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Measuring Business Damages In Fraudulent Inducement Cases

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I. Summary

II. Introduction

III Summary Characteristics of Fraudulent Inducement
   A. Damage Preliminaries
   B. Fraudulent Inducement Widens the Plaintiff’s Reach

IV The Evolution of Damages Law for Fraudulent Inducement
   A. The Standard of Practice Since 1980
   B. Expectancy Damages
   C. Perry Equipment
   D. Reliance Waivers and Class Actions

V Value As a Damages Metric
   A. Measuring Value
   B. Valuation Date

VI Lost Profits As A Damages Metric
   A. Mitigation
   B. Are Lost Profits Always Special Damages
   C. Gross Not Net Profits
   D. Ex Post v. Ex Ante Evidence

VII BOB v. OOP Approaches to Direct Damages
   A. Asset Transactions
   B. Service Contracts
   C. Expectancy Damages in Business Acquisitions
   D. Disconnected Values

VIII Special Damages

IX Reliance Damages

X Equitable Remedies

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I. Summary

In litigation, damage claims should be dynamic: a party’s strategy for maximizing or minimizing the expected remedy should influence discovery and pleading tactics. Similarly, damages strategy should be formulated with the goal of optimizing the damages award in light of the known facts and most likely rulings on the elements required to prove or disprove the case. Texas case law in fraudulent inducement, however, does not reflect much strategy as there appears to be significant confusion about the applicable legal requirements for proving damages. In many cases, the parties seem less focused on optimizing their cases than trying to survive an obstacle course or minefield.

This article will analyze and discuss how remedies and damages are structured and measured in claims for fraudulent inducement relating to corporate transactions. Sections III and IV will summarize the basic structure for damage claims in fraudulent inducement. Section III discusses the basic characteristics of the cause of action, including the many remedies available as well as the capacity to name defendants that would otherwise be difficult to reach. Section IV will review the evolution of Texas case law relating to measuring damages for fraudulent inducement and explain the nature of the judiciary’s long-standing concern about excessively speculative measures as well as the evolving standard of practice for both lawyers and judges.

Sections V to XI provides more of a strategic view in the analysis of key issues for a damage claims. Sections V and VI analyze the use of value and lost profits, respectively, as measures of expectancy damages. Section VII examines the differences between the two major approaches to direct damages, how the choice between alternative approaches can be affected by one’s election to accept or deny the contract and the nature of the contract. Examples are provided of case opinions that have confused this issue and of valuation findings that are disconnected with the case facts in general. Special damages and reliance damages are discussed in Sections VIII and IX, focusing mainly on how the choice of approach to direct damages can exclude certain special damages and how some special damages can be duplicative. Section X summarizes possible equitable remedies and how they can sometimes provide unique solutions to particular problems in the litigation process. Finally, Section XI briefly suggests how such litigation can be avoided altogether or, if unavoidable, how some of the more obvious risks can be minimized.
II Introduction

Defending against a claim for fraudulent inducement in Texas is like walking through a minefield without a reliable map; one mis-step could result in the financial equivalent of losing an arm or a leg. The analogy may applies as well to some plaintiffs or even judges who are not immune from harm or embarrassment in this area of litigation. Their confusion about the location of the mines can result in avoidable reductions in jury awards or reversals of court holdings for the lawyer or judge, respectively. Each participant can be at risk.

Defendants to consumer claims of fraudulent inducement have suffered severe damage awards. For example, a builder who constructed a home in 1984 for $641,000 was found to have tried to obscure a defective foundation. The jury awarded and court of appeals affirmed $550,000 for reasonable repairs; $107,000 for loss of market value after the repairs; $111,000 for legal fees; $300,000 for mental anguish; and $1,000,000 for punitive damages.²

Defendants to corporate claims can also be vulnerable to large jury awards. In a case that was later reversed, an agricultural insecticide distributor claimed that a financial partner ruined his business and his plans to manufacture feedstock chemicals by refusing to release about $200,000 of internally generated funds. The jury awarded $17.5 million of lost profits. The court of appeals found insufficient evidence to affirm the finding as the plaintiff had no experience in manufacturing chemicals and its distribution business was operating at a large loss.³

Plaintiffs face a risk⁴ that jury findings will be reversed as the Texas judiciary continues to fret that the potential for large damage awards in claims for fraudulent inducement is overwhelming other causes of action and that impressionable juries may accept excessively speculative measurements of the plaintiff’s damages. Perhaps these two concerns explain why two thirds of the relevant Supreme Court opinions have held for reversal or remand on damage

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4 Statements in this article about the relative frequency of any holding have not been statistically proven and should be viewed as anecdotal or based on impression. There can be no assurance that the article is based on all relevant case opinions or a representative sample of all relevant case opinions. To be fair, however, there can be no assurances that the full population of case opinions on any one issue is necessarily representative of how that issue is treated at the trial level. Perhaps the true import of such case statistics to a litigator can be summarized by paraphrasing a quote sometimes attributed to Joseph Stalin about casualties in war: one reversal is a tragedy; one million reversals is a statistic.
issues, affirming damages (5); remanding for trial or reconsideration (5); and denying damages (8).

Lawyers are exposed in multiple areas. First, law firms find themselves defendants to such claims even in the absence of privity with the plaintiff. Second, plaintiffs’ lawyers have to explain to their clients why the jury finding was overridden or remanded or how the jury instructions were defective or why certain key pieces of evidence were omitted and corporate clients can get upset about damage issues. For example, when the jury awarded a relatively small amount of damages, the corporate plaintiff could not understand why the specific contract clause that waived consequential and punitive damages precluded the award of such damages. The plaintiff lost in arbitration and appeal against the defendant in breach. That plaintiff then sued his legal team for legal malpractice on the damage issues but lost at both the trial and appellate level.

The Texas judiciary face hazards of their own, both real and perceived. First, trial judges and appellate panels face the prospect of reversal. Second, for more than 100 years, the Texas Supreme Court rejected expectancy damages for claims of fraudulent inducement even though two thirds of the other states had accepted such damages before 1900. The Court’s concern about speculative damage awards continues even now after the expectancy approach to measuring damages have been approved for such common law claims.

The Texas judiciary has reason to be concerned that juries can be easily swayed in cases of fraudulent inducement. Although the plaintiff testified that he had no direct evidence of damages, plaintiff’s counsel persisted and was quoted in the opinion for the following ambivalent argument:

8 McCamish, Martin, Brown & Loeffler v. F.E. Appling Interests, 991 S.W.2d 787, 791 (Tex. 1999)
10 See cases cited by defendant in error for 32 states. George v. Hesse, 93 S.W. 107, 107 (1906)
11 Hicks Oil & Butane Co. v. Garza, 2006 Tex. App. LEXIS 6997, *5(Tex. App.--San Antonio August 9, 2006, no pet.) (mem. op, not designated for publication) (“However, when asked if he had anything in writing or any documents to support how much money he thought he had lost, Garza replied, “Well it’s quite substantial, but I don’t have anything to prove it.”)
Well, we’re always a little stumped here. In a personal injury case where someone is seriously injured, there’s no equation that allows you to measure out so many dollars and cents against so many ounces or minutes or hours of pain and suffering or permanent injury. And, in this case that’s something that you are going to have to determine.\textsuperscript{12}

The jury still found damages of $42,000 which the court of appeals held were unsubstantiated.\textsuperscript{13}

Twenty years after the Texas Supreme Court first affirmed expectancy damages for commonlaw claims, the Court acknowledged its concern that fraudulent inducement can overwhelm breach of contract as a cause of action:

We recognize the need to keep tort law from overwhelming contract law, so that private agreements are not subject to readjustment by judges and juries. But we long ago abandoned the position that procuring a contract by fraud was simply another contract dispute.\textsuperscript{14}

The judiciary’s concerns about a vulnerable or volatile jury process is the result of at least two compounding factors: (1) that claims for fraudulent inducement offer strong financial remedies in the possible combination of expectancy and punitive damages and (2) the common wisdom that juries may be more motivated to employ these strong remedies in cases where the defendant is proven to have been deceitful, i.e. that juries punish liars.

There is no complete explanation of why this litigation is error prone. The Texas judiciary may be reacting to fears of impressionable juries or

\textsuperscript{12} Id. See also the closing argument in Miles Homes Div., Insilco Corp. v. Smith, 790 S.W.2d 382, 395 (Tex. App.--Beaumont 1990, writ denied). For an example of a jurist’s confusion, see Manon v. Tejas Toyota, Inc., 162 S.W.3d 743, 756-57 (Tex. App.-Houston [14th Dist.] 2005, no pet.) (“The trial judge also appears to have been uncertain as to which theory of liability was applicable. While considering this issue, the trial judge stated, "Oh, DTPA, same as fraud. I'm still contemplating whether or not I can go under DTPA, although I'm leading more toward DTPA and less toward fraud. Okay? But I haven't totally made up my mind yet. I'll flip a coin. Okay? All right." Therefore, we agree with Tejas that the damage award is not a model of specificity.”)

\textsuperscript{13} Hicks Oil at *5

\textsuperscript{14} Tony Gullo Motors I, L.P. v. Chapa, 212 S.W.3d 299, 303 (Tex. 2006). See also PPG Indus. v. JMB/Houston Ctrs. Ltd. P’ship, 146 S.W.3d 79, 89 (Tex. 2004) (“DTPA claims generally are also punitive rather than remedial. In this respect, it is important to remember that the DTPA overlaps many common-law causes of action, including breach of contract, warranty, fraud, misrepresentation, and negligence. Frequently, the DTPA is pleaded not because it is the only remedy, but because it is the most favorable remedy. In this case, for example, JMB pleaded one set of factual allegations that was then incorporated wholesale into claims for breach of contract, warranty, and the DTPA. The contract and warranty claims offered a remedy, but only the DTPA offered treble damages.”)
dominant remedies but there is insufficient evidence to prove this supposition or even to establish that jury findings in fraudulent inducement are more disproportionate than in other causes of action. Similarly, the Texas judiciary’s aversion to ‘speculative’ damage findings is not limited to claims of fraudulent inducement. Aside from inferring fears and speculating about speculativeness, a more tangible explanation lies with the view that the standard of practice for both lawyers and jurists since 1980 has needed improvement. Jury findings may have been overruled at a disproportionate rate because some lawyers and judges have demonstrated confusion on how to comply with the established requirements for instructing juries as well as proving or distinguishing damage claims for fraudulent inducement.

The minefield of hazards does have an established map or guide, although the map is easier to discern for asset transactions than service contracts. There has not been much change in the requirements for proving damages from fraudulent inducement except for the addition of expectancy damages which has been applied extensively for breach of contract. The basic elements required for proving direct and special damages for contract claims in asset transactions have been fairly constant for at least 85 years.\(^{15}\) For example, measuring expectancy damages especially in the form of lost profits has been commonplace in Texas courts since the late nineteenth century.\(^{16}\)

Either side’s approach to litigating a claim for fraudulent inducement can incorporate damages strategy. Few causes of action offer such a variety of optional methods and approaches to the many alternative remedies. Few causes of action offer as much integration of remedies at law with remedies in equity. This wealth of options and alternatives allows a plaintiff or defendant to implement a damages strategy that encompasses the party’s unique case facts, the alternative legal doctrines, the likely procedural issues and even the state of relevant business conditions before or after the related contract was executed.

