sustained by innocent third parties.

The majority in *Casa Clara* twice cited *AFM Corp. v. Southern Bell Telephone & Telegraph Co.*,⁴⁰ wherein the Florida Supreme Court stated that "without some conduct resulting in personal injury or property damage, there can be no independent tort flowing from a contractual breach which would justify a tort claim solely for economic losses."⁴¹ Noting that each of these cases was brought as a negligence based tort claim, the Florida Supreme Court's strong language led lower Florida courts to bar similar negligence-based claims where there existed a contract between the parties and the plaintiffs had suffered no physical injury or property damages. However, even the majority could not have foreseen that the *Casa Clara* catch-22, in lieu of *AFM Corp.*'s seemingly categorical use of the economic loss rule, would have resulted in fraud-based intentional torts also falling prey to the rule.⁴² Lower Flor-

34. *See id.* 1248 (Barkett, C.J., dissenting).

35. *See id.*

36. *See id.*

37. *See id.* at 1248 (Shaw, J., dissenting).

38. *Id.*

39. *Id.* at 1249.

40. 515 So. 2d 180 (Fla. 1987).

41. *Id.* at 181-82.

42. *See Hoseline v. U.S.A.*, 40 F.3d 1198 (11th Cir. 1995) (finding that the economic loss rule bars action for fraud and civil theft based upon breach of contract); *Richard Swaebe, Inc. v. Sears World Trade, Inc.*, 639 So. 2d 1120, 1121 (reversing awards of punitive damages and fraud because of the economic loss rule).

Florida courts began to routinely dismiss intentional tort claims where the only damages suffered were pecuniary and there was a contract between the parties addressing the subject matter of the fraud. Consequently, this issue repeatedly found its way into law review journals as Florida courts (state and federal alike) began to utilize the economic loss rule to dismember fraud in the inducement of a contract as a claim independent from the breach of contract.

A. *Fraud in the Inducement of a Contract*

Florida's common law fraud in the inducement of a contract as a tort theory as rooted in over 800 years of English common law.⁴³ It represents an abuse of the contract bargaining process in general and has been seen as a "wrong" characteristic of tort law.⁴⁴ It does not sound in contract partly because it arises before the terms of the contract are defined.⁴⁵ Nonetheless, contract law treatises cannot avoid the topic of fraud in the inducement due to its close relation to contract law. At least one contract law writer classifies its elements as: (1) an assertion that is not in accord with the facts; (2) which is fraudulent (intentional) in nature and related to a material issue; (3) which assertion is relied upon by the recipient; and (4) upon which reliance must be justifiable.⁴⁶ The Florida Supreme Court has held that the recipient of an assertion "may rely on the truth of a representation, even though its falsity *could* have been ascertained had he made an investigation, unless he knows the representation to be false or its falsity is obvious to him."⁴⁷ The Supreme Court has articulated the essential elements of a fraudulent misrepresentation as "(1) a false statement concerning a material fact; (2) the representor's knowledge that the representation is false; (3) an intention that the representation induce another to act on it; and, (4) consequent injury by the party acting in reliance on the representation."⁴⁸

43. See *Woodson v. Martin*, 663 So. 2d 1327, 1330 (Fla. 2d DCA 1995) (Altenbernd, J., dissenting).

44. See WADE, *supra* note 19, at 1013.

45. For a more extensive explanation of this statement, see *infra* notes 49-51 and accompanying text.

46. See FARNSWORTH, *supra* note 16, § 4.12, at 260. Farnsworth notes that a "close question may be presented if the recipient made an independent investigation of the fact asserted" but distinguishes between an instance where the recipient relies solely upon her own investigation and a case where the "investigation tended to confirm the misrepresentation but was somewhat inconclusive."

47. *Besett v. Basnett*, 389 So.2d 995, 997 (Fla. 1980) (adopting RESTATEMENT (SECOND) OF TORTS §§ 540-41 (1976)) (emphasis added). Stated another way, the recipient of an asserted fact is not under a duty to discover an affirmative misrepresentation made by the one asserting it.

48. *Johnson v. Davis*, 480 So.2d 625, 627 (Fla. 1985).

1. "OOPS! I JUST MADE A CONTRACT!"

To find the proper place for fraudulent inducement, whether in tort law or contract law, it is essential to distinguish between classic and modern contract theories. Contrary to the classic view of contracts⁴⁹, modern contract law, largely relying on the Uniform Commercial Code (UCC) and the Restatement (Second) of Contracts, does not look for a particular time when the contract suddenly exists and immediately before which time it did not.⁵⁰ Classic contract theory looked for a definite offer and an expression of acceptance, without which a contract could not exist.⁵¹ Prior to the acceptance of an offer, the parties were in a stage of pre-contract negotiation during which no contractual duties had yet arisen between them. They were, however, as subjected to tort duties as they would have been to all other persons, irrespective of whether a contract resulted from the negotiation process.

Under the classic view, fraudulent inducement of a contract fit neatly as a tort theory, separate and independent from contract, because the alleged fraud occurs prior to the existence of any contractual duties. Thus, parties alleging fraud in the inducement were in fact alleging a wrong which arose prior to the contract, the result of which was the contract which the complaining party usually had partly performed without the anticipated performance from the opposing party.

In contrast, modern contract theory has interwoven the negotiation process into the process of contract. It arguably has eliminated the moment of the "making" of a contract. To best illustrate this, one need look no further than article 2 of the UCC⁵² or to the Restatement (Second) of Contracts.⁵³ For example, the UCC has cast aside the pre-requisite of finding the "moment of [a contract's] making" before finding that a contract exists.⁵⁴ Contract generally is perceived as a process under this modern view and encompasses negotiation, performance, and enforcement. Modern statutes that follow the UCC allow for interpretation of the terms of an agreement by looking to the course of the parties' performance.⁵⁵ Comment 1 to section 2-208 of the UCC notes, "The

49. See FARNSWORTH, *supra* note 16, §§ 3.1-3.5, at 112-18.

50. See STUART MACAULAY ET AL., *CONTRACTS: LAW IN ACTION* 193-94 (1995). Macaulay et al., note that the Restatement (Second) of Contracts "invites courts to abandon the old religion and follow the [Uniform Commercial] Code's approach in areas other than sales of goods where Article 2 applies." *Id.* at 194.

51. See FARNSWORTH, *supra* note 16, § 3.6, at 118-120.

52. See U.C.C. § 2-208 (1990).

53. See RESTATEMENT (SECOND) OF CONTRACTS § 33.

54. See U.C.C. § 2-204(2) (1990); FLA. STAT. ANN. § 672.204(2) (West 1993).

55. See U.C.C. § 2-208 (1990); FLA. STAT. ANN. § 672.208 (West 1993); *see also* Lalow v. Codomo, 101 So.2d 390, 393 (Fla. 1958) ("the actions of the parties may be considered as a means of determining the interpretation that they themselves have placed upon the contract");

parties themselves know best what they have meant by their words of agreement and their action under that agreement is the best indication of what that meaning was."⁵⁶

Even more provocative in modern contract theory than course of performance is the UCC's introduction of course of dealing.⁵⁷ Where course of performance is used to interpret what the parties intended in their *past* agreement, course of dealing looks forward with the proactive effect of coloring the *future* negotiation process.⁵⁸ Section 1-205(1) of the UCC states that "[a] course of dealing is a sequence of previous conduct between the parties to a particular transaction which is fairly to be regarded as establishing a common basis of understanding for interpreting their expressions and other conduct."⁵⁹

Therefore, conduct and conversations during the negotiation process are not inconsequential to the interpretation of the resulting contract. However, even under the modern view, these issues are addressed in terms of contract doctrine. Consequently, contract treatises now address the negotiation process and negotiation-based topics such as fraudulent inducement. This raises the questions of whether modern contract principles, having interwoven the negotiation phase into the process of contract, also has usurped fraudulent inducement from tort law, and whether the economic loss rule is merely the doctrinal expression of this modernization.

2. "I KNOW YOU THINK YOU KNOW WHAT I PROMISED."

Fraud in the inducement is addressed in contract law for yet another reason. When a bargaining party intentionally misleads the negotiation process by asserting untrue facts, his actions may be interpreted as making promises which he never intended to keep. Thus, if a contract actually is formed, it is nonetheless doomed before the parties undertake any performance and the defrauded party's expectation will be disappointed.

John E. Murray Jr., *The Chaos of the "Battle of the Forms": Solutions*, 39 VAND. L. REV. 1307, 1314 (Oct. 1986) (arguing that "[b]ecause the [contracting] parties should be permitted to modify their factual bargain without technical interference, their course of performance not only will provide the strongest evidence of their contract's intended meaning; it also will operate to overcome their previously expressed terms") (citing U.C.C. § 2-208(2) (1990)).

56. U.C.C. § 2-208, cmt. 1 (1990); cf. FLA. STAT. ANN. § 672.208 cmt. 1 (West 1993).

57. See U.C.C. § 1-205 (1990); cf. FLA. STAT. ANN. § 671.205 (West 1993).

58. See *id.*

59. *Id.*; see also *Kiwanis Club of Little Havana v. Kalafe*, 723 So. 2d 838 (Fla. 3d DCA 1998) (holding that a written contract can be modified by subsequent oral agreement between the parties or by the parties' course of dealing.); see also Aremana G. Bennett, *Diminishing Returns: Doing Without a Provision for Implied Warranty Disclaimers Through Dealing, Performance and Usage*, 41 CLEV. ST. L. REV. 1, 14 (1993).

