

The ELR and Fraudulent Inducement Claims

The Florida Supreme Court confirmed in **HTP, Ltd. v. Lineas Aereas Costarricenses, S.A.**,¹ that the economic loss rule (“ELR”) has not eliminated causes of action based upon the independent tort of fraudulent inducement to contract.² Since that decision, however, courts have struggled with the question of what types of fraudulent inducement claims are sufficiently independent of the contract to survive the ELR. Although all provide lip service to the same basic pronouncements, the decisions are often inconsistent and hard to rationalize.

The question becomes critical in that a plaintiff can gain several advantages by initiating a fraud claim, including obtaining access to discovery that would otherwise be unavailable and the possibility of recovering punitive and consequential tort damages not recoverable for breach of contract.

As one judge has noted, “Hopefully, the supreme court will give us further guidance in this matter.”³ Until that occurs, however, it is possible to draw some general rules from the caselaw which has developed in the last few years.

The Supreme Court Addresses the Issue

In **HTP**, the Supreme Court set forth the general criteria:

Fraudulent inducement is an independent tort in that it requires proof of facts separate and distinct from the breach of contract. It normally “occurs prior to the contract and the standard of truthful representation placed upon the defendant is not derived from the contract,” *i.e.*, “whether the defendant was truthful during the formation of the contract is unrelated to the events giving rise to the breach of contract.”⁴

¹ 685 So. 2d 1238 (Fla. 1996).

² Fraud in the inducement requires proof of: (1) a false statement of material fact; (2) that the defendant knew or should have known was false; (3) that was made to induce the plaintiff to enter into a contract; and (4) that proximately caused injury to the plaintiff when acting in reliance on the misrepresentation. **Johnson v. Davis**, 480 So. 2d 625 (Fla. 1985); **Bradley Factor v. United States**, 86 F. Supp. 2d 1140 (M.D. Fla. 2000). A breach of contract claim requires proof solely of the existence of the contract, breach and damages flowing from the breach. **Knowles v. C.I.T. Corp.**, 346 So. 2d 1042 (Fla. 1st DCA 1977).

³ **Puff ‘N Stuff of Winter Park, Inc. v. Bell**, 683 So. 2d 1176, 1180-81 (Harris, J., concurring specially) (Fla. 5th DCA 1996).

⁴ 685 So. 2d 1238 (cites omitted). The direct quotes are from **Woodson v. Martin**, 663 So. 2d 1327, 1331 (Fla. 2nd DCA 1995) (Altenbernd, J., dissenting), and

The Court agreed with the analysis in Huron Tool & Engineering Co. v. Precision Consulting Services, Inc..⁵

Fraud in the inducement presents a special situation where parties to a contract appear to negotiate freely — which normally would constitute grounds for invoking the economic loss doctrine — but where in fact the ability of one party to negotiate fair terms and make an informed decision is undermined by the other party’s fraudulent behavior

The Court also agreed with Judge Altenbernd’s dissent in Woodson v. Martin,⁶ and his recognition that a cause of action for fraudulent inducement may co-exist with breach of contract claims because:

[T]he 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 the 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.⁷

The Supreme Court decisions addressing the ELR since HTP have confirmed the Court’s intent that the ELR be applied sparingly. Thus, in Moransais v. Heathman,⁸ the Supreme Court held that the ELR does not preclude claims of professional negligence. In discussing the application of the ELR, the Court noted its prior lack of clarity on the application of the rule, leading to its unintended application by trial and appellate courts “beyond its principled origins” and “to situations well beyond our original intent.”⁹ Noting its recognition in HTP of “the danger in an unprincipled extension of the rule,” the Court reiterated its refusal to extend its application to actions based on fraudulent inducement, and emphasized that the primary intent of the ELR was to restrict products liability actions, “. . . and its application should generally be limited to those contexts or situations where

Williams v. Peak Resorts Int’l Inc., 676 So. 2d 513, 317 (Fla. 5th DCA 1996).

⁵ 532 N.W. 2d 541, 545 (Mich. App. 1995).

⁶ 663 So. 2d 1327 (Fla. 2nd DCA 1995).

⁷ 1240, citing to Woodson, 663 So. 2d at 1330 (Altenbernd, J., dissenting). . .