III. Summary Characteristics of Fraudulent Inducement

Claims for fraudulent inducement must prove the six elements of fraud:

(1) that a material representation was made;
(2) the representation was false;
(3) when the representation was made, the speaker knew it was false or made it recklessly without any knowledge of the truth and as a positive assertion;
(4) the speaker made the representation with the intent that the other party should act upon it;

\(^{15}\) Since no later than Booth v. Coward, 265 S.W. 1026 (Tex. Comm’n App. 1924, judgmt adopted) 
\(^{16}\) Jones v. George, 61 Texas 345, 347 (1884)
(5) the party acted in reliance on the representation; and
(6) the party thereby suffered injury\textsuperscript{17}

Furthermore, the subject contract must satisfy the Statute of Fraud for the plaintiff to be entitled to expectancy damages.\textsuperscript{18}

Fraudulent inducement can be plead in Texas under statute or common law.\textsuperscript{19} Claims under Texas Business and Commerce Code, Section 27.01 ("Section 27.01") are limited to transactions in real estate or common stock transactions and apply to defendants who made false misrepresentations or a third party who was aware of the falsity of a representation made by another party. Claims under this section are required to prove causation as under common law claims except that plaintiff is not required to prove that the defendant knew of the falsity of her representation at the time unless the plaintiff pleads for punitive damages. From 1919 to 1983, the statute provided for expectancy damages; in 1983 the statute was amended to provide for the award of legal fees but expectancy damages were deleted. Generally, claims are allowed a four year limitations period.

Commonly referred to as the Deceptive Trade Practices Act ("DTPA"), Texas Business and Commerce Code, Section 17.41, et. seq. was enacted as a consumer protection act.\textsuperscript{20} In 1995, claims under the DTPA were limited to transactions of $500,000 or less.\textsuperscript{21} The statute provides for a plaintiff to claim actual damages, punitive damages, mental anguish\textsuperscript{22} and legal fees although non-economic damages are now limited to a maximum of three times actual damages.\textsuperscript{23} Direct and special

\textsuperscript{17} In re FirstMerit Bank, N.A., 52 S.W.3d 749, 758(Tex. 2001)
\textsuperscript{19}Statutory standing is provided under Tex. Bus. & Com. Code § 17.41 or Tex. Bus. & Com. Code § 27.01.
\textsuperscript{20} Woods v. Littleton, 554 S.W.2d 662, 663 (Tex. 1977) ("Deceptive Trade Practices-Consumer Protection Act, Texas Business and Commerce Code, Section 17.41, et seq. The Consumer Protection Act, originally enacted on May 21, 1973, was amended effective September 1, 1975 and effective May 23, 1977.")
\textsuperscript{21} Tex. Bus. & Com. Code § 17.49 (g) Nothing in this sub-chapter shall apply to a cause of action arising from a transaction, a project, or a set of transactions relating to the same project, involving total consideration by the consumer of more than $500,000, other than a cause of action involving a consumer’s residence.
\textsuperscript{22} Arthur Andersen & Co. v. Perry Equip. Corp., 945 S.W.2d 812, 816 (Tex. 1997) ("In 1995, the Legislature amended § 17.50(b)(1) to permit recovery of "economic damages" and, if the defendant acted knowingly, "damages for mental anguish," instead of "actual damages." Act of May 17, 1995, 74th Leg., R.S., ch. 414, 1995 Tex. Gen. Laws 2992.")
\textsuperscript{23} Tony Gullo Motors I, L.P. v. Chapa, 212 S.W.3d 299, 304 (Tex. 2006) (" For breach of contract, Chapa could recover economic damages and attorney’s fees, but not mental anguish or exemplary damages. For fraud, she could recover economic damages, mental anguish, and exemplary damages, but not attorney’s fees. For a DTPA violation, she could recover economic damages, mental anguish, and attorney’s fees, but not additional damages beyond $21,639 (three times her economic damages). The court of appeals erred by simply awarding them all. [references omitted]")
damages are required to meet the producing cause standard of causation.\textsuperscript{24} Claims for damages are allowed a two year limitations period while claims for restitution are allowed a four year limitations.\textsuperscript{25}

It has been held that the statutes do not limit the measure of actual damages; statutory provisions are considered cumulative or in addition to those damages normally allowed for claims under the common law.\textsuperscript{26} Causation is presumed for direct damages but special damages must be proven to be the proximate cause of the misrepresentation.

Claims for constructive fraud can also be plead as fraudulent inducement. Proof of a prior confidential or fiduciary relationship is required although no proof is required of an intent to defraud.\textsuperscript{27} A court might be more likely to exercise its equitable discretion in favor of a constructive trust for constructive fraud because fiduciary issues was one the original sources of jurisdiction for a court in equity. Under some circumstances, a breach of fiduciary duty accompanied by the remedy of a constructive trust has allowed plaintiffs to avoid Statute of Frauds issues.\textsuperscript{28}

A. Damage Preliminaries

Actual damages are defined as those damages recoverable at common law\textsuperscript{29} and include direct and special damages. \textit{Perry Equipment} offers the following comparison between direct and special damages.

Direct damages are the necessary and usual result of the defendant's wrongful act; they flow naturally and necessarily from the wrong. Direct damages compensate the plaintiff for the loss that is conclusively presumed to have been foreseen by the defendant from his wrongful act.\textsuperscript{30}

While

Special damages, on the other hand, result naturally, but not necessarily, from the defendant's wrongful acts. Under the common law, consequential damages need not be the usual result of the wrong, but must be

\textsuperscript{24} Arthur Andersen & Co. v. Perry Equip. Corp., 945 S.W.2d 812, 816 (Tex. 1997) (“Of course, foreseeability is not an element of producing cause under the DTPA.”)
\textsuperscript{25} Thomas v. State, 226 S.W.3d 697, 707 (Tex. App.-Corpus Christi 2007, pet. dism’d)
\textsuperscript{26} Wright v. Carpenter, 579 S.W.2d 575, 577 n.1 (Tex. Civ. App.-Corpus Christi 1979, writ ref’d n.r.e.)
\textsuperscript{27} Chien v. Chen, 759 S.W.2d 484, 494-95 (Tex. App.--Austin 1988, no writ)
\textsuperscript{28} Eglin v. Schober, 759 S.W.2d 950, 953 (Tex. App. - Beaumont 1988, writ denied) (“An oral promise to buy for another creates a constructive trust which can bypass the Statute of Frauds.”);
\textsuperscript{30} Arthur Andersen & Co. v. Perry Equip. Corp., 945 S.W.2d 812, 816 (Tex. 1997)
foreseeable and must be directly traceable to the wrongful act and result from it.\footnote{Id.}

Special damages include incidental, consequential and reliance damages. The three categories can be duplicative and their applicability can be limited by the plaintiff’s approach to direct damages.

Under the market method\footnote{Dan Dobbs, Law of Damages § 3.2, page 288 (Practitioner Treatise Series 1993)}\footnote{Formosa Plastics Corporation USA v. Presidio Engineers and Contractors, Inc 960 S.W.2d 41, 49 (Tex. 1998)}, direct damages can be measured according to the Out-of-Pocket Approach (a restitutionary measure, “OOP”) or the Benefit-of-the-Bargain Approach (an expectancy measure, “BOB”). The OOP measure compensates for the actual injury sustained, "measured by the difference between the value of that which he has parted with, and the value of that which has been received."\footnote{Id.} The BOB approach measures the plaintiff’s expectancy interest: "The benefit-of-the-bargain measure computes the difference between the value as represented and the value received."\footnote{Arthur Andersen & Co. v. Perry Equip. Corp., 945 S.W.2d 812, 816 (Tex. 1997) and Formosa Plastics Corporation USA v. Presidio Engineers and Contractors, Inc 960 S.W.2d 41, 49 (Tex. 1998)} The benefit-of-the-bargain method can include lost profits on the bargain if such damages are proved with reasonable certainty and on the basis of the bargain being realized as mis-represented.

Technically, the BOB and OOP approaches are described as measures of direct damages\footnote{See Federal Land Bank Ass'n v. Sloane, 825 S.W.2d 439, 442-43 (Tex. 1991) and notes 179 to 183 and accompanying text.} although special damages can be claimed under either approach and the choice of one approach over the other will restrict the plaintiff’s claims for special damages. no holding has been found that precludes the OOP approach from being applied to special damages. Only the BOB approach provides for lost profits (generally as a special damage alternative to direct damage)\footnote{Henry S. Miller Co. v. Bynum, 836 S.W.2d 160, 164 (Tex. 1992)( Phillips, concurring) (Affirming special damages under the OOP approach.) (See discussion in notes 98 through 101 and accompanying text).} but consequential or reliance damages have been affirmed under the OOP approach.\footnote{D.S.A., Inc. v. Hillsboro Indep. Sch. Dist., 973 S.W.2d 662,664 (Tex. 1998)} Assumptions that may allow for certain types of special damages under the BOB approach would not be permitted under the OOP approach which is largely considered the default approach to special damages in the absence of claiming expectancy damages.\footnote{D.S.A., Inc. v. Hillsboro Indep. Sch. Dist., 973 S.W.2d 662,664 (Tex. 1998)}

Direct and consequential damages are subject to different causation standards. Causation is presumed for direct damages but the plaintiff must satisfy the producing cause standard under the DTPA or the proximate cause standard for claims under Section 27.01 or under the common law. Foreseeability is determined by the facts
known at the time of the contract\textsuperscript{39} and should be established for the types of special damages at issue; the plaintiff is not required to prove that the amount of the consequential damage was foreseeable.\textsuperscript{40} Similarly, Texas common law is much more concerned with the plaintiff’s proving that she experienced at least some damage on a non-speculative basis, the damages in fact. Once the fact of damage is established, the estimate or projection of damage must be reasonable and founded in sufficient fact the exact measure is not expected to be exact or without some uncertainty.\textsuperscript{41}

\section*{B. Fraudulent Inducement Widens the Plaintiff’s Reach}

It would be a mistake to conclude that the relative power of a claim for fraudulent inducement lies only in the plaintiff’s right to ‘stack’ expectancy and punitive damages. Compared to a claim for breach of contract, a claim for fraudulent inducement also allows the plaintiff to name potential defendants otherwise difficult to reach.

Under claims for fraudulent inducement, it is straightforward to include the defendant individually.\textsuperscript{42} One opinion even acknowledged the tactic as a viable alternative to piercing the corporate veil.\textsuperscript{43} Individuals can also be held liable for punitive damages.\textsuperscript{44}

Plaintiffs that are third parties to a contract, not identified as specific beneficiaries under the contract, are now regularly granted jurisdiction for claims of fraudulent inducement. Plaintiffs have generally been allowed to make a variety of

\textsuperscript{39} Investors, Inc. v. Hadley, 738 S.W.2d 737, 739 (Tex. App.--Austin 1987, writ denied)

\textsuperscript{40} See Motsenbacker v. Wyatt, 369 S.W.2d 319,323 (Tex. 1963) and E. Allan Farnsworth, Farnsworth on Contracts § 12.14 (3d ed. 2004) (“The magnitude of the loss need not have been foreseeable, and a party is not disadvantaged by its failure to disclose the profits that it expected to make from the contract.”)

\textsuperscript{41} Southwest Battery Corp. v. Owen, 131 Tex. 423, 428 115 S.W.2d 1097, 1099 (Tex. 1938) citing Jones v. George, 61 Texas 347 (“The courts draw a distinction between uncertainty merely as to the amount and uncertainty as to the fact of legal damages. Cases may be cited which hold that uncertainty as to the fact of legal damages is fatal to recovery, but uncertainty as to the amount will not defeat recovery. A party who breaks his contract cannot escape liability because it is impossible to state or prove a perfect measure of damages.”); See also Restatement (Second) of Torts section 912 ( 1977) (“The rule that precludes recovery of uncertain and speculative damages applies where the fact of damages is uncertain not where the amount is uncertain. Once plaintiff has established the fact of damages, uncertainty as to the amount does not bar recovery.”)