This observation raises the question as to whether the recipient of a false representation has a contract claim, tort claim, or both.

It has been held by at least one Florida court that the mere promise to perform X, along with a specific intent to not perform X, is sufficient to plead fraudulent inducement if the promise induced the recipient to enter an agreement.⁶⁰ The only difference between that scenario and the simplest form of willful breach of a contract, which has been held by Florida courts to not amount to a fraud claim,⁶¹ is the presence of specific intent during the negotiation process. This requires a turn in the analysis to a determination of what assurances the parties to that negotiation phase may claim under the law.

For example, if the court follows the modern contract view as espoused by the UCC and adopted by Florida's legislature, then the negotiation phase is to be considered part of the overall contract process. Therefore, wrongs committed during that phase might be best addressed in a contract claim, if a contract resulted from the negotiations. If, on the other hand, a court is willing to separate the negotiation process from the contract itself, then based upon classic contract theory, it could rely on the fact that the wrong was committed before any contract existed. Under the classic theory, tort law properly applies because no contract was in existence at the precise time the wrongs were committed. In addition to the tort claim, any resulting breach of contract could be addressed by traditional contract remedies, including any remedial clauses found in the written agreement.

It is apparent from the above discussion that, with both tort law and contract law bearing down upon a fraud in the inducement claim, each bringing with them their attendant public policies and foundational principles, the question as to which should govern overlapping issues has become difficult to answer. Fraud in the inducement, however, must be distinguished from fraud in the performance. The latter is by no means a tort claim, and the line between the two is not always so easily perceived.

B. *Fraud in the Performance of a Contract*

Fraud in the inducement must be carefully distinguished from fraud in the performance of a contract. Alleged fraud in the performance of a contract, which cannot be fairly distinguished from a willful breach of the contract, remains barred by the economic loss rule.⁶² For example,

60. See *Century Property, Inc., v. Machtinger*, 448 So. 2d 570, 572-73 (Fla. 2d DCA 1984).

61. See, e.g., *McCutcheon v. Kidder, Peabody & Co.*, 938 F. Supp. 820, 824 (S.D. Fla. 1996).

62. See *Dantzler Lumber & Export Co. v. Bullington Lumber Co.*, 968 F. Supp. 1543 (M.D. Fla. 1997).

in *Dantzler Lumber & Export Co. v. Bullington Lumber Co.*, a lumber distributor asserted a fraud claim against a lumber manufacturer for "strawberry packing" lumber shipped to the distributor.⁶³ The U.S. District Court for the Middle District of Florida applied state law and held that this activity, though fraudulent, did not constitute a fraud which could independently support a tort claim.⁶⁴ In fact, the contract between the distributor and the manufacturer specifically addressed the quality of lumber to be delivered.⁶⁵ The court precluded the distributor's fraud claim against the manufacturer citing the economic loss rule as a bar to suit.⁶⁶

The *Dantzler* court also noted that the distributor failed to allege any wrongful acts by the manufacturer which were not specifically addressed in the contract between them. Rather, this claim was a "fraud claim, 'where the only misrepresentation by the dishonest party concern[ed] the quality or character of the goods sold . . .'"⁶⁷ The court concluded that the claim was barred by the economic loss rule because the contract addressed the very wrong (breach) which the plaintiff alleged as an intentional tort.

The *Dantzler* court upheld the following three principles in Florida law regarding tort claims that may survive independently of contract remedies. First, "the intentional acts must be independent from the acts that breached the contract."⁶⁸ Second, a plaintiff's fraud claim is barred by the economic loss rule if the facts surrounding the tort claim are "interwoven" with the facts surrounding the breach of contract claim.⁶⁹ Finally, an independent tort "requires proof of facts separate and distinct from the breach of contract."⁷⁰

The *Dantzler* court then established a test to determine whether a fraud claim "revolves around the performance of the contract."⁷¹ The court concluded that "if claims relate to fraud in the performance, the

63. *Id.* at 1544-45. "Strawberry packing" occurs when unacceptable or non-conforming lumber is hidden inside a layer of good lumber making it impossible to see the poorer-quality lumber. In this case the distributor shipped the lumber to its customers and did not discover the manufacturer's fraudulent performance until it was brought to their attention by their customers.

64. *See id.* at 1546.

65. *See id.*

66. *See id.* at 1548.

67. *Id.* at 1546 (quoting *Huron Tool & Engineering CO. v. Precision Consulting Servs.*, 532 N.W.2d 544, 545 (Mich. 1995)). *Huron Tool* was cited with apparent approval by the Florida Supreme Court in *HTP, Ltd. v. Lineas Aereas Costarricenses, S.A.*, 685 So. 2d 1239, 1240 (Fla. 1996).

68. *AFM Corp. v. Southern Bell Tel. & Tel. Co.*, 515 So. 2d 180, 181 (Fla. 1987).

69. *See Serina v. Albertson's, Inc.*, 744 F.Supp. 1113, 1117-18 (M.D. Fla. 1990).

70. *HTP, Ltd.*, 685 So. 2d at 1239.

71. *Dantzler Lumber & Export Co.*, 968 F.Supp. at 1546 (citing *HTP, Ltd.*, 685 So. 2d at 1240).

economic loss rule will preclude fraud recovery Even allegations that the fraud induced the plaintiff to perform additional acts and incur additional expenses will not raise the fraud to an acceptable level of independence.⁷²

A particularly salient articulation of why fraud in the performance of a contract is limited to contractual remedies was provided by the Southern District of Florida in *McCutcheon v. Kidder, Peabody & Co.*⁷³ That court stated that:

[w]here a contract exists, and a plaintiff asserts a claim for fraud in the breach, this is essentially the equivalent of a claim that the breach was willful. A claim for willful breach of contract is still a claim for breach of contract, and does not give rise to tort remedies, e.g., punitive damages, no matter how oppressive the breach.⁷⁴

This is not to imply that independent torts that arise alongside a breach of contract are not recoverable. What the courts will seek are separate elements in these causes of action based upon separate facts which are not so closely “intertwoven” with the breach of contract as to make them merely part of the breach itself.⁷⁵ The Southern District of Florida drew this distinction in *Future Tech International, Inc., v. Tae Il Media, Ltd.*,⁷⁶ where it observed that the mere existence of a contract claim “does not automatically vitiate all causes of action in tort.”⁷⁷ Thus, even though contractual remedies must be sought to recover for claims that expressly or essentially seek damages for economic losses attendant to breach of contract, a plaintiff does not face an absolute bar to tort claims. The *Future Tech* court found it necessary to separate tort and contract law from each other in order to:

foster the reliability of commercial transactions. Where the parties have limited liability and allocated risk by agreement, tort remedies should not be allowed to supersede the parties’ prior understanding of the consequences of deficient performance. Contractual duties are imposed by agreement between the parties; the scope of those duties and liability in the event of their breach is limited by the agreement. Tort duties, by contrast, are imposed by society, may not always be limited by the understanding of the parties, and can give rise to more punitive remedies if a breach occurs. As observed by the Eleventh

72. *Dantzer*, 968 F.Supp. at 1546 (citing *HTP, Ltd.*, 685 So. 2d at 1240 (citing *Williams Elec. Co., Inc. v. Honeywell, Inc.*, 772 F. Supp. 1225, 1238 (N.D. Fla. 1991))).

73. 938 F. Supp. 820 (S.D. Fla. 1996).

74. *Id.* at 824 (citing *Leisure Founders, Inc. v. CUC Int’l, Inc.*, 833 F. Supp. 1562, 1572 (S.D. Fla. 1993)).

75. *See Leisure Founders*, 833 F. Supp. at 1572.

76. 944 F. Supp. 1538 (S.D. Fla. 1996).

77. *Id.* at 1566 (citing *Kee v. National Reserve Life Ins. Co.*, 918 F.2d 1538, 1543 (11th Cir. 1990)).

Circuit, however, "[t]ort claims can be appropriate under Florida law where there is some wrongful conduct which amounts to an independent tort in addition to the conduct resulting in the contractual breach."⁷⁸

Similarly, the Florida Supreme Court in *AFM Corp. v. Southern Bell Telephone & Telegraph Co.*,⁷⁹ noted that "a breach of contract, alone, cannot constitute a cause of action in tort It is only when the breach of contract is attended by some additional conduct which amounts to an independent tort that such breach can constitute negligence."⁸⁰

III. CLEARING THE FIELDS ON FRAUD IN THE INDUCEMENT

After *Casa Clara*⁸¹ and *AFM Corp.*,⁸² Florida courts began to significantly diverge on the question as to whether the economic loss rule would bar a claim for fraud in the inducement of a contract.⁸³ In particular, two opposing appellate court decisions came to the Florida Supreme Court in 1995.⁸⁴ One common issue presented was whether fraud in the inducement was barred by the economic loss rule.

Theoretically speaking, if a party misrepresents material facts and induces another to enter a commercial agreement, then the victim of that fraud is likely to suffer only economic damages.⁸⁵ Notwithstanding the economic loss rule, which obviously is implicated by such a fraud, it is also likely that the induced agreement substantially addresses the subject matter of the fraud and may even offer contractually based remedies. At

78. *Future Tech*, 944 F. Supp. at 1566 (citing *Kee*, 918 F.2d at 1543). It is important to recall that even when courts speak in absolute terms of allocating risks by agreement among contracting parties, that tort duties owed to the public do in fact supercede duties to other individuals as agreed in a contract. For instance, duties imposed by illegal contracts will not be enforced by courts because the duty owed to the public is higher than the duty arising by the agreement. But, these are recognized as exceptions to the rule favoring enforcement of the parties' agreement. See also FARNSWORTH *supra* note 16 § 5.1, at 345-50.