⁸ 744 So. 2d 973 (Fla. 1999).

⁹ 744 So. 2d at 980.

the policy considerations are substantially identical to those underlying the product liability-type analysis.”¹⁰

In its latest consideration of the ELR, **Comptech International, Inc. v. Milam Commerce Park, Ltd.**,¹¹ the Court reiterated its intent that the application of the ELR be limited and not be used to bar well established common law and statutory causes of action.

Decisions after HTP

Since the HTP decision, the various Florida Courts of Appeal as well as the Federal District Courts have attempted to formulate a “bright line” test for assessing viable fraud in the inducement claims.¹²

Puff ‘N Stuff Judges Present Differing Interpretations

The first decision of note, **Puff ‘N Stuff of Winter Park, Inc. v. Bell**,¹³ heard *en banc*, resulted in a five-four decision, with a special concurrence by one judge and a lengthy dissent by another directly discussing the ELR’s application to fraud in the inducement. The issue presented was whether the plaintiffs could allege fraudulent inducement by their lender’s purported oral representation to fund over its lending limit. If answered in the affirmative, the plaintiffs would effectively avoid the statute of frauds requiring that credit agreements be in writing.¹⁴ Four judges upheld the summary judgment entered for the lender, stating that to decide otherwise “would effectively repeal the statute.”¹⁵

In his special concurrence, Judge Harris addressed the ELR’s application, finding ambiguities in the Supreme Court’s references in HTP to “torts independent of the contractual breach” and “a tort action . . . independent from acts that breached the contract.” Judge Harris specifically noted that, “Fraud in the inducement is an independent

¹⁰ 744 So. 2d at 982.

¹¹ 753 So. 2d 1219 (Fla. 1999).

¹² Other cases have simply cited to HTP decision in deciding on both sides of the issue. See e.g., **Pearson v. Ford Motor Company**, 694 So. 2d 61 (Fla. 1st DCA 1997) (discussed *infra*); **Dantzer Lumber & Export Company**, 751 So. 2d 137 (Fla. 3rd DCA 2000).

¹³ 683 So. 2d 1176 (Fla. 5th DCA 1996).

¹⁴ §687.0304(2), Fla. Stat. (1989).

¹⁵ 683 So. 2d at 1177, citing to **Canell v. Arcola Housing Corp.**, 65 So. 2d 849 (Fla. 1953) (statute of frauds may not be avoided by suit for fraud based upon oral representations).

tort but the fraudulent misrepresentation underlying the action may or may not be independent of the contract.”¹⁶ Bemoaning the plethora of fraud claims in recent years, and commenting that almost any contract claim can be framed as a fraud in the inducement claim, Judge Harris advocated an analysis based upon the substance rather than the form of the claim to determine whether it was in fact an “integral part of the contract, either express or implied. Accordingly, if a breach of the contract causes damage, the ELR should apply to bar tort claims and limit a party to a contractual cause of action.”¹⁷ On that basis, Judge Harris agreed with the majority decision.

In her dissent, Judge Griffin agreed “that fraud is a much overused and mis-used cause of action,”¹⁸ but rejected Judge Harris’ observation that “almost any contract claim can also be framed as a fraud in the inducement action,”¹⁹ Instead, Judge Griffin argued that the issue should be addressed as one of proof:

The problem is not with the distinction between fraud and breach of contract, however, the problem lies in our courts’ failure to appreciate or require competent proof of the distinct elements. The statement that virtually any breach of contract action can be pleaded as fraud in the inducement proves the point. Every breach of contract cannot be pleaded as fraud in the inducement — at least, not properly. Certainly, the classic type of fraud present in this case — a knowingly false representation of fact — requires a specific allegation of such a false representation. Even “promissory fraud,” however, requires a specific allegation (and ultimate proof) that the promise was made with no intent to perform.²⁰

Distinguishing between misrepresentations of fact (not within the statute of frauds) and promises of future performance (which are),²¹ Judge Griffin noted that “[T]he plaintiffs were

¹⁶ 683 So. 2d at 1179-80.

¹⁷ 683 So. 2d at 1180.