\textsuperscript{44} \textit{Id.}
claims in equity against defendants who are not signatories for constructive trusts and fiduciary duty cases but pecuniary claims at law are somewhat new and have succeeded against real estate brokers, accountants, title companies, lenders and attorneys.

When applied in the context of the breach of a settlement agreement, the claim of fraudulent inducement effectively allows the plaintiff to add punitive damages to his underlying claim. Assuming the plaintiff can establish the requisite intent for the defendant, she can plead her claim underlying the settlement as direct damages and seek punitive damages as well. In at least three cases, a court of appeals has affirmed punitive damages in excess of the amount either provided under the settlement or the amount claimed by the plaintiff underlying the settlement. Thus the Eleventh District substantiated the punitive damages partially on the basis of the plaintiff’s original claim. The court of appeals in McDill justified the $4 million of punitive damages on the basis of the value of the plaintiffs settlement or about $2.2 million.

Perhaps the most colorful example of settlement fraud is to be found in family law. A prosperous lawyer convinced his wife that they needed to divorce to protect their community property from a pending malpractice claim. The husband arranged for a friend to represent both of them in an agreed divorce that separated $1.1 million of property for the wife (7.5% of the community estate.) After the divorce was finalized, the husband asked his ex-wife to move out of the house and he then promptly married the ex-wife’s ‘best friend.’ In a subsequent jury trial relating to fraud on the wife’s separate property, the jury split the community property 58 percent ($8.5 million) to 42 percent ($6.1 million) to the wife and husband, respectively, but the wife was also awarded $1.3 million in mental anguish, $1 million in punitive damages and $1.5 million in prejudgment interest. Subsequently, the husband and their joint counsel were also suspended from the practice of law for two years.

45 Pope v. Garrett, 147 Tex. 18, 211 S.W.2d 559, 562 (1948)
46 Ginther v. Taub, 675 S.W.2d 724, 728 (Tex. 1984) and Kinzbach Tool Co. v. Corbett-Wallace Corp., 160 S.W.2d 509, 514 (Tex. 1942)
48 Arthur Andersen & Co. v. Perry Equip. Corp., 945 S.W.2d 812, 816 (Tex. 1997)
49 American Title Co. v. BOMAC Mortgage Holdings, L.P., 196 S.W.3d 903, 911 (Tex. App.-Dallas 2006, no pet.)
50 Commerce Bank v. Lebco Constr., Inc., 865 S.W.2d 68, 84 n.13 (Tex. App.--Corpus Christi 1993, writ denied)
Cases and commentary provided by Dunn show that fraudulent inducement claims relating to settlement agreements are asserted in other jurisdictions. The majority rule apparently does not limit actual damages in such claims to the settlement value of the claims underlying the settlement.\(^{55}\) This may lead to the ‘trial within a trial’ process that is sometimes associated with legal malpractice. Defendants to claims for a fraudulent settlement might reasonably fear a jury’s view of the ‘trial within a trial’ if the jury has already determined the defendant to be a fraudfeasor.

IV. The Evolution of Damages Law for Fraudulent Inducement

Texas was a relative latecomer to the doctrine that common law plaintiffs are entitled to expectancy damages for claims of fraudulent inducement. The Texas Supreme Court rejected the doctrine from 1849\(^{56}\) until 1983\(^{57}\) even though two thirds of the states had adopted it by 1900.\(^{58}\) To many observers it makes little sense for the common law to allow expectancy damages for claims of unintentional breach of contract but to deny the alternative measure in cases of intentional fraud.\(^{59}\)

Furthermore, the Texas Supreme Court approved expectancy damages in a halting and haphazard manner. The Court first affirmed such an award in 1983 for common law\(^{60}\) and DTPA\(^{61}\) claims without much explanation until the Formosa Plastics opinion in 1998 which formally excluded fraudulent inducement from its prior holdings in Delanney and Walter Homes.\(^{62}\)

Case opinions imply the judiciary’s belief that juries would act in an uncontrolled or vengeful manner or that the BOB approach is too speculative.

But the present belongs to a different class of cases, in which (it is said)“the common law loses sight of the principle of compensation and gives damages by way of punishment for acts of malice, vexation, fraud or oppression.” (Sewg. Meas. Dam. 34) In these cases it has been found

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\(^{56}\) Graham v. Roder, 5 Tex. 141, 149; 1849 Tex. LEXIS 117 (Denying expectancy damages for common law fraudulent inducement).

\(^{57}\) Trenholm v. Ratcliff, 646 S.W.2d 927, 933 (Tex. 1983) (Court affirms expectancy damages for common law fraudulent inducement).

\(^{58}\) See cases cited by defendant in error for 32 states. George v. Hesse, 93 S.W. 107, 107 (1906).


\(^{60}\) Trenholm, 646 S.W.2d at 933.


\(^{62}\) Formosa Plastics Corporation USA v. Presidio Engineers and Contractors, Inc 960 S.W.2d 41, 46 (Tex. 1998) citing Southwestern Bell Telephone Co. v. DeLanney, 809 S.W.2d 493, 494 (Tex. 1991) and Jim Walter Homes, Inc. v. Reed, 711 S.W.2d 617 (Tex. 1986).
difficult to set any fixed or precise limits to the discretion of the jury, or in fact to prescribe any rule whatever.\textsuperscript{63}

In a 1906 opinion, the Court argued that such the OOP approach provides an appropriately similar outcome to the alternative remedy of rescission.\textsuperscript{64} The Court further cited two U.S. Supreme Court cases\textsuperscript{65} which both rejected expectancy damages for an investor that bought a worthless silver or gold mine. In Sigafus the Court acknowledged that the plaintiff had paid about $400,000 for a mine that would have been worth $1,000,000 as represented but also rejected such damages as the “expected fruits of an unrealized speculation.”\textsuperscript{66} The doctrine embodied in these cases became the foundation for measuring damages in federal securities claims.\textsuperscript{67}

In 1924, the Texas Supreme Court continued to exclude expectancy damages by reversing the award of expectancy damages for fraudulent inducement.\textsuperscript{68} The Court justified the reversal solely on the basis that the underlying claim was one for deceit rather than breach of contract, acknowledging that expectancy damages would have otherwise been appropriate.\textsuperscript{69} In 1938, the Court again rejected expectancy as too speculative to furnish a correct measure of damages.\textsuperscript{70} Left unexplained is why the measure was too speculative for deceit but not for breach of contract.\textsuperscript{71}

\begin{footnotes}
\item[63] Graham v. Roder, 5 Tex. 141, 149; 1849 Tex. LEXIS 117.
\item[64] George v. Hesse, 93 S.W. 107, 108 (1906) (“The contract in this case was not to convey a tract of land with a “gusher” on it; but was to convey a certain tract of land, which was falsely represented to have a “gusher” on it, which false representation was an inducement which led to the contract. Logically, therefore, what he has lost by the transaction is the measure of his damages. Let us suppose that when the fraud was discovered George had not conveyed any of the property transferred to him, and Hesse had sued for a rescission as he would have had the right to do; the parties would simply have been placed in statu quo, and the plaintiff would have recovered nothing for his failure to get the property as represented. He would have recovered his property and there would have been no loss, except the expense of the litigation. So in this case, if the plaintiff recovers a sufficient sum in money to make that which he has received equal to that which he has conveyed and that which he has assumed to pay, he is compensated for his loss, and, as we think, that is the measure of his damages.”)
\item[65] Smith v. Bolles, 132 U.S. 125 (1889) and Sigafus v. Porter, 179 U.S. 116 (1900)
\item[66] Sigafus, 179 U.S. at 125.
\item[67] That doctrine was challenged in a Second Circuit opinion that held that securities plaintiffs, especially securities sellers, should be awarded the benefit of their bargains if the bargain can “be established with adequate certainty” asserting that the basis of the two Supreme Court opinions was concern over the reliability of the measurement of the expectancy. Osofsky v. Zipf, 645 F.2d 107, 114 (2d Cir. 1980)
\item[68] Booth v. Coward, 265 S.W. 1026 (Tex. Comm’n App. 1924, judgmt adopted)
\item[69] Id. at 1027.
\item[70] Morriess-Buick Company v. F. C. Pondrom 131 Tex. 98; 113 S.W.2d 889 (Tex. 1938) quoting 27 C. J., pp. 98
\item[71] To draw the distinction even a little finer, there is an interesting group of cases that has been largely ignored in the courts’ discussion and may be useful. Even before the Court’s opinion in George v. Hesse, both the Texas and U.S. Supreme Court held that if the defendant willfully or fraudulently breached a contract to sell real or personal property, the plaintiff was entitled to expectancy damages. Otherwise the plaintiff was awarded compensatory damages. See Phillips v. Herndon, 78 Tex. 378; 14 S.W. 857; 1890 citing Hopkins v. Lee, 6 Wheaton (U.S.) 109
\end{footnotes}
The legislature diverged from this doctrine in 1919 by passing statutory authority for expectancy damages in fraudulent inducement claims relating to transactions in common stock and land\textsuperscript{72} as Article 4004 (now section 27.01). In 1973, it also passed the precursor to the Deceptive Trade Practices Act which was intended to enable consumers to secure adequate remedies for 'unconscionable' business practices, including fraud\textsuperscript{73} although it never provided for any specific measure of actual damages.

A. The Standard of Practice Since 1980

Case opinions on remedies for fraudulent inducement surged in the early 1980's as the effects of the DTPA began to filter through the system. Most of those opinions in the 1980's and 1990's related to whether the plaintiff was entitled to expectancy damages or whether jury findings were the product of adequate instruction and sufficient evidence. The general standard of practice of remedies law in the trial court and court of appeals, as represented by case opinions, was weak and inconsistent with the long-time standards for the BOB or OOP approach to direct damages for breach of contract. Indeed, most of the corrections in the opinions were applicable to either approach on issues of general technique not just details relevant to expectancy damages.

Jury findings that were flawed in one or more of the following ways were frequently reversed:

- Vague or broad jury instructions which failed to instruct the jury as to the accepted measures of damages\textsuperscript{74};
- Jury instructions that asked the jury to find damages as a lump sum, applying what was sometimes called the 'total loss' approach, without distinguishing direct from special damages\textsuperscript{75};

\textsuperscript{72} El Paso Dev. Co. v. Ravel, 339 S.W.2d 360, 363 (Tex. Civ. App. - El Paso 1960, writ ref d n.r.e.) (“Prior to the enactment of Article 4004, supra, in 1919, the Texas rule for measuring damages in fraud cases involving transactions in land was the rule announced in 1906 by the Supreme Court of Texas, in the case of George v. Hesse, 100 Tex. 44, 93 S.W. 107, 8 L.R.A., N.S., 804, and followed by that Court in Booth v. Coward, Tex.Com.App., 265 S.W. 1026, 102...”)

\textsuperscript{73} Woods v. Littleton, 554 S.W.2d 662, fn. 1 (Tex. 1977) (“The Consumer Protection Act, originally enacted on May 21, 1973, was amended effective September 1, 1975 and effective May 23, 1977.”)

Jury findings assessed without supporting evidence for the fair market value \(^{76}\); and

Jury findings assessed without any objective evidence of salvage values \(^{77}\).

Attention to details was increasingly emphasized; if the plaintiff claimed that the service or asset received was without salvage value, for example, she was expected to establish sufficient evidence for the jury to make such a finding. Failure to comply with this search for details often led to remanding the case or denying the damages for claims even with strong cases for liability.