79. 515 So. 2d 180 (Fla. 1987).

80. *Id.* at 181.

81. 620 So. 2d 1244 (Fla. 1993).

82. 515 So. 2d 180 (Fla. 1987).

83. See Mankoff, *supra* note 29, at 468-88; Schweip, *supra* note 29, at 40.

84. See *HTP, Ltd. v. Lineas Aereas Costarricenses, S.A.*, 661 So. 2d 1221 (Fla. 3d DCA 1995); *Woodson v. Martin*, 663 So. 2d 1327 (Fla. 2d DCA 1995).

85. This is not to say that physical injury or property damage cannot result from fraudulent inducement. For example, if a seller fraudulently represents that a plane is flight worthy and another relies on that misrepresentation and buys the plane and if the plane crashes injuring the buyer, the buyer has suffered more than economic damages. In that scenario, the economic loss rule would not apply because of the physical injuries. Most fraudulent commercial transactions that become appellate fodder lack the physical injury or property damage components, thus the fraudulent inducement controversy revolves around fact patterns dissimilar to the defective plane illustration.

first blush, *Casa Clara* and *AFM Corp*, seem to limit the defrauded party to contractual remedies.

The first of the two appellate decisions was the Third District's in *HTP, Ltd. v. Lineas Aereas Costarricenses, S.A.*⁸⁶ The court was confronted with a claim that the defendants had fraudulently induced the plaintiff into a negotiated settlement agreement.⁸⁷ The Third District permitted the claim irrespective of the fact that only economic losses were pled.⁸⁸ It was likely that the plaintiff could not allege any loss other than the missed opportunity to collect more damages due to the defendants' fraud during the settlement negotiations. Such a claim could hardly be characterized as anything but a prayer for relief for purely economic loss. As a result, the opinion was peculiarly devoid of facts and perhaps designedly so. Consequently, the plaintiff's claim could have been characterized as little more than disappointed expectations.

In finding that the claim was not barred by the economic loss rule, the Third District reached beyond the Florida Supreme Court's ruling in *Casa Clara* to find one of its own earlier precedents, *Burton v. Linotype Co.*⁸⁹ In that case, the Third District held "Fraud in the inducement and deceit are independent torts for which compensatory and punitive damages may be recovered."⁹⁰

Notwithstanding the Third District's doctrinal basis for its holding, it cannot be overlooked that *HTP* involved a settlement agreement.⁹¹ Because courts must approve negotiated settlement agreements,⁹² the Third District may have been reacting to what it perceived as fraud upon the court.⁹³

Two months after *HTP*, the Second District Court of Appeal reached an opposite conclusion in *Woodson v. Martin*.⁹⁴ Whereas the

86. 661 So. 2d 1221 (Fla. 3d DCA 1995).

87. *See id.*

88. *See id.* at 1222.

89. 556 So. 2d 1126 (Fla. 3d DCA 1989).

90. *Id.* at 1128.

91. *See HTP, Ltd. v. Lineas Aereas Costarricenses, S.A.*, 685 So. 2d 1238, 1238-39 (Fla. 1996).

92. For an example of the way Florida courts have handled settlement agreement approvals see, *Peterson v. Morton F. Plant Hosp. Ass'n, Inc.*, 656 So. 2d 501 (Fla. 2d DCA 1995) (involving settlement agreement entered into by personal representatives of patient's estate in malpractice action against hospital) and *Cohen v. Cohen*, 629 So. 2d 909, 910 (Fla. 4th DCA 1993) (approving oral settlement agreement announced in open court in marriage dissolution proceedings).

93. This fact may or may not be significant considering this case's companion, *Woodson v. Martin*, was addressed by the Florida Supreme Court at the same time. *Woodson* constituted a standard fraud in the inducement claim without the settlement wrinkle. 663 So. 2d 1327 (Fla. 2d DCA 1995).

94. *See id.* at 1327.

HTP appellate court overlooked *Casa Clara* entirely, the *Woodson* appellate court followed the *Casa Clara* reasoning and read *AFM Corp.* as eliminating all independent tort claims which flowed from a contractual breach absent some physical injury or property damage.⁹⁵

In *HTP, Ltd. v. Lineas Aereas Costarricenses, S.A.*, Justice Shaw, writing on behalf of the Florida Supreme Court, held that the broad positions articulated in *Casa Clara* and *AFM* did not preclude fraud in the inducement as a viable tort claim.⁹⁶ Rather, fraud in the inducement exists irrespective of a breach of contract claim.⁹⁷ Recall that Justice Shaw dissented in *Casa Clara*, arguing that the reasonable foreseeability of harm to innocent third parties not in privity should have permitted the third parties to circumvent the economic loss rule.⁹⁸

Woodson, in contrast to *HTP*, involved a claim of fraud in the sale of real property, not entirely unlike *Casa Clara*. Additionally, the *Woodson* appellate court noted that the parties had agreed that the lower court's reasoning in barring the claim was based upon language in *Casa Clara*. The Second District followed the lower court's lead and quoted extreme (and overbroad) language from *Casa Clara* which, if intended to be followed in this manner, had the effect of virtually destroying fraud in the inducement and many other intentional tort claims that purely economic damages.⁹⁹

The *Woodson* majority, quoting from *Casa Clara*, argued that: economic losses are 'disappointed economic expectations' which are protected by contract law rather than tort law [T]his is the basic difference between contract law, which protects expectations, and tort law, which is determined by the duty owed to an injured party [F]or a recovery in tort 'there must be a showing of harm above and beyond disappointed expectations.'¹⁰⁰

As for a test to determine whether the economic loss rule should apply, the *Woodson* majority continued, "We believe that the nature of the damages suffered determines whether the economic loss rule bars recovery based on tort theories. If the damages sought are economic losses only, the party seeking recovery for those damages must proceed on contract theories of liability."¹⁰¹

95. See *id.* at 1329 (quoting *Airport Rent-A-Car v. Prevost Car Inc.*, 660 So. 2d 628, 632 (Fla. 1995) (quoting *AFM Corp. v. Southern Bell Tel. & Tel. Co.*, 515 So. 2d 180, 181-82 (Fla. 1987))).

96. See *HTP, Ltd.*, 685 So. 2d 1238, 1239 (Fla. 1996).

97. See *id.* at 1239.

98. See *Casa Clara Condominium Ass'n v. Charley Toppino & Sons, Inc.*, 620 So. 2d 1244, 1248-49 (Fla. 1993).

99. See *Woodson*, 663 So. 2d at 1328.

100. *Id.* (quoting *Casa Clara*, 620 So. 2d at 1246).

101. *Woodson*, 663 So. 2d at 1329.

Essentially, the Second District framed the question in a way that assumed the answer. Its test asked, if economic losses are precluded from tort recovery in the absence of physical injury or property damage, should fraud in the inducement be barred by the economic loss rule where damages from the fraud are purely economic losses? In this analysis, there is no distinction between negligence-based tort claims and intentional tort claims, even though tort law traditionally distinguishes the damages available under the two different theories.¹⁰²

Using this test, and answering in the affirmative, the Second District, sitting en banc, affirmed the lower court's dismissal of the claim.¹⁰³ Thus, the Second District extended an overly broad *Casa Clara* ruling to bar fraud in the inducement when the only tort damages claimed were pecuniary.

Judge Altenbernd dissented from the *Woodson* majority opinion arguing that the economic loss rule should not apply to intentional torts.¹⁰⁴ He noted that "[a]n action for deceit has existed at common law since 1201"¹⁰⁵ and traced the modern common law of fraud to the 1789 case *Pasley v. Freeman*.¹⁰⁶ Because both *Casa Clara* and *AFM Corp* were negligence actions where no intentional tort claims were asserted, the language in those cases which the majority seized upon to obliterate all "independent tort" theories need not be read so broadly.¹⁰⁷

Judge Altenbernd also made a useful observation, arguing that there existed three separate theories of the economic loss rule, none of which necessarily precluded recovery for intentional torts such as fraud in the inducement.¹⁰⁸ He noted that, first, there were Florida cases which espoused a "products liability economic loss rule: If the defendant's product physically damages only itself, causing additional economic loss, no recovery is permitted in 'tort.'"¹⁰⁹ Second, he observed that Florida has a "contract economic loss rule: If the parties have entered into a contract, the obligations of the contract cannot be relied upon to

102. Florida law permits both punitive and nominal damages in intentional tort cases but precludes them in negligence-based suits. See *Ciamar Marcy, Inc. v. Monteiro Da Costa*, 508 So. 2d 1282, 1283 (Fla. 3d DCA 1987) (awarding punitive damages in intentional tort cases); *Guthartz v. Lewis*, 408 So. 2d 600, 602 n. 4 (Fla. 3d DCA 1981) *aff'd* 428 So. 2d 222 (Fla. 1982) (awarding nominal damages in intentional tort cases); *White Const. Co., Inc. v. Dupont*, 455 So. 2d 1026, 1028 (Fla. 1984) (stating that something more than gross negligence is required to permit punitive damages).

103. See *Woodson*, 663 So. 2d at 1329.

104. See *id.* at 1331.

105. *Id.* at 1330.