¹⁸ 683 So. 2d at 1184. Judge Griffin noted that this was due not only to the punitive damage and discovery issues, but has also “been exacerbated by Florida’s embrace of the ‘promissory’ form of fraud whereby a promise made with no intent to perform is deemed actionable as fraud.” 683 So. 2d at 1185.

¹⁹ 683 So. 2d at 1179 (Harris, J., specially concurring).

²⁰ 683 So. 2d at 1185 (Griffin, J., dissenting).

²¹ This reference is somewhat curious in that the purported misrepresentation at issue in **Puff ‘N Stuff** was a misrepresentation as to future performance — to fund over the funding limit when necessary.

not complaining that the lender had breached the agreement to lend — the loan was made. Their complaint is that they would not have done business with FTB at all if they had been told the truth. I would reverse on this point.”²² Whether or not one agrees with Judge Griffin’s ultimate conclusion on the facts before her, her suggestion that the issue be looked at from a “proof” perspective has gained favor with the courts.²³

The “Interwoven” Line of Cases

The Third District Court of Appeal addressed the issue in the oft-cited case of **Hotels of Key Largo, Inc. v. RHI Hotels, Inc.**,²⁴ finding a fraud in the inducement claim barred because the alleged promises upon which that claim was premised were addressed in the series of detailed licensing agreements between the parties under which the plaintiffs’ hotels were to become part of the Radisson Hotels family. The plaintiffs alleged they had been fraudulently induced to enter into these agreements by three unfulfilled promises:

(1) that they would become part of the Radisson Hotels family and receive all the benefits inherent therein;

(2) that they would be the sole beneficiaries of the Radisson reservation system in the Florida Keys; and

(3) that more than 40% of their reservations would be derived from the reservation system.

Finding all of these issues covered by the terms of the contract, the court noted:

A critical distinction must be made where the alleged fraudulent misrepresentations are inseparably embodied in the parties’ subsequent agreement. This would seem especially so where the parties have specifically agreed in an integration clause that their written contract “supersedes all prior agreements or understandings.”²⁵

²² 683 So. 2d at 1186.

²³ *Infra* at pp. 12-13.

²⁴ 694 So. 2d 74 (Fla. 3rd DCA 1997), *rev. denied*, 700 So. 2d 685 (Fla. 1997).

²⁵ The **Hotels of Key Largo** court specifically referenced the existence of an integration clause as a factor in its decision. It is unclear, however, what impact the existence of such a clause should have, particularly since prior case law has held that an integration or merger clause does not protect a contract from a claim of fraud in the inducement or procurement of that contract. **Noack v. Blue Cross and Blue Shield of Florida, Inc.**, 742 So. 2d 433 (Fla. 1st DCA 1999); **Cas-Kay**

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It makes sense that a truly independent cause of action for fraudulent misrepresentation, where the ability of one party to negotiate fair terms is undermined by the other's fraudulent behavior, is not barred by the economic loss rule.²⁶

Thus, the Third District held that misrepresentations relating to the breaching party's performance under the contract do not give rise to an independent tort cause of action, "because such misrepresentations are interwoven and indistinct from the heart of the contractual agreement."²⁷

The application of this principle — *ie.* the determination of what is "interwoven" with the contract — has been problematic, and appears to have resulted in conflicting opinions, even within the same District Courts of Appeal. In **Pressman v. Wolf**,²⁸ a home in obvious disrepair was sold "as is" after the buyer conducted pre-closing inspections which warned of such significant problems that her attorney had recommended renegotiation. The Third District held that the claim of fraudulent inducement — based on a purported representation that all repairs could be done for \$100,000 — failed because the "allegedly fraudulent misrepresentations were inseparably embodied in the parties' subsequent agreement."²⁹ Conversely, in **Pershing Industries, Inc. v. Estate of Sanz**,³⁰ the Third District reversed a summary judgment for the defendant, upholding the plaintiff's claim that she had been fraudulently induced to enter into a contract with the defendant, d/b/a Vista Memorial Gardens, by the misrepresentation that she would be receiving two internment rights. Such a representation certainly appears to go to the issue of contractual performance.