Frequently jury instructions also failed to instruct the jury on the appropriate standard for causation or even what evidence to consider in calculating their damage findings. The issue of lump sum findings has caused difficulty for both the plaintiff and defendant at the appellate level for their inability to distinguish between appropriate or inappropriate portions of the finding. \(^{78}\)

### B. Expectancy Damages

Ironically, the Texas Legislature and courts were again out of sync as the Texas legislature discontinued statutory authority for expectancy damages in the 1983 amendments to section 27.01 which was the same year that the Supreme Court first affirmed expectancy damages for a common law claim.


\(^{76}\) Woods v. Littleton, 554 S.W.2d 662, 664 (Tex. 1977); Smith v. Kinslow, 598 S.W.2d 910, 913; 1980; Johnson v. Willis, 596 S.W.2d 256, 262 (Tex.Civ.App. -- Waco 1980, writ ref. n.r.e.);


\(^{78}\) Myers v. Walker, 61 S.W.3d 722, 732 (Tex. App.--Eastland 2001, pet. denied) (Defendant claimed that damages should not include mental anguish but court overruled the objection because there was sufficient evidence of damages other than mental anguish to substantiate the jury award.); Barnes v. Cumberland Int'l Corp., 1994 Tex. App. LEXIS 2011 (Tex. App. Houston 14th Dist. Aug. 11, 1994) ( "When a damage issue is submitted in broad form, an appellate court cannot ascertain with certainty what amount of damages is attributable to each element."
In the 1980’s and 1990’s, despite the fact that the appellate courts were split on the availability of the expectancy damages\(^7\), there was a substantial body of opinions that affirmed the BOB approach for claims under the DTPA\(^8\) and the common law.\(^81\) In subsequent ‘landmark’ opinions like *Leyendecker\(^82\)* and *W.O. Bankston\(^83\)*, the Court overlooked its own first two opinions that affirmed the BOB approach for claims under the DTPA and common law in *White\(^84\)* and *Trenholm\(^85\)*, respectively. The plaintiff in *Trenholm* originally plead a statutory cause of action but the court of appeals ordered a second trial under the common law. The appeal from the second trial led to the Supreme Court opinion that reinstated the jury award for lost profits under the BOB approach. *Trenholm* was largely ignored until the Fifth Circuit discovered the opinion as support for switching from denying expectancy damages in 1994\(^86\) to affirming expectancy damages in 1995\(^87\). Since that time, *Trenholm* was also been cited by the

\(^82\) Leyendecker & Associates, Inc. v. Wechter, 683 S.W.2d 369, 373 (Tex. 1984);
\(^83\) W.O. Bankston Nissan, Inc. v. Walters, 754 S.W.2d 127, 128 (Tex.1988)
\(^84\) White v. Southwestern Bell Tel. Co., 651 S.W.2d 260, 263(Tex. 1983)
\(^85\) Trenholm, S.W.2d at 933.
\(^86\) Camp v. Ruffin, 30 F.3d 37 (5th Cir.1994) (rejecting benefit-of-the-bargain damages in common-law fraud action)
\(^87\) Hiller v. Mfrs. Prod. Research Group of N. Am., 59 F.3d 1514, 17-18 (5th Cir. 1995)(“Before we address Federal's first argument, we clarify whether Duravision and MPR can recover any lost profits under Texas law. Texas common law traditionally awarded only out-of-pocket costs in fraud cases. Morriss-Buick v. Pondrom, 131 Tex. 98, 113 S.W.2d 889 (1938); see also Camp v. Ruffin, 30 F.3d 37 (5th Cir.1994) (rejecting benefit-of-the-bargain damages in common-law fraud action). That measure, however, is no longer exclusive. With the enactment of the DTPA, Texas expanded the allowable methods by which damages in a fraud case can be measured, and today, Texas common law allows "either the "out-of-pocket' or the 'benefit of the bargain' damages, whichever is greater.")
Supreme Court.88 White was a DTPA case but was ignored in Leyendecker and only belatedly remembered in Bynum.89

The Leyendecker opinion does not state that Texas common law fraud affords expectancy damages. It merely states that Texas common law affords the out of pocket approach and that under some statutory claims, the benefit of the bargain approach is appropriate.90 The Court’s statement is also dicta for both statutory and common law fraudulent inducement; the Court held that the trial judge and court of appeals were wrong to override the jury finding that there was no difference between the value received and represented.91 While of no precedential value, the case head notes summarize that part of the opinion as holding that Texas common law affords both the BOB and OOP approaches. Ironically, the Leyendecker case is now effectively cited for the head note rather than the actual opinion.92

The W.O. Bankston opinion does state that Texas common law provides for both approaches but again the statement is dicta for the common law claim because the Bankston case relates to a DTPA claim for the fraudulent sale of a pickup truck.93 The plaintiff traded in a car to buy a truck that was represented to be a 1982 model but was actually a 1981 model. When the bank determined that the truck was actually a 1981 rather than a 1982 model, it denied the plaintiff’s loan application. By the time that the plaintiff returned the truck for lack of financing, his car had already been re-sold. The plaintiff’s damages were presented as a net result: he claimed the value of the lost trade-in.

The Supreme Court acknowledged the defendant’s liability but denied damages because the plaintiff had failed to establish the value of the purchase as represented and the value as delivered to the plaintiff.94 At trial, the plaintiff made a ‘lump sum’ or ‘total loss’ claim very similar to the claim for economic rescission made in Dallas

88 Tooke v. City of Mexia, 197 S.W.3d 325, 346 (Tex. 2006)
90 Leyendecker & Associates, Inc. v. Wechter, 683 S.W.2d 369, 373 (Tex. 1984) ("Texas courts have recognized two measures of damages for misrepresentation. Texas common law allows an injured party to recover the actual injury suffered measured by "the difference between the value of that which he has parted with, and the value of that which he has received." George v. Hesse, 100 Tex. 44, 93 S.W. 107 (1906). This measure of damages is known as the "out of pocket" measure and is calculated as of the time of sale.")
91 Id.
93 W.O. Bankston Nissan, Inc. v. Walters, 754 S.W.2d 127, 128 (Tex.1988)
94 Id. ("Walters’ burden of proof in this case was to show either the difference between the fair market value of the pickup as delivered and the value of the truck as it was represented; or the difference in value between that with which he parted and that which he received. He did neither. Walters had the burden of requesting jury issues on the proper measure of damages. Having failed to do so, his cause of action must fail.")
Farm Machinery: a transaction had gone bad and the plaintiff wanted the value of his trade-in equipment which had already been re-sold by the dealer. In Bankston, the plaintiff’s jury instructions and evidence both failed to meet the standard of measuring the difference between the price paid and the value received or the value represented.

In Henry S. Miller, the plaintiff secured a jury finding under the lump sum approach for a DTPA claim. The plaintiff alleged that the misrepresentations of the defendant real estate broker induced the plaintiff to lease space in a shopping center. The plaintiff recovered as actual damages the total amount of his net capital investment in the lease venture over a 21-month period. Even though the plaintiff did not present evidence to support an "out-of-pocket" or "benefit-of-the-bargain" measure of damages, the Supreme Court held that the evidence supported the award of these damages as part of the "actual loss" the plaintiff sustained. In his concurring opinion, Chief Justice Phillips emphasized the fact that the plaintiff in that case only sought special or consequential damages. This point plus the fact that the plaintiff measured its damages only according to the OOP approach precluded the need to distinguish damages between direct and special damages or between the BOB or OOP approaches.

C. Perry Equipment

The Court’s opinion in Arthur Andersen & Co. v. Perry Equip. Corp. ("Perry Equipment") is important because it provides the most cogent explanation of the Court’s paradigm for damages, at least in an asset transaction. Perry Equipment purchased Maloney Pipeline ("Maloney") from Ramteck II in August of 1985 on the basis of two financial statements prepared by Arthur Andersen as of March 31 and June 30 of 1985, both of which showed Maloney to be profitable. However, on May 20, 1985 Arthur Andersen also sent an undisclosed report to Ramteck II which indicated that Maloney was operating at an annual loss of $600,000. Perry Equipment paid $4,088,237 to purchase the company and spent an additional $1,361,231 on Maloney after the acquisition to try to salvage its investment. Maloney filed for Chapter 11 protection in October 1986 and thereafter the case was converted to a Chapter 7 liquidation.

The jury instructions asked "What sum of money, if any, if paid now in cash, would fairly and reasonably compensate PECO for its losses which resulted from

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95 Dallas Farm Mach. Co. v. Reaves, 158 Tex. 1,14-15; 307 S.W.2d 233, 241 (Tex. 1957) ("The money recovery awarded in this case was the market value of the trade-in machinery which petitioner had sold. It was awarded in lieu of a return of the trade-in machinery. There was evidence supporting the trial court's finding that the fair market value of the machinery was $2100.00, and it was not error to award respondent a recovery of $2094.00 in lieu of the return of the trade-in machinery.")
96 W.O. Bankston Nissan, Inc. v. Walters, 754 S.W.2d 127, 128 (Tex. 1988)
100 Id.
101 Arthur Andersen & Co. v. Perry Equip. Corp., 945 S.W.2d 812, 816 (Tex. 1997)
such conduct.” The jury awarded $5,449,468 of direct damages as well as $3,449,468 of prejudgment interest and $1,973,009 in legal fees in its suit against Arthur Andersen.

In a brief and problematic opinion, the First District recited the distinction between the BOB and OOP approaches but it overlooked the distinction between direct and special damages. The First District adopted the plaintiff’s claim that Maloney, the acquired company, was a veritable sink hole into which the plaintiff threw the purchase price and subsequent additional expenditures to attempt to salvage the operation, aptly called ‘sinkhole expenses.’ The First District’s opinion quotes the Supreme Court’s Bynum opinion, following the ‘total loss’ approach, but the First District opinion neglected to distinguish direct from special damages.

The Supreme Court held that the evidence supported the award of some of these damages as part of the “actual loss” the plaintiff sustained, even though the plaintiff did not present evidence to support an “out-of-pocket” or “benefit-of-the-bargain” measure of damages. Justice Cornyn’s opinion remanded the case for a new trial because Perry Equipment failed to obtain a jury finding that distinguished between direct and consequential damages and that acknowledged that the plaintiff had established that the defendant’s misrepresentations were the producing cause of some of the consequential damages. Ideally, Perry Equipment would have distinguished between three different types of damages according to the OOP approach:

Direct damages: the difference between the fair market value of Maloney Pipe’s equity as it actually was worth (acknowledging the operating losses) and the price paid in August of 1985.

Consequential damage: the difference between the fair market value of Maloney Pipe’s equity (as it was actually worth) in August, 1985 and the value when it filed for Chapter 11 protection (subject to proof of causation).

Consequential and incidental damages: the “sinkhole expenses” with which the plaintiff tried to salvage any value from Maloney Pipe after August, 1985.

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102 ld. at 814 (The Supreme Court describes this total as expenses incurred by Perry Equipment to salvage Maloney.) Arthur Andersen & Co. v. Perry Equip. Corp., 898 S.W.2d 914, 920 (Tex. App.--Houston [1st Dist.] 1995) (The First District opinion shows that the largest single item was the cost of Perry Equipment’s management time and expenses.)


104 ld. at 920.

105 ld. at 919 quoting Henry S. Miller Co. v. Bynum, 836 S.W.2d 160, 162 (Tex. 1992) (“The DTPA provides that a prevailing consumer may obtain "the amount of actual damages found by the trier of fact." TEX. BUS. & COM. CODE ANN. § 17.50(b)(1) (Vernon Supp. 1994). The amount of actual damage recoverable under the DTPA is "the total loss sustained [by the consumer] as a result of the deceptive trade practice.")