106. See *id.* (citing *Pasley v. Freeman*, 3 Term Rep. 51, 100 Eng. Rep. 450 (1789)).

107. *Woodson*, 663 So. 2d at 1330.

108. See *id.* at 1331.

109. *Id.* (citing *Casa Clara Condominium Ass'n v. Charley Toppino & Sons, Inc.*, 620 So. 2d 1244 (Fla. 1993)).

establish a cause of action in tort for the recovery of purely economic damages."¹¹⁰ Finally, he defined a "negligence economic loss rule: Common law negligence will not be expanded to protect economic interests in the absence of personal injury or property damage unless the judiciary is convinced that a strong public policy requires an expansion of the common law to protect specific economic interests."¹¹¹

According to Judge Altenbernd, none of these theories necessarily require that the economic loss rule be extended to intentional torts such as fraud in the inducement of a contract.¹¹² He argued that if the majority's reasoning was correct in its reliance on *Casa Clara* and *AFM Corp*, then "both fraud and negligent misrepresentation have been essentially abolished in Florida."¹¹³

The moral of the story here is that two esteemed District Courts of Appeal came to vastly different conclusions about the viability of a fraud in the inducement claim where the recovery sought was for purely economic losses. The supreme court's reasoning on this issue came in answer to the defendants' appeal from the Third District's ruling in *HTP Ltd. v. Lineas Aereas Costarricenses, S.A.*¹¹⁴ The appellants-defendants argued that because the plaintiffs failed to plead or prove any physical injury or property damage, their fraud in the inducement tort claims were precluded by the economic loss rule based upon *AFM Corp*.¹¹⁵

In response to this argument, Justice Shaw stated unequivocally that:

[t]he economic loss rule has not eliminated causes of action based upon torts independent of the contractual breach even though there exists a breach of contract action. Where a contract exists, a tort action will lie for either intentional or negligent acts *considered to be independent from* acts that breached the contract."¹¹⁶

The court also noted that *AFM* implicitly allowed for this result where in that opinion the court stated that "*AFM* has not proved that a tort *independent of the breach itself* was committed. Consequently, we find

110. *Woodson*, 663 So. 2d at 1331 (citing *AFM Corp. v. Southern Bell Tel. & Tel. Co.* 515 So. 2d 180 (Fla. 1987)).

111. *Woodson*, 663 So. 2d at 1331 (citing *Palau Int'l Traders, Inc. v. Narcam Aircraft, Inc.*, 653 So. 2d 412 (Fla. 3d DCA 1995)).

112. See *Woodson*, 663 So. 2d at 1331.

113. *Id.*

114. 685 So. 2d 1238 (Fla. 1996). The Second DCA's ruling barring the tort claim was quashed without opinion in *Woodson v. Martin*, 685 So. 2d 1240 (Fla. 1996).

115. See *HTP, Ltd. v. Lineas Aereas Costarricenses, S.A.*, 685 So. 2d 1238 (citing *AFM Corp. v. Southern Bell Tel. & Tel. Co.*, 515 So. 2d 180 (Fla. 1987)).

116. *HTP, Ltd.*, 685 So. 2d at 1239 (citing *Ferguson Transp., Inc. v. North Am. Van Lines, Inc.*, 662 So. 2d 1275 (Fla. 4th DCA 1996)) (emphasis in original).

no basis for recovery in negligence.”¹¹⁷

The court, on the basis of both fact and law, went on to explain why fraud in the inducement is an independent tort. Factually, fraud in the inducement “requires proof of facts separate and distinct from the breach of contract.”¹¹⁸ Doctrinally, the court, quoting Judge Altenbernd’s dissenting opinion in *Woodson* with approval, noted that fraud in the inducement of a contract “normally ‘occurs prior to the contract and the standard of truthful representation placed upon the defendant is not derived from the contract.’”¹¹⁹

The Supreme Court of Florida also adopted the analysis of the Michigan Supreme Court in *Huron Tool & Engineering Co. v. Precision Consulting Services, Inc.*,¹²⁰ where it was reasoned that fraud in the inducement creates a special situation where “the ability of one party to negotiate fair terms and make an informed decision is undermined by the other party’s fraudulent behavior.”¹²¹ Therefore, because of the fraud, there is no freely negotiated contract to force the parties (and the court) to look to the contractual terms should there be a later breach. The court concluded with a final approval of Judge Altenbernd’s dissenting opinion below in *Woodson* quoting that:

the interest protected by fraud is society’s need for true factual statements in important human relationships, primarily commercial or business relationships. More specifically, the interest protected by fraud is a plaintiff’s right to justifiably rely on the truth of a defendant’s factual representation in a situation where an intentional lie would result in loss to the plaintiff. Generally, the plaintiff’s loss is a purely economic loss.¹²²

However, reliance on these other decisions left several questions unanswered. First, should every fraud in the inducement claim be considered an independent cause of action, separate from any breach of the

117. *HTP, Ltd.*, 685 So. 2d at 1239 (quoting *AFM*, 515 So. 2d at 181) (emphasis in original).

118. *HTP, Ltd.*, 685 So. 2d at 1239.

119. *Id.* (quoting *Woodson*, 663 So. 2d at 1331 (Altenbernd, J., dissenting)). It should be noted that the Florida Supreme Court has apparently, in *HTP*, reverted from modern contract theory, where the negotiation phase is part and parcel of the contracting process, to the classic view of contracts. See *supra* notes 113, 49-51 and accompanying text. As previously mentioned, Florida, having adopted both the U.C.C. and many principles of the Restatement (Second) of Contracts, now routinely follows modern contract theory. Here, however, the Supreme Court of Florida states that it is significant that the fraud inducing the contract at issue occurred “prior to the contract” and that the standard of truthful representation to be applied is “not derived from the contract.” *HTP, Ltd.*, 685 So. 2d at 1239. These are words characteristic of classic, not modern, contract theory.

120. 532 N.W.2d 541 (Mich. 1995).

121. *HTP, Ltd.*, 685 So. 2d at 1239-40 (quoting *Huron Tool*, 532 N.W.2d at 545).

122. *HTP, Ltd.*, 685 So. 2d at 1240 (quoting *Woodson*, 663 So. 2d at 1330 (Altenbernd, J., dissenting)).

contract? That is, should the Supreme Court of Florida's opinion in *HTP* be read to hold that fraud in the inducement of a contract is an independent tort theory and therefore is not precluded by the economic loss rule? Or, are there some cases where the fraud may be so closely intertwined with the performance or the terms of the contract itself that the "defrauded" party has arguably agreed that the contract remedies will be exclusive?

Additionally, the Supreme Court in *HTP* argued that it is the free and fair negotiation in the formation of a contract which protects contracting parties in the allocation of their respective losses in a venture.¹²³ Does this mean that if the parties have bargained for a remedy to protect against a suspected element of fraud the court will upset the parties' choice of remedy? If the answer to that question is "yes," then how is the court not requiring that a party remain *naive* in negotiation (and therefore exposed to a substantial economic loss due to potential fraud) in order to retain a judicial remedy? The remaining portion of this article explores these issues.

IV. FREE TO BE STUCK, STUCK WITH YOUR CHOICE, CHOOSING A REMEDY

As mentioned in Part II, contract law must be analyzed when considering fraud in the inducement of a contract. Not many would argue that courts that provide a remedy for misrepresentation and fraud act contrary to contract law generally. This is due largely to the sense that freedom to contract is a virtue that promotes healthy commercial activity. However, this virtue only flows without restriction when all parties to a contract understand the risks and facts surrounding an agreement. In the ideal world, contracts are most effective as a means of stabilizing business transactions when there is mutual assent.¹²⁴ Assent, however, implies knowledge of facts that underly the promises the parties are willing to commit themselves to, even if their bargain does not reap them the great profit they expect.

Much of traditional contract law views contracting parties as negotiating their respective bargains at arms length. In an arms-length transaction it is more difficult for the parties to interpret the words and intentions of their opponents during the negotiation process. Interpretation is contextual and depends in part upon each party's ability to trust her own assessment of the other's spoken intentions. The context necessary to make these assessments often is lacking in an arms length agreement. For instance, such discrete transactions may make it considerably

123. See *HTP, Ltd.*, 685 So. 2d at 1239-40.

124. See generally FARNSWORTH, *supra* note 16 §§ 3.6-3.8, at 118-33.

more difficult for each party to determine whether the other has a reputation for standing by her word. As a result, parties may find it necessary to cautiously approach each other as they attempt to consider every possible eventuality from their relationship. They ultimately seek to come away with what they perceive to be a complete and beneficial agreement from their own perspective.

In an arms-length transaction between two companies largely unfamiliar with one another, the parties will not have established a rapport justifying significant mutual trust. They may sense a greater need to protect themselves from economic loss in the event that one is advantaging itself with pertinent information unknown to the other. In many instances, such unknown information remains undisclosed even after the parties have performed and parted ways.

The law only takes notice of their contractual relationship when it is wrecked and needs sorting out. This is an expensive and time consuming process for all concerned. To avoid this expense, the law imposes two separate forms of protection for parties to a contract. The first kind, which originates in tort law, is imposed on all individuals whether they are contracting parties or not.¹²⁵ The second is imposed by the contracting parties on one another by the terms and clauses of their mutual agreements. Contract law provides this protection in the concepts of warranties, liquidated damages, rescission and reformation provisions, subsequent agreements to amend the terms, and the like.¹²⁶

But what should the law do when bargained-for-remedies expressly deal with an aspect of the agreement which was also the substance of a fraud inducing the contract? For example, if the parties have bargained for a liquidated damages clause to attempt to protect themselves from potential fraud and that fraud is perpetrated, should the "defrauded" party be restricted to the negotiated remedy?