The Fourth District rejected the lower court's dismissal of a claim based upon **Pressman** in **Azam v. M/I Schottenstein Homes, Inc.**,³¹ holding that the plaintiff's allegation that the defendant developer represented a certain parcel was a "natural preserve," when he knew there was a plan to build a school on that parcel, was sufficient

Enterprises, Inc. v. Snapper Creek Trading Center, Inc., 453 So. 2d 1147 (Fla. 3rd DCA 1984); **Nobles v. Citizens Mortgage Corporation**, 479 So. 2d 822 (Fla. 2nd DCA 1985).

²⁶ 694 So. 2d at 77.

²⁷ 694 So. 2d at 78.

²⁸ 732 So. 2d 356 (Fla. 3rd DCA 1999), *rev. denied*, 744 So. 2d 459 (Fla. 1999).

²⁹ 732 So. 2d at 361.

³⁰ 740 So. 2d 1246 (Fla. 3rd DCA 1999).

³¹ 25 Fla.L.Weekly D1530 (4th DCA June 28, 2000).

to allege fraud in the inducement. In **Straub Capital Corporation v. L. Frank Chopin, P.A.**,³² the Fourth District rejected a claim that tenants were fraudulently induced to enter into a commercial lease by an oral promise as to the date the space would be available, although the contract was silent on this issue,³³ finding the subject misrepresentations “directly related” to the breaching party’s performance of the lease.³⁴ And in **Pearson v. Ford Motor Company**,³⁵ the First District held the ELR did not bar a car dealer’s claim that he was fraudulently induced to enter into a dealership agreement by misrepresentations that the manufacturer would meet the plaintiff’s financial needs as a minority dealer, although one would think the financial aspects of the relationship being formed would have been at the heart of the contract.

Cases Applying the “Proof” Distinction

Recently, the United States District Court for the Middle District of Florida in **Bradley Factor, Inc. v. United States**,³⁶ applying Florida law, took issue with the are “interwoven” concept, criticizing that it “is so broad that it swallows the exception whole.” Citing to **Budgetel Inns, Inc. v. Micros Systems, Inc.**,³⁷ the court continued:

The **Huron** limitation suggests a misunderstanding of the tort of fraud in the inducement. In all fraud in the inducement cases the alleged fraudulent misrepresentations will either concern the quality and characteristic of the underlying subject matter, because that is the definition of “fraud in the inducement” itself . . . Because the contract concerning the “particular thing” will always be considered interwoven with the deceit under **Huron**, fraud in the inducement claims will always be barred. The tort, after all, is inducing someone to enter into a contract, so to say it does not apply where the

³² 724 So. 2d 577 (Fla. 4th DCA 1999).

³³ The contract did contain a merger clause, and a “time is of the essence” provision.

³⁴ Oral misrepresentations which are directly contradicted by or specifically addressed in the contract ultimately executed by the parties will not support a fraudulent inducement claim. See e.g., **Hillcrest Pacific Corporation v. Yamamura**, 727 So. 2d 1053 (Fla. 4th DCA 1999); **Khosrow Maleki, P.A. v. M.A. Hajianpour, M.D., P.A.**, 2000 WL 275847 (Fla. 4th DCA 2000). However, if the contract does not directly address the issue, the defendant may have difficulty avoiding the claim under the “interwoven” test.

³⁵ 694 So. 2d 61 (Fla. 1st DCA 1997).

³⁶ 86 F.Supp. 2d 1140, 1145 (M.D. Fla. 2000).

³⁷ 8 F.Supp.2d 1137 (E.D. Wis. 1998).

tort involves the contract or its subject matter analytically makes no sense.³⁸

Returning to the **Hotels of Key Largo** language, and employing some of Judge Griffin's rationale, the District Court reiterated that fraud in the inducement is precontract fraudulent conduct which undermines one party's ability to negotiate and make informed decisions, so that the factual inquiries supporting the fraud are distinguishable from those supporting a subsequent breach of contract claim. Using that criterion, the court upheld the plaintiff's claim that it had been fraudulently induced to enter into an agreement in which it was to receive the defendant's security interest in another entity by the defendant's concealment of the fact that it had released certain equipment from that security interest. Thus it would appear that the Court also fell back on the distinction noted by Judge Griffin between a precontractual representation of existing fact, including a misrepresentation of intent to perform, and a promise of future performance of contractual obligations.