106 Arthur Andersen & Co. v. Perry Equip. Corp., 945 S.W.2d 812, 814 (Tex. 1997)
The Supreme Court’s opinion left two open issues. First, the opinion states that the plaintiff must show that the defendant’s misrepresentation was a producing cause of the consequential damages. It advises that transaction causation would be insufficient, i.e. it was not enough for the plaintiff to assert that but for the misrepresentation, there wouldn’t have been any acquisition and therefore no consequential damages. Typically, the loss causation standard is only applied in federal securities cases, not to fraudulent inducement cases nor even for state securities claims. Taken at face value, this additional requirement would represent a major shift in Texas common law which has not adopted the loss causation standard. Perhaps Justice Cornyn contemplated a standard in between the two alternatives or a light version of the loss causation standard as Dunn points out that there are many versions or interpretations of that standard.

Justice Cornyn’s opinion also volunteers an inconclusive discussion of the role that the defendant can pursue to prove that the plaintiff failed to mitigate its damages and thereby receive a limiting instruction from the court on jury instructions for damages. Even in fraud cases, juries have found the defendant liable but reduced the damages for failing to mitigate. His suggestion is well-taken but it fails to offer any observations on the boundary between the plaintiff’s burden to substantiate consequential damages and the defendant’s burden of proof to establish the plaintiff’s failure to mitigate.

As a ‘landmark opinion’ on fraudulent inducement, the Court’s opinion in Formosa Plastics is doubly ironic. First it merely confirmed that expectancy damages are available for claims of fraudulent inducement under the common law after originally making that holding in 1983 in Trenholm and making that statement as dicta in Leyendecker, W.O. Bankston and Perry Equipment. As a part of the Formosa Plastics

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107 Id. at 817 (“Subsequent losses, however, are recoverable only if the misrepresentation is a producing cause of the loss. See Haynes & Boone, 896 S.W.2d at 182. Without this limitation, an investor could shift the entire risk of an investment to a defendant who made a misrepresentation, even if the loss were unrelated to the misrepresentation. The basis of a misrepresentation claim is that the defendant's false statement induced the plaintiff to assume a risk he would not have taken had the truth been known. But to allow the plaintiff to transfer the entire risk of loss associated with his investment, even risks that the plaintiff accepted knowingly or losses that occurred through no fault of the defendant, would unfairly transform the defendant into an insurer of the plaintiffs entire investment.”)

108 Duperier v. Tex. State Bank, 28 S.W.3d 740, 753-54 (Tex. App.--Corpus Christi 2000, pet. dism'd) (“Loss causation is not an element of or a defense to a claim brought under this particular provision of the Act. Until it was amended in 1995, the federal version of article 581-33A(2), 15 U.S.C. § 77l(1) (commonly known as section 12(2) of the Securities Act), did not impose loss causation criteria and federal courts did not include loss causation as an element in a cause of action brought under that section.”)

109 Dunn, supra note 55, section 1.6 at page 19


holding, the Court confirmed that its doctrine in *DeLanney* did not apply to fraudulent inducement because “it is well established that the legal duty not to fraudulently procure a contract is separate and independent from the duties established by the contract itself.” Second, while the opinion also confirms the distinctions made in Perry Equipment between the OOP and BOB approaches for measuring direct damages, it struggles with the hypothetical construct for expectancy damages and fails to note differing measures between asset transactions and service contracts. The opinion states that the proper calculation for this contractor case for expectancy damages is “Presidio’s anticipated profit on the $600,000 bid plus the actual cost of the job less the amount actually paid by Formosa.” Unfortunately this approach is not compared to or grouped with prior service contract cases like *Kish* or *Bynum* to help distinguish damage claims for service contracts from asset transactions.

**D. Reliance Waivers and Class Actions**

The Court’s opinion in *Swanson* is important because it recognizes an effective approach to waive fraud damages. The plaintiffs in *Swanson* claimed that when they formed a venture to develop their offshore diamond lease in South Africa, they were fraudulently induced into an agreement that forfeited their interests. The jury awarded and the court of appeals affirmed $15 million in actual damages and $35 million of punitive damages based on expert appraisals.

The Supreme Court’s opinion in *Swanson*, however, held that the contract clause in which Swanson disavowed any reliance on any representations from the defendants was indeed enforceable. Subject to public policy considerations, sophisticated parties are free to negotiate contracts in which the plaintiff can waive his reliance interest. In the absence of establishing his reasonable reliance, he cannot prove a prima facie case for fraud.

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112 Formosa Plastics Corporation USA v. Presidio Engineers and Contractors, Inc 960 S.W.2d 41, 46 (Tex. 1998)
113 Id. citing Dallas Farm Mach. Co. v. Reaves, 158 Tex. 1, 307 S.W.2d 233, 239 (Tex. 1957)
114 Formosa Plastics Corporation USA v. Presidio Engineers and Contractors, Inc 960 S.W.2d 41, 50 (Tex. 1998)
115 Kish v. Cowboy Pools, 692 S.W.2d 463; 466 (1985);
118 Swanson, 895 S.W.2d at 726.
120 See Forest Oil, 268 S.W.3d at 57-58.
The Federal Trade Commission has been successful in filing quasi-class actions against alleged fraudfeasors for unjust enrichment. The victims of the fraud are not individually named and the settlements or awards are held in trust for the FTC to dispense to victims as they are identified. In 2003, the FTC won about 100 judgments for total awards of about one billion dollars. Recently the Texas Consumer Protection and Public Health Division prevailed in some litigation that indicates that the Deceptive Trade Practices Act may spawn in Texas an effort by state agencies to follow the FTC example. In Thomas v. State, the Court held that the DTPA provided jurisdiction for the state agency to sue for restitution for unnamed plaintiffs. While most claims under the DTPA enjoy only a two year statute of limitations, the court held that claims for restitution were entitled to a four year period. Such statutory claims can be very powerful because of the ease of proving damages and the leverage normally associated with class claims.

IV. Value As A Damages Metric

In many areas of remedies law, lost value and lost profits are alternative measures of damage. For claims of fraudulent inducement relating to an asset transaction, Texas common law prefers loss in value; for claims of relating to service contracts, lost profits is preferred. Special care needs to be taken to understand the basis of the plaintiff’s valuation as well as possible claims for lost profits not only to maximize the plaintiff’s legitimate claim but also to avoid likely pitfalls for duplication.

As a metric of damage, value can offer some significant advantages to business plaintiffs. In comparison to claiming lost profits, loss in business value offers a longer time horizon and can incorporate factors such as risk and changes in capital structure. For example, consider the new retail chain that has secured a loan agreement to finance fifteen outlets. After five successful outlets are completed, the creditor terminates the loan agreement without cause and leaves the retailer unable to secure alternative financing. If the retailer measures his damages by lost profits, he may convince a jury to award projected operating profits for the next five to ten years for the additional ten outlets. By comparison, the plaintiff could claim damages as the difference in the fair market value of a five outlet chain and a fifteen outlet chain. Such a damage claim would include the difference of ten missing outlets for an infinite period of time (business valuations are based on infinite life) and the enhanced value due to increased size and diversity of a fifteen outlet chain versus a five outlet chain. In such a circumstance with the income projections based on exactly the same numbers for the

first five years, I have experienced a differential of 200% greater for change in value versus lost profits.

A. Measuring Value

There are a number of different types of value: fair market value (the price agreed to by a willing buyer and willing seller based on complete information), use value (the economic value of an asset based on a specific use for a specific owner) or subjective value (the value of an asset to specific individual based on that individual’s personal ‘relationship’ to the asset).125

To comply with business appraisal standards and the expectations of most litigation, it is important to ensure that there are no special assumptions in the estimate of fair market value that could taint or corrupt the usefulness of the estimate for direct damages.126 For transactions relating to personal property, for example, the plaintiff’s subjective value for the asset is irrelevant.127 For claims relating to business transactions, the business needs to be valued on a stand-alone or arm’s length basis.128 Therefore, the fair market value of a single fast food restaurant should be the same whether it is about to be acquired by a recent retiree who plans to provide the majority of the labor or by a national chain of such restaurants which enjoys substantial economies of scale in financing, purchasing and administration.

If the measure of the plaintiff’s lost profits were based strictly on a free standing or arm’s length relationship, i.e. no special consideration is given to the nature or special resources of the plaintiff, such a claim for lost profits would be duplicative of the direct damages that are claimed as a difference in fair market value.129 However,

125 Shannon Pratt, et. al., Valuing a Business, Third Edition page 544
126 Measuring value for expectancy damages, however, may require a valuation under the BOB approach to apply special assumptions based on the defendant’s misrepresentations to provide the plaintiff with the benefit of the bargain.
128 Dobbs, supra note 32, section 3.5, pages 324-333 but see Restatement of the Law, Second, Contracts § 347 Measure of Damages in General, comment b (“If defective or partial performance is rendered, the loss in value caused by the breach is equal to the difference between the value that the performance would have had if there had been no breach and the value of such performance as was actually rendered. In principle, this requires a determination of the values of those performances to the injured party himself and not their values to some hypothetical reasonable person or on some market. See Restatement, Second, Torts § 911. They therefore depend on his own particular circumstances or those of his enterprise, unless consideration of these circumstances is precluded by the limitation of foreseeability (§ 351).”) 129 Dobbs, supra note 32, 9.2(3) 558 (“How duplication occurs. ... If Blackacre, a farm, would be worth $500,000 with the good water supply represented by the seller, but is worth only $400,000 with the water that in fact exists, then the buyer who has paid $400,000 for the farm has $100,000 general damages under the loss of bargain measure. Thus sum reflects, as a capital sum, the expectation that, with limited water, the farm will produce fewer crops and that it will therefore earn less money. If the plaintiff is permitted to recover both $100,000 and the estimated value of the future crops themselves, the value of the diminished crops with will have been
lost profits are effectively subjective, not objective, and the plaintiff’s measure of lost profits is permitted to include most special factors that would have allowed the plaintiff to gain ‘special use’ profits.\(^{130}\)

In most cases, the plaintiff who asserts direct damages as the difference in market value can also substantiate those ‘special use’ profits as separate special damages. For example, assume that a national chain of restaurants was fraudulently induced into buying a similar individual restaurant. Before the acquisition, the national chain studied the acquisition and determined that on the basis of its proven management and operating system, it would improve the profitability of acquisition by $50,000 a year over and above the level of profitability that would otherwise be reasonable to expect from such an operation. In fact, the chain can document that in the twenty prior acquisitions, the outlet’s profit improvement ranged from $40,000 to $100,000 with an average of $50,000 per year. Accordingly, the chain assesses a corporate charge to each restaurant of $50,000 to reflect the corporate contribution to the outlet’s performance. Therefore the defrauded chain can claim direct damages in the form of the value differential for the outlet as well as consequential damages of $50,000 per year for the chain for the lost profit from lost corporate charges without risk of duplication.

Consider the case of Naegli Transport in which the plaintiff bought a piece of used machinery for $10,000 and hired the defendant to transport and store the machinery until the plaintiff was ready to restore it.\(^{131}\) In the meantime, the plaintiff found a customer to buy the equipment, restored, for $280,000. The plaintiff reasonably estimated that restoration would require $25,000 of cash expenditures. The plaintiff sued the defendant when it became clear that the equipment was irretrievably lost while under counted twice."). See also Ryan Mortgage Investors v. Fleming-Wood, 650 S.W.2d 928, 936 (Tex. App.--Fort Worth 1983, writ ref'd n.r.e.).