This section first considers the basic operation and principles underlying the law on liquidated damages in Florida. Second, it discusses whether a fraud in the inducement claim should avail the defrauded party of compensatory and punitive damages despite available contractual remedies. Third, whether there is a valid fraud in the inducement claim where there is actually a free negotiation for the liquidated damages clause. Finally, whether a liquidated damages clause aimed at a term later discovered to be the subject of the fraud should be success-

125. For example, consider the duty of good faith and fair dealing. *See e.g.*, *Green Companies Inc., of Fla. v. Kendall Racquetball Investments, Ltd.*, 560 So. 2d 1208, 1210 (Fla. 3d DCA 1990) (quoting *RESTATEMENT (SECOND) OF CONTRACTS* § 205 (1981)).

126. *See generally* *FARNSWORTH, supra* note 16, §§ 12.1-12.20, at 839, 955.

ful in pulling the tort claim into the contract and require resolution under contract principles.

A. *A Summary of Florida's Law on Liquidated Damages*

Florida jurisprudence recognizes the right of contracting parties to agree to a liquidated damages clause that supplies the exclusive remedy for specified breaches.¹²⁷ The parties may stipulate in advance to an amount to be paid or retained as liquidated damages in the event of a breach. However, for contracting parties to succeed in choosing such a remedy, the parties and the circumstances in which the clause would operate must meet certain requirements.¹²⁸

The Florida Supreme Court has stated that two conditions must be satisfied: "First, the damages consequent upon a breach must not be readily ascertainable."¹²⁹ Second, the sum stipulated to be forfeited must not be so grossly disproportionate to any damages that might reasonably be expected to follow from a breach as to show that the parties could have intended only to induce full performance, rather than to liquidate their damages."¹³⁰

The second prong of the test is essentially the court's proscription of penalty clauses.¹³¹ The common law has remained particularly defiant of a stipulated remedial clause that acts as a penalty in the event of a breach. This is due largely to contract law's distaste for casting moral

127. *See Mayor's Jeweler's Inc. v. State of Cal. Public Employee's Retirement Sys.*, 685 So. 2d 904, 907 (Fla. 4th DCA 1996) (stating that Florida law holds that it is possible for contracting parties to agree to a liquidated damages clause that supplies the exclusive remedy for specified breaches.); *Coastal Computer Corp. v. Team Management Sys. Inc.*, 624 So. 2d 352, 353 (Fla. 2d DCA 1993) (stating that parties to a contract may stipulate to what the consequences of a breach of the agreement will be.); *Hatcher v. Panama City Nursing Ctr. Inc.*, 461 So. 2d 288, 290 (Fla. 1st DCA 1985) (stating that there is a general principle of law that parties to a contract may stipulate what the consequences of a breach shall be and if the stipulation is reasonable, it will control and exclude all other consequences.); *Dillard Homes Inc. v. Carroll*, 152 So. 2d 738 (Fla. 3d DCA 1963).

128. *See Lefemine v. Baron*, 573 So. 2d 326 (Fla. 1991).

129. In the hypothetical posited by this article, Jane Acquiror would counter Bob Owner's attempt to limit her damages with the liquidated damages clause by arguing that the contract lacked this first element required by Florida law. If she could demonstrate that the Owner knew of the concealed fraudulent government contracts then she would also probably be able to establish that her damages resulting from a breach of the contract were readily ascertainable to the Owner. If successful, she would then argue that the liquidated damages clause should be ruled unenforceable as a matter of law.

Although this would support her claim for contract (calculated as the difference between the contract price and the true value), it would not support her tort claim. She still would be precluded in contract from recovering her preparation damages and punitive damages. She must convince the court to permit her to plead tort claims independently in order to recover those damages.

130. *Lefemine*, 573 So. 2d at 328.

131. *See id.*

blame on a breaching party and its generally permissive attitude toward the "efficient breach of contract."¹³²

In some cases, the second prong of this test has been characterized as a proscription of "unconscionable" liquidated damages clauses.¹³³ The difference (and the difficulty) arises when it becomes necessary to predict from which perspective the court will view the reasonableness of the clause.

If the court focuses on the clause from the "time of contracting," reasonableness may require little more than a rationally based relationship to the subject matter of the contract terms and a desire to legitimately liquidate their damages.¹³⁴ This fits well with the concept of projected damages being "not readily ascertainable" at the time of contracting.¹³⁵ Under this analysis, the court asks whether the sum to be paid is "disproportionate to the *probable* injury *likely* to result from a breach of the contract."¹³⁶

If, on the other hand, the court decides reasonableness from the time of breach and designates it "unconscionable,"¹³⁷ then it has demanded that the parties perform an entirely different calculation during the negotiation process. Essentially, the parties would have been required to predict an amount of damages the court would not permit their clause to exceed even though that sum is admittedly "not readily ascertainable."¹³⁸ This balance is difficult to achieve when drafting a liquidated damages clause.¹³⁹ Nevertheless, if the liquidated damages provision in question fails either of the two prongs, the court will declare it "void as a matter of law and unenforceable."¹⁴⁰

A successfully drafted liquidated damages clause can be an effective way for parties to estimate their future damages and avoid costly

132. FARNSWORTH, *supra* note 16 § 12.3 & n.3, at 847.

133. *Berndt v. Bieberstein*, 465 So. 2d 1264, 1265 (Fla. 2d DCA 1985).

134. *Rosero v. State of Fla.*, 668 So. 2d 1114, 1115 (Fla. 4th DCA 1996).

135. *Lefemine*, 573 So. 2d at 328.

136. *Action Orthopedics, Inc. v. Techmedia, Inc.*, 759 F.Supp. 1566, 1569 (M.D. Fla. 1991) (quoting *Southern Menhaden Co. v. How*, 71 Fla. 128 (1916)).

137. *Berndt*, 465 So. 2d at 1265.

138. *Action Orthopedics*, 759 F. Supp. at 1569.

139. *See Parrish v. Dougherty*, 505 So. 2d 646, 649 (Fla. 1st DCA 1987) (stating that a valid liquidated damages clause is valid only as to damages which would not be ascertainable at the time of contracting in the event of a breach and that any liquidated damages clause which later proves to obtain an unconscionable result will not be enforced). The point here is that the only damages which can be awarded under a liquidated damages clause are those that are not ascertainable when the agreement is reached. However, even if that requirement is met, the courts will still "Monday-morning quarterback" the contracting parties' clause to determine if, after a breach, the enforcement would be unconscionable. The *Parrish* court required the parties to not be able to ascertain potential damages and simultaneously be able to foresee the limit of potential damages before it would enforce a liquidated damages clause.

140. *Humana Med. Plan, Inc. v. Jacobson*, 614 So. 2d 520, 523 (Fla. 3d DCA 1992).

litigation.¹⁴¹ The downside to such a clause is the risk that a party suffering damages from a contractual breach may find that he has underestimated his damages in the drafting of the clause. However, a clause fixing unreasonably small liquidated damages is not void as a penalty.¹⁴² In other words, a liquidated damages clause is "void as a penalty only in regard to the party required to pay, not the payee. Under a liquidated damages clause, a party entitled to receive an amount representing less than his actual damages cannot assert that the clause operates as a penalty against him."¹⁴³ Even if such provisions are inadequate, greater compensatory damages may not be awarded.¹⁴⁴

Thus, if a liquidated damages clause satisfies the established two-prong-test, then "effect should be given to the stipulation as one for liquidated damages, without regard to its designation or the amount of injury actually suffered as a result of the breach."¹⁴⁵ The general rule in Florida is to permit contracting parties to choose their remedies. A valid liquidated damages clause will be enforced in the event the contractually described breach occurs. The parties have chosen their remedy and they are stuck with it.

However, the preceding analysis involves cases where no tort claim is asserted. The principle issue in such cases is whether the liquidated damages clause in the agreement amounts to a penalty. But the inquiry should not necessarily end there. After all, if the contract as a whole was induced by fraud then arguably any choice of remedy clauses contained therein were also fraudulently induced.

B. *Big Lies and Little Lies*

Theoretically, in terms of fraudulent inducement, there is little if any distinction between a contract with a liquidated damages clause and a contract without one. For a fraudulent inducement claim to exist, the tortious conduct must occur prior to the formation of the contract. Necessarily, when the fraud actually occurs, the liquidated damages clause

141. See *id.* at 521. This statement, lifted from the *Jacobson* opinion, seems to oversimplify the tension that Florida courts have articulated relating to enforcement of liquidated damages clauses. See *supra* notes 129-39 and accompanying text. If a valid clause must liquidate unascertainable damages how can those damages be estimated? Furthermore, if the parties' estimate of those unascertainable damages is off sufficiently to render the enforcement of the clause unconscionable then not only do they not have a useful estimate to gauge their potential damages in the event of a breach but they also have costly litigation.

142. See *Action Orthopedics*, 759 F. Supp. at 1570.

143. *Id.*

144. See *Hi Neighbor Enterprises, Inc. v. Burroughs Corp.*, 492 F. Supp. 823, 826 (N.D. Fla. 1980) (stating that compensatory damages can be no more than those set out in the agreements).