Similarly in **La Pesca Grande Charters, Inc. v. Moran**,³⁹ the plaintiff purchased a yacht which subsequently caught fire. He brought several claims, among which was a claim that the seller's president had fraudulently represented the physical condition of the vessel prior to sale. The court reversed the lower tribunal's dismissal of the claim on the basis of the ELR, noting these were misrepresentations of existing fact made prior to execution of the contract, not fraud in the performance of the contract. The court noted,

It is no more desirable to have tort law drown in a sea of contract than to have contract law drown in a sea of tort. The notion that a knowing fraud perpetrated to induce someone to enter into a contract can be extinguished by the simple expedience of including the fraudulent representation in the contract makes no sense.⁴⁰

Several courts have also adopted Judge Griffin's suggestion that the issue should be addressed as one of proof. One example is **Connecticut General Life Assurance Company v. Jones**,⁴¹ where the First District quoted from Judge Griffin's dissent with approval, agreeing that the issue is one of proof and that the factual inquiry as to precontract fraud is different from the determination of a subsequent breach of contract. Based upon its finding that the plaintiff did not satisfy its burden of proving the elements of a fraudulent inducement, the court reversed a jury verdict and resulting judgment in the plaintiff's favor.

³⁸ 86 F. Supp.2d at 1145, citing to **Budgetel**, 8 F. Supp.2d at 1147.

³⁹ 704 So. 2d 710 (Fla. 5th DCA 1998).

⁴⁰ 704 So. 2d at 712.

⁴¹ 2000 WL 702371 (Fla. 1st DCA June 1, 2000).

Using the same type of analysis, and taking an apparently even more liberal approach, the Federal District Court for the Southern District in **Nautica International, Inc. v. Intermarine USA, L.P.**,⁴² also addressed this as a “proof” issue, emphasizing the difference in timing:

To prevail on this claim, plaintiff will have to demonstrate that defendant induced plaintiff to participate in this joint project by promising to use its best efforts to procure the SOCOM RIB contract. This is, of course, distinct from proof that defendant actually did not use its best efforts, which plaintiff relies upon to support its breach of contract claim.⁴³

In **Medalie v. FSC Securities Corporation**, the same court upheld a fraudulent inducement claim based upon plaintiffs’ allegations that defendant made material misrepresentations about the risks involved with certain investments to induce plaintiffs to make the investments,⁴⁴ the court specifically finding these allegations met the **Hotels of Key Largo** test.

Conclusion

Although no one specific rule as to what is and what is not a viable fraudulent inducement claim can be taken from these cases, certain guidelines certainly emerge:

(a) Any promise, warranty, obligation or issue that is specifically and directly addressed in and covered by the contract cannot form the basis of a fraud in the inducement claim. To that end, if you would have a claim for breach of contract based upon the same factual allegations, you probably will be found not have a fraud in the inducement claim.

(b) The alleged fraudulent misrepresentation must have been made prior to and during the formation of the contract. Otherwise, there can be no finding of reliance.

(c) The alleged misrepresentation should be shown to have undermined the plaintiff’s ability to negotiate fair terms and make an informed decision. Would the plaintiff have negotiated different terms? A different purchase price? Not entered into the contract at all?

(d) If the alleged misrepresentation was one of then present fact, as opposed to future performance, it is a easier burden of proof and also a much better argument that

⁴² 5 F. Supp. 2d 1333 (S.D. Fla. 1998).

⁴³ 5 F.Supp.2d at 1346.

⁴⁴ 87 F. Supp. 2d 1295 (S.D. Fla. 2000).

this is precisely the type of conduct against which society is intended to be protected under tort law.

(e) Allegations of promissory fraud are somewhat trickier, as any promise of performance would seem to relate to contractual obligations. However, since several courts view this as an issue of proof, and several have accepted this type of fraud in the inducement claim, it appears it can still be brought so long as the plaintiff can satisfy the burden of proving the defendant's intent not to perform at the time the representation was made.

Even with these guidelines, it is difficult to determine what claims will be upheld and what claims will be found barred. Hopefully, the Supreme Court, which now seems intent on clarifying and providing limits to the ELR, will come forward with further elucidation on this issue.