\(^{130}\) Dobbs, supra note 32, 12.2(3) (“To see an example of consequential damages, suppose the defendant reneges on a promise to deliver a specified computer system for $150,000. The computer is worth $160,000. A general or market measure of damages would give the plaintiff an award in such a case ($10,000). But suppose the plaintiff is unable to use the computer as planned to calculate factory production schedules for maximum efficiency. This in turn may cause a reduction in profits compared to those that would have been earned had the computer been available. Damages based on the market value of the computer will not compensate the plaintiff for the profits lost in this way. Nor would the general damages measure provide compensation for the added expense the plaintiff might suffer in hiring added worked to do customer billing by hand that the computer could do more efficiently. The added expense and the loss of profits are real losses not based directly on the market value of the computer. They are losses in consequence of not having the computer.”) See also Checker Bag Co. v. Washington, 27 S.W.3d 625, 641 (Tex. App.--Waco 2000, pet. denied) (“Business reputation or “goodwill” is usually considered to be a part of the value of a business. Nelson v. Data Terminal Systems, Inc., 762 S.W.2d 744, 748 (Tex. App.--San Antonio 1988, writ denied). The ability of the business to make a profit is reflected in its value. City of San Antonio v. Guidry, 801 S.W.2d 142, 150 (Tex. App.--San Antonio 1990, no writ). Thus, the recovery of both lost profits and damage to business reputation could easily be duplicative. See Id.; C. A. May Marine Supply, 649 F.2d at 1053.”)

the care of the defendant. The jury awarded damages to the plaintiff on the basis of direct damages of $25,000 and consequential damages of $150,000 for lost profits. The plaintiff succeeded in securing an award of most of the asset’s subjective value.

Many business claims relate more to limited term business ventures than established ongoing businesses such as real estate developments or even the advertising component of an existing business.\(^{132}\) In such circumstances, a claim for lost profits may seem more suitable even if such special damage claims are subject to the standard of proximate cause as opposed to the presumptive causation permitted direct damages. On the other hand, the valuation of a business or venture according to the income method is nothing more than the present value of the projected profits (as adjusted for cash expenditures) and the terminal value of the venture.\(^{133}\) If an expert can measure the present value of lost profits, she can reasonably estimate the value of that business and may want to consider why damages are presented in the form of lost profits rather than lost value.\(^{134}\)

Alternatively, business venture plaintiffs have asserted damages based on the plaintiff’s costs or expenditures made for the venture on the implied basis that the small venture is too obscure or too small to be appraised.\(^{135}\) Some business appraisals have been made on the basis of cost but such a practice is generally regarded as a last resort among professional business appraisers and the courts have generally criticized such practice.\(^{136}\) Such a damages measure would only be appropriate for consequential or reliance damages and only under the OOP approach.\(^{137}\)

While the topic is outside the scope of this article, it is also important to note that the cost to repair the plaintiff’s damage is sometimes plead as an alternative for the plaintiff or as a limiting condition by the defendant.\(^{138}\)

\(^{132}\) White v. Southwestern Bell Tel. Co., 651 S.W.2d 260,262-63 (Tex. 1983)
\(^{133}\) Galveston, Harrisburg & San Antonio Co. v. Texas, 210 U.S. 217, 227 (1908) (”The commercial value of property consists in the expectation of income from it.”) See also Abraxas Petroleum Corp. v. Hornburg, 20 S.W.3d 741, 761 (Tex.App.--El Paso 2000, no pet.)
\(^{134}\) For example, claims for lost profits might measure the present value of lost profits according to a ‘normal’ discount rate of 10% when the appropriate discount rate for the business in question might be 20% which unchecked would allow the plaintiff to claim excessive damages.
\(^{136}\) Woo v. Great Southwestern Acceptance Corp., 565 S.W.2d 290, 297-298 (Tex.Civ.App. Waco 1978, writ ref’d n. r. e.) but see Raye v. Fred Oakley Motors Inc., 646 S.W.2d 288, 291 (Tex.App.--Dallas 1983, writ ref’d n.r.e.) (”Woo is the only authority cited, or found, where actual damages are measured by proof of cost, rather than market value, of the product purchased where there is no proof that the product was without value in the hands of the purchaser.”)
\(^{138}\) Dobbs, supra note 32, 12.2(2) page 28 (“Commonly, however, the choice in measuring expectancy damages is a choice familiar in other areas – a choice between a market value measure and a cost-of-substitute performance measure, either of which might also be supplemented with special damages such as lost profits when the facts warrant.”)
B. Valuation Date

Texas courts generally insist that valuations be made as of the date that the contract was executed. Some case opinions have allowed that date to vary within a range of dates in cases of ‘string along fraud’ which includes fact patterns where the defendant makes significant misrepresentations to induce the contract and to either extend or hide the earlier misrepresentations after the contract is executed. Outside of Texas, a minority of jurisdictions allow the relevant valuations to be made as of the date of discovery.

The choice of Texas courts to require valuation on the date of execution can create some complications for those plaintiff’s whose purchased assets continue to decline in value after the date the contract is signed. Contrary to general theory, recent Texas case opinion defines direct damages as that damage, measured by the difference in market value, on the date the contract is signed rather than that damage that is the natural and usually result of the misrepresentation. Apparently, in Texas it is possible for the plaintiff to experience damage that naturally and usually occurs as a result of the misrepresentation after the date of the contract and should therefore be treated as special damage, requiring greater proof as to causation and special pleading.

A 1991 opinion from El Paso shows that failing to consider the time frame of a plaintiff’s claim can result in the denial of damages. The plaintiff bought a house for $135,000 that required substantial renovation. The plaintiffs spent $80,125 on improving the house and then tried to sell the property. After they secured a contract, the plaintiffs learned that a wall of the house encroached on an adjoining property and the contract fell through. Absent the encroachment the property was appraised at $229,000 although the plaintiffs thought the property was worth $258,000 which was the value that the defendant told the plaintiffs that the property would be worth with some improvement.

The jury instruction asked “What sum of money, if paid in cash, do you find from a preponderance of the evidence, would fairly and reasonably compensate [the plaintiffs] for their actual damages, if any?” After having found the defendant liable for fraudulent inducement, the jury found that actual damages were $42,000 (probably

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139 For an exception to this rule see the following cases relating to string along fraud. Hycel, Inc. v. Wittstruck, 690 S.W.2d 914, 924 (Tex. App.--Waco 1985, writ diam'd) and Formosa Plastics Corp., USA v. Kajima Int'l, Inc., 216 S.W.3d 436, 459 (Tex. App.--Corpus Christi 2006, pet. denied)
140 Dunn, supra note 55, section 5.5 at page 205
141 See notes 104 to 108 and the accompanying text on the Texas Supreme Court’s opinion in Perry Equipment. See also notes 179 to 183 and accompanying text on how Texas Supreme Court’s definition of lost profits also abridges this common law doctrine.
143 Id.
144 Id. at 244.
measured as the approximate difference between $258,000 and the plaintiffs’ cost basis of $215,125. In response to the defendant’s no evidence motion, the appellate court reversed the trial court and ordered that the plaintiffs take nothing:

The Appellees’ judgment must be reversed. It was Appellees’ burden to offer proper proof to support their DTPA claim and there is no evidence in the record concerning the difference between the purchase price of the realty and its actual value as received by Sam and Carol Meraz.145

Not only was the plaintiff’s damages strategy inadequate to substantiate the $145,190 judgment but it probably also understated the plaintiff’s actual loss. If the house had a fair market value of less than the cost basis of $215,125, the total damages would be greater than $42,000, i.e. the difference between $258,000 and the current fair market value.

Under the BOB approach, the Meraz’ damages would have two components:

- the loss in value on the date of purchase (the fair market value on the date of sale of the property as represented less the consideration paid)
- the lost profit as measured by the difference between the fair market value of the house as represented and restored and the fair market value on the date of sale of the property as represented.

Damages under the OOP approach would offer less relief. The plaintiff would be entitled to direct damages of the difference between the price paid and the fair market value of the house on the date of sale as delivered, i.e. with full knowledge of the encroachment. The improvements would not qualify as reliance damages because improvements qualify as damage only to the extent that they fail to improve the value of the plaintiff’s property or assets.146 To the extent that a defendant can prove that reliance damages would result in a loss to the plaintiff, the loss can not be included as damage.147 However, the plaintiff might be able to prove some incidental damages for expenses that the plaintiff incurred in salvaging or re-selling his asset. Under the OOP approach, however, no consequential damages in the form of lost profits would be admitted.

V. Lost Profits As A Damages Metric

145 Id. at 245.
147 See note 262 and accompanying text
Business claims for expectancy damages in fraudulent inducement claims are generally plead as lost profits. Historically, Texas courts have preferred business damages to be measured as losses in value for the loss of the entire business and lost profits for damage of part of the business or loss of the business for a limited time period.\textsuperscript{148} That historical bias no longer seems prevalent and in cases of fraudulent inducement there appears to be no requirement to measure by difference in value in asset transactions.\textsuperscript{149} Opinions in service contract cases generally consider only lost profits.

For the purposes of fraud damages, four types of lost profits can be distinguished. First, there is the gain on sale or transaction profit.\textsuperscript{150} The best example of this form of lost profit is the opinion in \textit{Replacement Parts} where the plaintiff had a contract to sell certain real estate lots to the defendant as a result of which the plaintiff would have enjoyed significant profits.\textsuperscript{151} In that case lost profits were held to be direct damages. Second, there is the normal operating profits that were lost in the past and/or that are expected to be lost in the future. Of course, there is significant litigation over how these lost profits should be measured. With some exceptions, this type of lost profit is only admissible under the BOB approach and is not admissible for consideration as damage for negligent misrepresentation.\textsuperscript{152} Third, lost profits have been asserted as evidence of the damage to the plaintiff’s credit reputation or goodwill.\textsuperscript{153}

The fourth group of lost profits relates to the economic theory of opportunity cost. Claims for opportunity costs have been plead under two different sets of circumstances. The first and most frequent form is by plaintiffs who are not entitled to expectancy damages but who attempt to claim lost profits in the form of reliance or special damages as they relate to the subject contract of the misrepresentation.\textsuperscript{154}


\textsuperscript{149} But see the following cases that hold that lost profits is the only appropriate measure for damages in a breach of contract. Abraxas Petroleum Corp. v. Hornburg, 20 S.W.3d 741, 761 (Tex.App.--El Paso 2000, no pet.) and Nelson v. Data Terminal Systems, Inc., 762 S.W.2d 744, 747 (Tex.App.--San Antonio 1988, writ denied)

\textsuperscript{150} Dobbs, supra note 32, 3.3(3) page 299 (“In some cases the plaintiff’s loss is found in the fact that the plaintiff did not make the gain to which she was entitled. This is notably the case with expectancy damages in contracts. The horse purchaser has a loss in the sense that she failed to reap the $50,000 gain that contract performance would have given him. It is appropriate to say that the plaintiff failed to reap a “gain” or entitlement here but not helpful to say that he lost “profit,” which would suggest that an expected income stream was lost or diminished. Although lost profits may be recoverable in some cases, they will be recoverable as consequential damages, not as market damages.”)

\textsuperscript{151} Cmty. Dev. Serv., Inc. v. Replacement Parts Mfg., 679 S.W.2d 721, 725-26 (Tex. App.--Houston [1st Dist.] 1984, no writ)


\textsuperscript{153} Duval County Ranch Co. v. Wooldridge, 674 S.W.2d 332, 336 (Tex. App. -- Austin 1984, no writ) (“The amount of damage is also supported by sufficient evidence. Wooldridge testified generally to his losses and to one particular instance of a lost job which was worth from $192,000.00 to $288,000.00 to Wooldridge. The jury’s award was well within that range.”)