145. *Action Orthopedics*, 759 So. 2d at 1569.

does not exist between the parties. Rather, it comes into being along with the fraudulently induced contract.

A fraud in the inducement claim, whether based upon negligent misrepresentation or intentional fraud, asserts that a legal “wrong” was committed. The Second District Court of Appeals stated in *Century Properties, Inc. v. Machtinger*,¹⁴⁶ that “fraud cannot be predicated solely upon the failure to perform a promise. . . . However, a promise may be a basis for fraud where there is evidence the promisor had a specific intent not to perform at the time the promise was made.”¹⁴⁷ The *Machtinger* court provided for a remedy in tort when a promisor specifically intended to abrogate his promise. To provide the foundation for the independent tort, the promise would have to be such that, in its absence, the promisee would not have assented; *ergo*, the contract was fraudulently induced. One can imagine a scenario where a party, specifically intending to abrogate his promise, also negotiates to insert a liquidated damages clause to restrict available remedies in an action against him to damages under the clause.

In such a scenario, the promisor has stated, “I promise to do X if you will do Y.” The co-existence of a specific intent not to do “X” represents fraud—a big lie with big consequences for which the *Machtinger* court was willing to provide a tort remedy. But, should *Machtinger* preclude the operation of remedies clauses that may be contained in the fraudulently induced contract?

It seems consistent with both tort and contract law that remedial clauses of a fraudulently induced contracts be considered irrelevant to a valid intentional tort claim against the promisor. Arguably, the fraud is complete when the overall promise “to do X” is made with the requisite intent “[not] to do X” and the promisee detrimentally relies on that promise and offers his own promise in exchange. It would seem unjust for the law to convert an independent tort claim based upon such a fraud into a restricted contract claim based solely upon a choice of remedy clause that happens to exist in the fraudulently induced contract. Doing so would permit a liar to use a carefully crafted little lie to preclude his victim from obtaining an otherwise valid remedy for a substantially more injurious big lie.

C. *If This is Freedom, I'll Do Without*

Florida’s law on liquidated damages clauses is rooted in the principle that contracting parties should be free to negotiate the terms of their contracts subject only to public policy (*e.g.*, the restriction against pen-

146. 448 So. 2d 570 (Fla. 2d DCA 1984).

147. *Id.* at 572 (citations omitted).

alty clauses.)¹⁴⁸ This same foundational principle also requires that parties truthfully represent facts asserted during the contract negotiation process.¹⁴⁹ Although a party negotiating a contract is not always required to disclose all facts to his opponent, when he does speak, he must do so truthfully.¹⁵⁰

Given such ideals, it would be contradictory that Florida's policy against fraud and policy in favor of freedom of contract might be so easily overthrown by the simple inclusion of a provision purporting to liquidate damages for failure to perform when the promisor never intended to perform. If this is the law, then the victim of such a fraud would be doubly injured. He must not only judicially seek reparations due to the breach (a costly endeavor notwithstanding his attempt to overcome the remedial provision), but those reparations would be severely limited by the very instrument that the fraud induced. This outcome would bind the victim to a remedy for which he did not freely bargain because it was fraudulently induced.

While it may appear superficially that the victim bargained for the remedy, the clause itself is an essential part of a fraudulently induced instrument. A contracting party who lies to induce another to bind himself in contract has taken from the defrauded party the ability to freely negotiate. No negotiation has occurred at all as to those facts that were falsely asserted. Rather the contracting party has tricked the victim. Surely he was not bargaining for a lie but for a particular performance or something of value. If this trickery counts for good-faith negotiation then every scoundrel in Florida would try to inject such a clause in every fraudulently induced contract to limit his damages to the contract claim. Thus, the scoundrel would be the only party protected in the event the victim discovers he has been victimized.

Before these strong words are carried too far, it is important to observe that they suggest that a fraudulently induced contract is a "void" contract, and thus no contract at all, because there was no mutual assent. That conclusion may be "right" in rare instances where the falsely asserted fact goes directly to the "character or essential terms of a proposed contract."¹⁵¹ However, in the "great bulk of cases, the misrepre-

148. See *Green v. Life & Health of Am.*, 704 So. 2d 1386, 1390 (Fla. 1998).

149. See *Besett v. Basnett*, 389 So. 2d 995, 998 (Fla. 1980) (adopting *RESTATEMENT (SECOND) OF TORTS* §§ 540-42 (1976)). The Restatement (2d) of Torts provides that "[t]he recipient of a fraudulent misrepresentation of fact is justified in relying upon its truth, although he might have ascertained the falsity of the representation had he made an investigation." *Id.* § 540.

150. See *Johnson v. Davis*, 480 So. 2d 625 (Fla. 1985). In *Johnson*, the Supreme Court noted that "[t]he law appears to be working toward the ultimate conclusion that full disclosure of all material facts must be made whenever elementary fair conduct demands it." *Id.* at 628.

151. *RESTATEMENT (SECOND) OF CONTRACTS* § 163 (1976); see also *FARNSWORTH supra* note 16 § 4.10, at 249-50.

sentation is seen as going only to the *inducement*, with the result that the contract is *voidable*.¹⁵² For the defrauded party, the result is the same. A court may refuse to enforce the contract against the defrauded party should that party refuse to perform. This action was illustrated by the Florida Supreme Court when, quoting the Fifth District Court of Appeals, it stated that "one who has been fraudulently induced into a contract may elect to stand by that contract and sue for damages for the fraud. When this happens and the defrauding party also refuses to perform the contract as it stands, he commits a second wrong."¹⁵³

What makes this question difficult is that both Florida's policy on enforcing liquidated damages clauses and its policy on permitting independent tort claims for fraud in the inducement partly find their respective foundations in the same jealousy for freedom of contract. When these two large bodies of law collide, a question arises as to which body of law should rule? Still, this question does not frame the issue properly. Considering that the answer's cash value lies in whether the victim should enjoy the availability of the more liberal tort damages,¹⁵⁴ it is more logical to ask which law's policy would suffer the greater offense if it were sacrificed to the other? This is similar to the lesser-of-two-evils question characteristic of a conflict of laws analysis involving the public policy of two independent jurisdictions which each have contacts with a particular occurrence or transaction.¹⁵⁵ Florida courts are familiar with this analysis from their own choice of law cases.¹⁵⁶ The following section applies these principles by analogy.

D. *When Tort and Contract Collide*

In 1980, the Florida Supreme Court adopted the analysis provided in the Restatement Second, Conflicts of Laws, Section 6, when deciding how to choose between conflicting laws of two jurisdictions.¹⁵⁷ This section of the Restatement lists the important factors for choice of law considerations in all areas of law as: (a) the needs of the interstate and international systems; (b) the relevant policies of the forum; (c) the relevant policies of other interested states and the relative interests of those

152. FARNSWORTH, *supra* note 16 § 4.10, at 250 (emphasis added). In the majority of the cases, the distinction only significantly effects how third parties, holders in due course, or bona fide purchasers take property that is the subject of the "contract." *Id.*

153. HTP, Ltd. v. Lineas Aereas Costarricenses, S.A., 685 So. 2d 1238, 1239 (Fla. 1996) (quoting Williams v. Peak Resorts Int'l, Inc., 676 So. 2d 513, 517 (Fla. 5th DCA 1996)).

154. See generally Williams, 676 So. 2d at 521 (discussing when it is appropriate to allow a cause of action for tort damages in a breach of contract case).

155. See generally CAVERS, THE CHOICE OF LAW PROCESS (1965); E. SCOLES AND P. HAY, CONFLICT OF LAWS, §§ 17.11-17.17 (1982).

156. See, e.g., Mezroub v. Capella, 702 So. 2d 562, 564 (Fla. 2d DCA 1997).

157. See Bishop v. Florida Specialty Paint Co., 389 So. 2d 999 (Fla. 1980).

states in the determination of the particular issue; (d) the protection of justified expectations; (e) the basic policies underlying the particular field of law; (f) certainty, predictability and uniformity of result; and (g) ease in the determination and application of the law to be applied.¹⁵⁸

Section 6 applies to cases where arisen has a conflict of laws among independent jurisdictions. It provides assistance in guiding an analysis in choosing between two conflicting substantive law policies within the same jurisdiction. However, not all of the principles listed in Section 6 are relevant to this question. For example, subsection (a) "the needs of the interstate and international systems," would not come into play at all.¹⁵⁹ Furthermore, subsections (b) and (c) would be unnecessary as there would be no other jurisdiction with which to compare Florida's important policy considerations.¹⁶⁰

Nevertheless, following the Restatement's relevant treatment of choice of law by analogy, the court should ask some specific questions to determine whether Florida's policy on enforcing otherwise valid liquidated damages clauses should trump the policies which permit independent torts, such as fraud in the inducement, to co-exist with a contract claim. For instance, what public policies are represented by the conflicting substantive laws? Second, the court should ask what the justified expectations of the parties were. A third question asks what are the basic policies underlying the particular fields of law which are in conflict? Fourth, the court ascertains what effect its ruling will have on certainty, predictability and uniformity of results. Finally, how might the court's ruling promote ease in the determination and application of the law to be applied? In essence, the court would question the overall effect of sacrificing one body of substantive law for a conflicting one?