\textsuperscript{154} Dobbs, supra note 32, section 12.3(1) at page 54.
These claims are generally rejected as thinly disguised claims for expectancy damages.155

The second form is taken more seriously as it relates to the opportunity costs or lost profits on secondary contracts or business transactions aside from the subject transaction. One such claim was regarded as too attenuated as asserting loss from a contract too far removed and speculative from the transaction at issue.156 Another claim was also rejected but received more serious consideration and was only rejected for want of adequate substantiation. The plaintiff claimed that the defendant had induced the defendant into pursuing intensified service under the existing contract in anticipation of being awarded a second and more lucrative contract. The plaintiff was awarded significant damages for consequential and reliance damages. However, the plaintiff also asserted special damages in the form of profits that the company would have otherwise earned by devoting its attention to more lucrative business opportunities than the project that it was induced into pursuing. This opportunity cost claim, as manifested in the jury’s finding, was rejected on the basis of inadequate substantiation.157 It seems reasonable to note that this sort of claim, without overwhelming evidence and sympathetic circumstances, is bound to meet substantial resistance from judges who fear such excessive speculation and who could invoke the higher standard implicit in requiring proof of ‘damages in fact.’158

Occasionally, a plaintiff can secure lost profits aside from expectancy damages. If the plaintiff sells goods or services to the defendant and thereafter claims damages in the amount of such sales, the damages include the plaintiff’s lost profits on

155 Baylor Univ. v. Sonnichsen, 221 S.W.3d 632, 637 (Tex. 2007) (“Damages arising from the inability to obtain employment during the 1996-1997 season and the lost opportunity to advance career and increase earning capacity are benefit-of-the-bargain damages because they are premised on the assertion that Baylor is liable for not employing Sonnichsen during 1996-1997 as he expected and for not honoring an alleged contract. Sonnichsen's claim is not that he parted with or lost anything during his actual contract term, but that he did not benefit as he expected or would have if his employment by Baylor continued beyond 1995-1996.”) See also Sterling Chems., Inc. v. Texaco Inc., 259 S.W.3d 793, 798 (Tex. App.--Houston [1st Dist.] 2007, pet. denied) and See also Case Corp. v. Hi-Class Bus. Sys. of Am., Inc., 184 S.W.3d 760,779 (Tex. App. Dallas 2005, no pet.) ("HBS's description of its claimed damages makes clear HBS was not seeking to recoup its expenditures made in reliance on the Hatch representations. Instead, HBS was seeking to collect any prospective additional revenues it relinquished when it contracted: (a) to produce the Case catalogs at a discount from what it normally charged for such production; and (b) to reductions in license and maintenance fees.")

156 ISG State Operations, Inc. v. Nat'l Heritage Ins. Co., 234 S.W.3d 711, 718 (Tex. App.--Eastland 2007, pet. denied) (“ISG's damage model exceeds the Hoechst contractor's claim because it does not seek profits collaterally lost due to underlying events, but the profits it expected to receive from a future contract.”)

157 Hoechst Celanese Corp. v. Arthur Bros., Inc., 882 S.W.2d 917 (Tex. App.--Corpus Christi 1994, writ denied) (“The evidence shows, not that the increased staff and focus caused the increased sales in 1990 and 1991, only that 1990 and 1991 continued the trend of increased construction that began in 1989. We find no evidence to support the finding of lost profits. We sustain point five as to the lost profits on fraud.”)

158 See note 41 and accompanying text.
those sales because the plaintiff is seeking payment of the full price. Unless the defendant objects, it is unlikely that the court would notice such implied profits.  

Case opinions have described some strong examples of lost profit analysis. A simple example is provided from a breach of contract case relating to a cigarette distributor that lost its supply of cigarettes from the breach of a requirements contract. The plaintiff estimated the lost profits over the remaining life of the contract on the basis of both lost volume and increased cost of alternative sourcing for the cigarettes. Similarly, the Fifth Circuit recently affirmed a lost profits analysis in Hiller which also related to the plaintiff's loss of supply of a unique product. The opinion approved the damage award of $3,995,000 because it was based on the sales revenue from specific contracts that were lost as a result of the defendant's breach or fraud. Those revenues were offset by costs of goods sold and operating expenses to measure lost profits.

The lost profits analysis described in *Hycel* was sophisticated and was generally affirmed by the court of appeals. That case relates to a dispute in which the plaintiff ordered a new blood testing machine for $125,000 that had yet to reach actual production but was promised for delivery by the defendant for a specific date. The defendant never produced a machine that met the promised specifications of the contracted equipment although the plaintiff employed a less efficient temporary substitute with less capacity manufactured by the defendant. For a period of at least three years, the plaintiff waited for the promised machine that the defendant reaffirmed would be soon delivered before the plaintiff returned the defendant's substitute machine and bought two machines from a competitor to replace the contracted capacity. The plaintiff sued for lost profits in the form of lost efficiency and lost capacity which was reduced to $3,426,973 after a remittur of $1,351,000.

Hycel's success in claiming three to four years of lost profits was based in part on its proof that the defendant made a series of subsequent reinforcing misrepresentations, i.e. string-along fraud, that precluded the plaintiff from replacing the promised machine sooner. Hycel's claim also benefited from the fact that the DTPA only requires that the plaintiff show that the misrepresentation was the producing cause of the damage, not the proximate cause.

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159 New Process Steel Corp., Inc. v. Steel Corp. of Tex., Inc., 703 S.W.2d 209, 215 (Tex. App.-Houston [1st Dist.] 1985, writ ref'd n.r.e.).
162 Hycel, Inc. v. Wittstruck, 690 S.W.2d 914, 924 (Tex. App.--Waco 1985, writ dism'd).
163 Id.
164 Id. ("The evidence is by no means conclusive on whether the Laboratory waited an unreasonable length of time to mitigate. It waited over three years, from the fall of 1977 to December 1980, before purchasing the Vickers and ACA analyzers. The doctors claimed, however, that when Hycel failed to deliver the M in the fall of 1977, they continued to rely on Hycel's repeated promises to deliver the M "very soon" or in another sixty or ninety days. The evidence presented a fact question on the Laboratory's diligence, but no issue was submitted to the jury.")
In the pertinent fraud cases, the issue generally reduces to the question of how far should the plaintiff be allowed to project ahead in terms of subsequent anticipated events. Lost profits from the existing contract are appropriate and subsequent contracts for resale may be affirmed especially when the plaintiff has firm agreements with third parties to buy assets or when the plaintiff can establish his business capability to reliably sell the assets. The plaintiff’s goodwill or business reputation can be a significant factor. The courts did not question that Trenholm would be able to sell the houses that he was building because he had a strong track record of successful home development and Hiller had contracts with waiting customers.

There have also been case opinions in which the Court of Appeals denied lost profits on subsequent contracts. Presumably in those contrary cases, the case facts were unconvincing or the court determined that those lost profits would be excessive as courts traditionally enjoy significant discretion in the area of lost profits.

A. Mitigation

The boundary is not well defined between (1) the plaintiff’s burdens of proof to establish adequate causation between the damages claimed and the defendant’s misrepresentation and (2) the defendant’s burden of proof to establish the plaintiff’s failure to mitigate his damages is not well defined. The Court in Perry Equipment reminds the defendant that it is possible to refute some or all of the plaintiff’s assertions about damage causation by proving that the plaintiff failed to mitigate damages but the Court avoids any discussion of the dividing line but seems to raise the issue.

165 Trenholm v. Ratcliff, 646 S.W.2d 927, 933 (Tex. 1983). See also Barnett v. Coppell N. Tex. Court, Ltd., 123 S.W.3d 804, 827-8 (Tex. App.--Dallas 2003, pet. denied) (“In contrast, in this case, Lewis testified he is a gymnastics instructor and teacher. He and Wanda owned and operated NTGA for three years before contracting with Barnett. During those three years, the business expanded significantly, increasing from twenty-four students to fourteen hundred students. The business was profitable, earning $106,000 in profit in 1997. Lewis testified that, in the terms of growth of the business profitability and the growth in Coppell, his expectation for profits after 1997 was from $150,000 to $180,000 per annum. He believed it to be a reasonable, if not conservative, estimate in light of the growth of Coppell and the existing business.”) and Hiller v. Mfrs Prod. Research Group of N. Am., 59 F.3d 1514, 1518 (5th Cir. Tex. 1995); and Munters Corp. v. Swissco-Young Indus., Inc., 100 S.W.3d 292, 301 (Tex. App.--Houston [1st Dist.] 2002, pet. dism’d)

166 ISG State Operations, Inc. v. Nat’l Heritage Ins. Co., 234 S.W.3d 711, 718 (Tex. App.--Eastland 2007, pet. denied) (“ISG’s damage model exceeds the Hoechst contractor’s claim because it does not seek profits collateral lost due to underlying events, but the profits it expected to receive from a future contract.”)

167 Mead v. Johnson Group, Inc., 615 S.W.2d 685, 687 (Tex. 1981) quoting Restatement (Second) of Contracts § 365 Unforeseeability and Related Limitations on Damages (3) Even if the party in breach had reason to foresee the loss as a probable result of his breach when the contract was made, a court may limit damages by excluding recovery for loss of profits, by allowing recovery only for loss incurred in reliance, or otherwise if it concludes that in the circumstances justice so requires.


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Defendants might reasonably wonder whether a jury that finds the defendant liable for fraud will seriously consider reducing the plaintiff’s damages for failing to mitigate her damages. In at least one case with ‘bad facts’ against the defendant the jury substantially reduced actual damages. The First District summarized the damming case facts as follows:

Evaluating the evidence under the factors set out in Alamo Nat'l Bank, there was sufficient evidence to support the appellee's theory of the case that the appellant ran a dishonest repair shop; that the appellant's conduct constituted a "bait and switch" operation; that appellants habitually cheated customers, especially the "little guys;" and that when appellants realized that appellee was willing to pursue his remedies at law, they instituted a cover-up in an attempt to avoid the consequences of their actions. 169

In that case, the jury reduced actual damages of $2,189 by $1,677 due to the plaintiff’s failure to mitigate his loss although the plaintiff was also awarded $30,000 in punitive damages. 170

Despite the contrary holding 171 and dicta 172 of the Texas Supreme Court, there is a small but continuing undercurrent of cases that wrongly assert that the plaintiff has no obligation to mitigate her damages in cases of intentional torts. 173 These statements are based on incomplete research on the appellate opinion in *Meadolake*. 174 The initial opinion was subsequently clarified 175, warranting a per curiam note from the Supreme Court that the writ was denied on the basis that the First Circuit’s holding had been revised to state that the defendant’s point of error on mitigation was rejected because the defendant had failed to previously raise the objection. 176

170 Id. at 274.
171 Gunn Infiniti v. O’Byrne, 996 S.W.2d 854, 857 (Tex. 1999).
174 Id. at 872.
Occasionally, the plaintiff’s good faith effort to mitigate damages can act as a sword as well as a shield. In Trenholm, the plaintiff was misled about the nature of the lots that it bought for building single family homes. After building out 11 of the 18 lots, the plaintiff learned the truth, that the unsightly trailer park adjacent to the property was not going to be removed. After learning the truth, the plaintiff continued to purchase and develop the remaining lots, later claiming that he couldn’t stop in the middle of the development, akin to a surgeon in mid-operation.\textsuperscript{177} Reversing the court of appeals, the Court held that the plaintiff’s development subsequent to learning the truth was reasonably necessary to avoid losses that would have been greater in the alternative.\textsuperscript{178}