As to the first question under the conflict of laws analogy, one should recall that the law imposes certain societal concerns over any duties mutually agreed to by contracting parties. For example, courts (including Florida courts) will not enforce "illegal contracts."¹⁶¹ Even the modern thinking of the Uniform Commercial Code imposes the duty of "good faith and fair dealing" on every contract subject to the Code.¹⁶²

158. See RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 6 (1971).

159. See *id.* at 6(a).

160. See *id.* at 6(b), (c).

161. See *Hoffman v. Boyd*, 698 So. 2d 346, 348 (Fla. 4th DCA 1997) ("It had 'long been the rule in a majority of the courts of this country and in this State that contracts intended to facilitate or promote the procurement of a divorce will be declared illegal as contrary to public policy.'") (quoting *Posner v. Posner*, 233 So. 2d 381, 382 (Fla. 1970) (citing *Allen v. Allen*, 111 Fla. 733, (1933) and *Gallemore v. Gallemore*, 94 Fla. 516, (1927))); see also *Castro v. Sangles*, 637 So. 2d 989, 991 (Fla. 3d DCA 1994) (holding that one may recover upon an apparently illegal contract only if he has not been guilty of wrongdoing).

162. See U.C.C. § 1-203 (1990); cf. FLA. STAT. ANN. § 672.203 (West 1993).

Thus, there already exists in Florida law an eye towards the public good when interpreting a contract, assessing damages resulting from a breach, or determining appropriate remedies.

Consider also, that when the law assesses damages in contract cases, punitive damages are unavailable.¹⁶³ Punitive damages are traditionally available only in tort.¹⁶⁴ In fact, the courts's refusal to validate particular liquidation damages clauses generally reflects the law's insistence the breach of a contractual duty does not amount to a wrong for which a penalty (or punishment) is appropriate.¹⁶⁵

Conversely, a victim of fraud may obtain punitive damages because of the intentional nature of the tort.¹⁶⁶ The law is, therefore, cognizant of substantial harm to the public when parties behave so recklessly as to create a substantial likelihood of injury to another or with the specific intent to injure others. Punitive damages are the courts' way of permitting the public, through juries, to punish the intentional tortfeasor and extract more damages than actually suffered as reflected by the evidence.¹⁶⁷ These damages are termed "exemplary."¹⁶⁸ This reflects strong public policy against intentional moral wrongs such as fraud in the inducement. It seems most appropriate to sustain the tort policy of providing adequate compensatory and punitive remedies for fraud despite any specific limitation on contract damages imposed by the policies governing the law on liquidated damages. But given the existence of a liquidated damages clause in a contract, would the court's permission of the tort claim contradict what the parties intended or expected?

In following Florida's choice of law rules, the second issue courts should address in choosing between contract or tort law principles involves the justified expectation of the parties. Florida courts enforce valid liquidated damages clauses because they reflect the intent of the parties at the time of contracting to provide for their remedies in as much as the law would allow.¹⁶⁹ Notwithstanding the parties' intentions, the negotiation process and the performance and enforcement of the agreement is ruled by overarching principles of "good faith" and

163. See *Williams v. Peak Resorts Int'l. Inc.*, 676 So. 2d 513, 521 (Fla. 5th DCA 1996).

164. See *Commissioner of the I.R.S. v. Schleier*, 515 U.S. 323, 343 (1995) ("The rule against punitive damages prevails even if the breach [of contract] is willful or malicious, as long as the breach does not amount to an independent tort."); see also *Lewis v. Guthartz*, 428 So. 2d 222, 223 (Fla. 1982).

165. See *Lefemine v. Baron*, 573 So. 2d 326, 330 (Fla. 1991).

166. See *Burton v. Linotype Co.*, 556 So. 2d 1126, 1128 (Fla. 3d DCA 1989) ("Fraud in the inducement and deceit are independent torts for which compensatory and punitive damages may be recovered.").

167. See *Ferguson Transp. Inc. v. North Am. Van Lines, Inc.*, 687 So. 2d 821, 822 (Fla. 1996).

168. *Id.* at 822-23.

169. See *Humana Medical Plans, Inc. v. Jacobson*, 614 So. 2d 520, 523 (Fla. 3d DCA 1992).

“fair dealing.”¹⁷⁰ Consider the significance of the Florida Supreme Court’s eighty-five year old opinion stating, “What is plainly injurious to good faith ought to be considered as a fraud sufficient to impeach a contract.”¹⁷¹ The tort action of fraud in the inducement exists in part because of the violence that fraud exercises against the negotiation process and freedom of contract.

It is true that when parties to a contract include a liquidated damages clause, they expect that their damages will be limited by the clause in the event of a breach. However, when fraud is present in the negotiation process, the law imposes other expectations. For example, Florida courts have held that in such instances, the contract itself may be voided as an equitable remedy.¹⁷² When the defrauding party argues that the victim should only have expected that damages arising under the contract would be limited by the liquidated damages clause, the courts respond that fraud so egregiously disrupts freedom during negotiation, that the parties are left with very little that they can justifiably expect.

In fact, given the courts’s position on fraud in the inducement, the defrauding party should only expect that he will be held to his bargain if the victim decides to stand by the contract.¹⁷³ The Third District Court of Appeal has ruled that if the defrauding party refuses to perform, he commits a second wrong for which the victim can claim recovery.¹⁷⁴ The victim should therefore at least be permitted to expect that he may rely on the truthfulness of the other party’s assertions. After all, “The interest protected by fraud is a plaintiff’s right to justifiably rely on the truth of a defendant’s factual representation in a situation where an intentional lie would result in loss to the plaintiff.”¹⁷⁵

Thus parties cannot justifiably expect that their chosen remedies will necessarily be upheld by the courts if the contract was induced by fraud. To the contrary, the existence of fraud opens the door to various mechanisms the courts often use to permit the victim to void and escape

170. See *Green Companies of Fla. v. Kendall Racquetball Inv.*, 560 So. 2d 1208, 1210 (Fla 3d DCA 1990) (quoting RESTATEMENT (SECOND) OF CONTRACTS § 205 (1981)) (“It is fundamental that [e]very contract imposes upon each party a duty of good faith and fair dealing in its performance and its enforcement.”). The Florida Supreme Court stated, “The right to make contracts of any kind, so long as no fraud or deception is practiced and the contracts are legal in all respects, is an element of civil liberty possessed by all persons who are sui juris.” *State ex rel. Fulton v. Ives*, 123 Fla. 401, 411 (1936).

171. 59 Fla. 517, 527 (1910). This opinion is a prime example of how some duties supercede duties which arise among parties by virtue of their agreement. Here the court imposed an overarching duty of “good faith” and permitted the breach of this duty to “impeach” the contract.

172. See *Kelly v. Tworoger*, 705 So. 2d 670 (Fla. 4th DCA 1998); see also *Petracca v. Petracca*, 706 So. 2d 904, 911 (Fla. 4th DCA 1998).

173. See *Williams v. Peak Resorts Int’l, Inc.*, 676 So. 2d 513, 516 (Fla. 5th DCA 1996).

174. See *Ashland Oil, Inc. v. Pickard*, 269 So. 2d 714, 723 (Fla. 3d DCA 1972).

175. *Woodson v. Martin*, 663 So. 2d 1327, 1330 (Fla. 2d DCA 1995) (rev’d on other grounds).

the contract,¹⁷⁶ to enforce the contract,¹⁷⁷ or arguably, to bring an independent action in tort.¹⁷⁸ Therefore, it would not do substantial violence to either party's justifiable expectations if Florida courts were to permit a tort claim in spite of a liquidated damages clause existing in the mutual agreement between the parties.

Following the conflict of laws analysis, the court should next determine whether the policies forwarded by contract law or tort law would suffer more seriously if sacrificed. This can be answered in terms of whether the public will suffer more if one is sacrificed for the other.¹⁷⁹ If the remedial clause of the contract claim is sacrificed to the intentional tort claim, the public suffers little, if any, harm. The clause was designed to liquidate damages as between private parties who are privy to the agreement and assume duties under the contract.¹⁸⁰ A court's refusal to enforce the clause does not principally involve the public's interest because the parties owe no specific duty to the public to keep the bargain. Should the clause be invalidated, no moral wrong would go unpunished, and no damages for injury, except what can be established by the evidence as compensatory, would be recovered. There is little the public loses by permitting a liquidated damages clause to be overcome by a tort claim.

Conversely, if the law is unable to levy punishment for intentional wrongdoing, it could be harmed substantially. The public at large possesses a considerable interest that all persons, whether parties to a contract or not, refrain from conduct that is intentionally tortious. For instance, consider how Florida Standard Jury Instruction (Civil) 6.12 reads, as quoted by the Supreme Court of Florida in *U.S. Concrete Pipe Co. v. Bould*:

If you find for (claimant) and find also that [the defendant] [any defendant whom you find to be liable to (claimant)] acted with malice, moral turpitude, wantonness, wilfulness or reckless indifference to the rights of others, you may, in your discretion, assess punitive damages against such defendant *as punishment and as a deterrent to others*.¹⁸¹

176. See *Kelly v. Tworoger*, 705 So. 2d 670 (Fla. 4th DCA 1998); see also *Petracca*, 706 So. 2d at 911 (Fla. 4th DCA 1998).

177. See *Ashland Oil*, 269 So. 2d at 723.

178. See *HTP Ltd. v. Lineas Aereas Costarricenses, S.A.*, 685 So. 2d 1238 (Fla. 1996).

179. See, e.g., *Beattay v. College Centre of Finger Lakes, Inc.*, 613 So. 2d 52, 55, (Fla. 4th DCA 1992).

180. See *Casa Clara Condominium Ass'n v. Charley Toppino & Sons Inc.*, 620 So. 2d 1244, 1246 (Fla. 1993); see also *Future Tech Int'l. Inc. v. Tae II Media Inc.*, 944 F.Supp 1538, 1566 (S.D. Fla. 1996) (citing *Kee v. National Reserve Life Ins. Co.*, 918 F.2d 1538, 1543 (11th Cir. 1990)).

181. 437 So. 2d 1061, 1069 (Fla. 1983) (emphasis added).

The use of punitive damages is the functional equivalent of the defendant's peers punishing the defendant for egregious behavior.¹⁸² The law recognizes and satisfies the need to permit juries to award punitive damages to establish a minimum standard of behavior, below which the public, through its juries, will not tolerate. To excise a jury's ability to award punitive damages by enforcing a liquidated damages clause contained in a fraudulently induced contract would be the equivalent of placing the interests of a forward thinking scoundrel above the interests of the public at large. What makes this even more evident is that if such a liquidated damages clause were not enforced, there would be little violence done to the parties' justifiable expectations and little, if any, harm to the public.

Finally, in deciding whether the policies of tort or contract should prevail, the court should focus on attaining the goals of certainty and ease of application.¹⁸³ Arguing for a bright-line rule, the law should, in most cases involving fraud in the inducement, permit the independent tort irrespective of any remedial clauses which may be contained in the fraudulently induced contract. To begin with, this rule would produce little uncertainty in the law. Any contract that the court might find induced by fraud could be deemed voidable, accurately reflecting current law in cases not involving remedial clauses.¹⁸⁴ The result would be that the independent tort claim would survive and clauses which purport to remediate damages under the contract would apply solely to contract claims asserted in separate counts. Each party would know that if it were to perpetrate a fraud in inducing a contract, that the law would not recognize any attempt to limit exposure to damages which would normally attend such an intentional tort. Thus, uniformity and certainty could be readily achieved by such a bright-line rule and would protect society's significant interest in preventing and punishing fraud.

As the above choice of law analysis demonstrates, Florida courts, under their own precedents, have the legal tools to balance the public's interests with that of the parties to a contract when tort law and contract law collide. Interestingly, the Fourth District Court of Appeal, in *Ray v. Elks Lodge # 1870 of Stuart*,¹⁸⁵ came to the same conclusion this article proposes. Regrettably, it did so with no analysis whatsoever.¹⁸⁶ Although that court boldly stated that "[a] . . . liquidated damages clause . . . does not constitute a defense to a claim for fraud in the inducement,"

182. See *Winn & Lovett Grocery Co. v. Archer*, 171 So. 2d 214, 221 (Fla. 1936).

183. See *Mezroub v. Capella*, 702 So. 2d 562, 565 (Fla. 2d DCA 1997).

184. See *Kelly v. Tworoger*, 705 So. 2d 670 (Fla. 4th DCA 1998); see also *Petracca v. Petracca*, 706 So. 2d 904, 911 (Fla. 4th DCA 1998).

185. 649 So. 2d 292 (Fla. 4th DCA 1995).

186. See *id.* at 293.

it did not cite a single authority or provide any rationale for its ruling.¹⁸⁷ Perhaps its conclusion was such an elementary proposition that the court felt it superfluous to provide authority. But it should not escape reasonable minds that the conflict over the application of the economic loss rule to fraud in the inducement claims, which continued for several years in Florida courts, belies the simplicity adopted by the Fourth District.

E. *To Protect or Not to Protect?*

If the Fourth District incorrectly decided *Elk's Lodge*,¹⁸⁸ then, equitably speaking, a liquidated damages clause raises substantial concerns regarding contracting parties' abilities to protect themselves from fraud in the inducement. As held by the Second District Court of Appeal in *Century Properties, Inc. v. Machtinger*,¹⁸⁹ when a party promises to perform his part of a bargain while possessing the specific intent to not perform, a valid fraud claim exists.¹⁹⁰ But if a *Machtinger*-type victim anticipates the possibility of misrepresentation and bargains for a liquidated damages clause, the only protected party would be the culprit. Furthermore, the only protection the clause would actually provide would be to benefit the culprit by barring the victim from suing for substantial tort damages. The victim would remain utterly exposed to the fraud and significantly restricted in the contract claim. Hindsight likely would prove painful for the victim in that a rejected opportunity to refuse the clause probably arose during the bargaining process.

The *Machtinger* victim, limited to the remedies provided for in a liquidated damages provision, would have been better off to remain *naive* in the bargaining process. Had the victim ignored the potential for misrepresentation, tort law would have afforded a remedy for the culprit's misrepresentation. Such a result turns contract law and tort law on their respective heads.

V. CONCLUSION

As this article demonstrates, Florida courts have settled on permitting claims of fraud in the inducement despite Florida's economic loss rule. The rationale for this result rests on differences that exist between the elements necessary to prove the intentional tort as opposed to an claim under the contract. The courts seem comfortable allowing the fraud claim to coincide along side a contract claim for breach due to the intentional nature of the tort. But, turning again to the hypothetical in

187. *Id.*

188. *See id.* at 292.

189. 448 So. 2d 570 (Fla. 2d DCA 1984).

190. *See id.* at 572-73.

Part I, should Jane Acquiror's claim be permitted notwithstanding the liquidated damages clause which she undoubtedly believed would protect her from fraud in the negotiation process?

In the facts presented, Acquiror realized that during the negotiation process for the sale of XYZ Corporation, Bob Owner was actively and intentionally preventing her from obtaining pertinent information. As the events unfolded, it became apparent that Owner had in fact concealed that pertinent information in cleverly recorded transactions and contracts with the government. As this article reflects, what makes Acquiror's case so difficult is that she permitted Owner to include the liquidated damages clause in the sales contract which dealt precisely with the value of XYZ.

Notwithstanding this difficulty, Florida's policy supporting the enforcement of liquidated damages clauses would not necessarily be offended by permitting the fraud claim to co-exist with the contract claim. A final analogy may be in order. Consider for instance the Fourth District Court of Appeal's handling of a similar issue in *Location 100, Inc. v. Gould S.E.L. Computer Systems, Inc.*¹⁹¹ In that case, the plaintiff, a seller of certain commercial real estate, instituted an action to recover as liquidated damages earnest money deposited by the defendant.¹⁹² The defendant counterclaimed that the seller had fraudulently misrepresented certain significant characteristics about the property.¹⁹³

The contract contained a provision whereby the buyer would be obligated to pay the seller's attorney's fees in the event that any dispute arose "out of the contract" for sale.¹⁹⁴ The case went to the jury on the issue of fraud along with other claims and counterclaims. The seller won in the trial court and filed a subsequent motion for attorneys' fees under the express term of the contract.¹⁹⁵ The trial court awarded the fees to the seller and the Fourth District reversed stating "an action to recover for fraud in the inducement is based, not on the contract, but on the tort."¹⁹⁶

The above result was obtained notwithstanding the intention of the parties as reflected by the express language of a contractual term. That term purported to deal precisely with the subject matter of the subsequent motion and appeal and yet the fraud claim overcame the contract term. Moreover, the defendant did not successfully prove the fraud claim. The seller won at trial and defeated the tort claim. Nevertheless,

191. 517 So. 2d 700 (Fla. 4th DCA 1987).

192. *See id.* at 701.

193. *See id.*

194. *Id.* at 706.

195. *See id.*

196. *Id.*

because the fraud counterclaim was not a cause of action based on contract, the court permitted the defendant to evade the clause regarding the payment of attorneys' fees. For similar reasons, the existence of a liquidated damages clause should not preclude a tort claim for fraud in the inducement.

On appeal, the *Location* court required on remand that the trial court below delineate what fees were paid to the seller's attorneys to defend against the contract-based counterclaims and what was paid to defend against the tort claim.¹⁹⁷ It ordered that the award for attorneys' fees be reduced by the amount paid to defend against the fraud counterclaim.

A similar process could be followed when a liquidated damages clause deals with the subject matter that later is discovered to be the basis of a fraudulent inducement. The court has no need to dismiss either the contract or the tort claim but can permit both to co-exist. Under the contract claim, the plaintiff may be limited by the liquidated damages claim. Under the fraud claim, however, the traditional tort remedies could be afforded the plaintiff without doing violence to either cause of action.

Under this analysis, Jane Acquiror should be permitted to bring the contract claim seeking enforcement of the liquidated damages clause along with the fraud in the inducement claim. Alternatively, she could seek to rescind the contract, recover from Bob Owner what money he obtained from the sale of XYZ under the principle of restitution, and still file the fraud in the inducement cause of action. Under the fraud claim, Acquiror should also be permitted to recover the \$75,000 spent in re-arranging her corporate structure in her preparation to receive XYZ under her corporate umbrella. Furthermore, she should be permitted to pray for punitive damages, the result of which would be subject to the standard analysis under *Winn & Lovett Grocery Co. v. Archer*.¹⁹⁸

BENJAMIN ENGLAND*

197. *See id.*

198. 171 So. 214 (Fla. 1936).

* At publication the author is a third year law student enrolled in the evening program at the University of Miami School of Law, Coral Gables, Florida. He also is a thirteen year veteran of the United States Food & Drug Administration (FDA). However, this article is published in the author's private and individual capacity and is in no way intended to reflect or represent the policies, opinions or positions of the FDA. The author is also a husband, and father of two young children, and would like to acknowledge his gratitude to his wife, Sandra P. England, for her deep understanding and long suffering.