B. Are Lost Profits Always Special Damages?

It has already been noted that the Court’s position in \textit{Perry Equipment}, that direct damages must be measured as of the date of the contract, limits the legal doctrine that direct damages are those damages that naturally and usually result from the defendant’s misrepresentation. In a case unrelated to fraudulent inducement but that cites fraudulent inducement case opinions, the Court has stated a similar limitation on claims for lost profits, that lost profits are only to be treated as special damages.\textsuperscript{179} In the future, the Tooke opinion could be limited to similar claims against municipalities but at least one federal district court has recently held that the Tooke opinion could be applied broadly outside claims against municipalities.\textsuperscript{180}

The Southern District’s interpretation of the \textit{Tooke} opinion contradicts Texas precedent\textsuperscript{181} and other authorities.\textsuperscript{182} In cases of fraudulent

\begin{footnotesize}
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\item \textsuperscript{177} Trenholm v. Ratcliff, 646 S.W.2d 927, 933 (Tex. 1983)
\item \textsuperscript{178} Id. at 932. ("If Trenholm had abandoned the agreement after discovering the fraud, he would have given up his right to whatever profits were still possible. Additionally, Trenholm testified his other loan agreements with Richardson would not have been renewed if he had abandoned the joint venture agreement. The fact that Trenholm purchased lots after the discovery of the fraud as he was obligated to do under the agreement does not conclusively establish as a matter of law that Trenholm did not rely on Ratcliff’s representation, or alternatively, that he waived his claim of fraud.")
\item \textsuperscript{179} Tooke v. City of Mexia, 197 S.W.3d 325, 346 (Tex. 2006) citing Trenholm v. Ratcliff, 646 S.W.2d 927, 933 (Tex. 1983) and Henry S. Miller Co. v. Bynum, 836 S.W.2d 160, 163-164 (Tex. 1992) (Phillips, C.J. concurring)
\item \textsuperscript{182} Dunn, supra note 55, Section 4.4 page 155 ("A careful analysis suggests that lost profits damages are not appropriately fitted into either the benefit-of-the-bargain rule or the out-of-
\end{itemize}
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inducement the difference between pleading lost profits as direct or special damages lies with the higher standard of proximate cause for special damages. The distinction is less important to fraudulent inducement than to breach of contract cases that dispute the coverage of contract provisions that waive consequential damages.  

C. Gross Not Net Profits

Profit is a more elusive term than most lawyers realize. The most significant dispute about the definition of profit is whether it should refer to the plaintiff’s profit before or after allocations of corporate costs, the distinction between ‘gross profits’ and ‘net profits.’ While the Restatement of Contracts does not refer specifically to gross profits or net profits, the practical result of the damage formula, lost revenues less costs saved, is the equivalent of gross profits. Most jurisdictions, including Texas, provide that gross profit is the relevant measure for contract disputes. In relation to fraudulent inducement claims, the case law has some opinions on either side of the issue but most discussions of the sufficiency of the evidence for certain awards of...
profit generally make a rough calculation of damages based on gross profits.\textsuperscript{189} It is a significant ongoing dispute in other areas of the law where the difference in measure between the two definitions can be surprisingly significant.\textsuperscript{190}

D. Ex Post v. ex ante Evidence

To the extent that a court would allow the plaintiff’s damages to be claimed as either loss in value or lost profits, it’s useful to recognize that each offers a tactical advantage or disadvantage depending on the trends of the business in dispute.\textsuperscript{191} A claim for lost value is based on ex ante valuations of the business interest while lost profits are measured on an ex post basis. Therefore, if the business at issue were a car dealership, bank or investment bank in the Spring of 2008, the difference in resulting damages would be larger as measured by the ex ante approach of the market method to direct damages than the ex post approach of lost profits to special damages. Damages to those businesses based on the value of the businesses in the Spring of 2008 would not be diminished by any events that occurred after the valuation date.\textsuperscript{192} However, any measure of lost profits would be reduced by the dramatic economic downturn and financial crisis in the Fall of 2008.\textsuperscript{193}

VII. BOB v. OOP Approaches To Direct Damages

A. Asset Transactions

The plaintiff’s choice between the BOB and OOP\textsuperscript{194} approaches is complicated by the plaintiff’s election of remedies and whether the subject contract is an

\textsuperscript{189} Cmty. Dev. Serv., Inc. v. Replacement Parts Mfg., 679 S.W.2d 721, 725 (Tex. App.--Houston [1st Dist.] 1984, no writ). (“Generally, lost profits are properly calculated by deducting from the actual contract price the costs of the injured party's performance supported by data. \textit{id}. "However, a witness may also prove lost profits by testifying as to what his profit would have been, based on his knowledge of the cost of performance of each element of the contract and subtracting the total of such costs from the contract price." \textit{id}. and B&W Supply, Inc. v. Beckman, 2009 Tex. App. LEXIS 2413, *10-11 (Tex. App. Houston 1st Dist. Apr. 9, 2009) (“Lost profits are recoverable only if the evidence shows that the loss of profits was a material and probable consequence of the breach complained of and the amount due is shown with sufficient certainty.”).

\textsuperscript{190} Counting the Beans: Unjust Enrichment and the Defendant's Overhead, supra note 184 at 488-490.

\textsuperscript{191} For a general discussion of the ex ante and ex post characteristics of damages for fraud, see Robert E. Scott, The Case for Market Damages: Revisiting the Lost Profits Puzzle, 57 U. Chi. L. Rev. 1155, 1161-62 (1990)

\textsuperscript{192} Williams v. Gaines, 943 S.W.2d 185, 193 (Tex. App.--Amarillo 1997, writ denied) (op. on reh'g) (Holing that subsequent data provides no probative evidence of value.)

\textsuperscript{193} For examples of cases that measure lost profits on the basis of ex post data see Pace Corp. v. Jackson, 155 Tex. 179, 190-91 (Tex. 1955)(breach of contract); Pena v. Ludwig, 766 S.W.2d 298, 302 (Tex. App.--Waco 1989, no writ) (breach of contract); Signal Peak Enters. of Tex., Inc. v. Bettina Invs., Inc., 138 S.W.3d 915, 924-25 (Tex. App.--Dallas 2004, pet. struck) (fraud)

\textsuperscript{194} Dobbs, supra note 32, section 9.2(1) page 549. Dobbs notes that the name for the OOP approach causes significant confusion among practitioners and the judiciary. Special meaning of "out-of-pocket". The out of pocket measure is a general measure, that is, one computed with reference to the value of the very thing purchased or sold. The term thus does not refer to
asset transaction or a service contract. The plaintiff to a fraudulent inducement claim must elect between accepting the contract and suing for breach of contract type of damages or rejecting the contract and seeking rescission and other equitable relief to reverse the impact of the contract.

The dynamics of the election differ between asset transactions and service contracts. For an asset transaction contract, if the plaintiff chooses to deny the contract, she will choose between equitable relief or special damages under the OOP approach. Expectancy or direct damages are inapplicable when the plaintiff chooses to deny the contract. After denying the contract the plaintiff would typically seek rescission of the contract which generally also allows for some forms of special damages, including punitive damages. After denying the contract under the OOP approach, the plaintiff could seek special damages in the form of incidental, consequential or reliance damages based on the assumption that the plaintiff knew the truth about the defendant’s misrepresentations. Generally, rescission or other equitable relief would be the superior alternative but there may be circumstances under which equitable relief may not be available.

Electing to deny a service contract is more problematic for equitable relief as rescission may not be possible. However, under the OOP approach, the plaintiff can claim special damages on the theory that had she known the truth, she would not have incurred costs that are recoverable as consequential damages as a result of the misrepresentation, although such expenses may be recoverable as consequential damages.

Technically, the BOB and OOP approaches only specifically apply to direct damages although the BOB approach allows for lost profits which are considered special damages. Effectively however, in the absence of the BOB approach, the OOP approach becomes the default approach. D.S.A., Inc. v. Hillsboro Indep. Sch. Dist., 973 S.W.2d 662, 664 1998 Tex. LEXIS 131 (Tex. 1998). See also notes 36 and 37 and accompanying text.

See notes 297 to 299 and accompanying text.

executed the contract and that therefore her purchase price and other special damages were lost as a result (adjusted for any remaining benefit of the service.)

When the plaintiff elects to accept an asset transaction contract, she can choose the BOB or OOP approaches to measure direct and special damages. Few forms of equitable relief apply except possibly for reformation. Direct damages are measured as either the difference between the value received and the value as represented (BOB) or the value received and the value paid (OOP). Since the value as represented will exceed that of the value paid (otherwise the plaintiff would reject the contract), direct damages under these circumstances will be greater under the BOB approach. Furthermore, special damages as determined under the BOB approach are generally broader than non-expectancy damages under the OOP approach because they enjoy the broader standard of assuming the truth of the defendant’s representations.

Barring unusual circumstances, the BOB approach will offer the plaintiff greater damages than the OOP approach for both asset transactions and service contracts. As an alternative to direct damages, claims for lost profits are also available under the BOB approach.

The key to applying the BOB approach is to determine a clear concept of the nature of the benefit of the bargain, to explain how assuming that the misrepresentation(s) are true causes the value of the construct contract to change. How is this construct case different from the actual result or the truth? It’s surprising how some artful pleading can try to adjust the construct to the plaintiff’s advantage. Thus a plaintiff’s attorney claimed that his expectancy damages from the client’s non-payment of a fee was the loss of $500,000 of future contingency fees for various un-named cases that were lost because the lawyer’s cash shortage precluded financing contingency fee cases. Similarly, a plaintiff in a dispute over investing in feedlot cattle claimed that the

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200 The Supreme Court’s opinion in Kish is a good example in which the plaintiff had to elect between the direct damages of accepting the contract and the special damages of denying the contract. The plaintiff made a claim under the DTPA for a contract to build a swimming pool which turned out to be defective. The jury found damages as

(A) The difference between the value received and the price paid for the swimming pool was $1500.

(B) The cost of removing the pool and restoring the Kishes’ back yard to its original condition would be $4000.

(C) The cost of removing the mechanic’s lien from the real property owned by the Kishes would be $8,000.

The Court affirmed the plaintiff’s election to reject the contract and claim findings B and C which would otherwise have been excluded if the plaintiff chose the $1,500 of direct damages measured according to the OOP. Kish v. Cowboy Pools, 692 S.W.2d 463; 466 (1985)

201 See notes 129 to 130 and the accompanying text about possible duplication of direct damages and lost profits.

202 Stuart v. Bayless, 964 S.W.2d 920, 921-22 (Tex. 1998) (per curiam)
failure of the defendant to pay the amount owed precluded him from successfully investing in five years of cattle feeding, realizing the same substantial profit for each lot of cattle.\textsuperscript{203} Both claims were quickly dismissed for lack of foreseeability and factual support, respectively.

In two opinions, the plaintiff succeeded in slightly adjusting the bargain to their advantage. Coastal Oil agreed to buy 50\% of a wildcat interest for a fixed amount that was represented to be the seller's cost basis in the property.\textsuperscript{204} Discovery revealed that the defendant had not actually expended the represented cost basis in cash outlays. The mineral lease was not independently appraised but an employee of the plaintiff testified that wildcat interests are generally valued at their cost. The court accepted this testimony and affirmed the award of the difference between the amount paid by Coastal and 50\% of actual cash cost basis for the defendant.\textsuperscript{205} The contract to buy a wildcat at a fixed price was effectively transformed into an agreement to buy the wildcat at half of cash cost or at least the damages were measured on that basis.

Similarly, there was a First District opinion involving the sale of natural gas to a gas pipeline in which the pipeline misrepresented the initial sales price for the gas in the first year, understating the initial price by 10 cents per MCF.\textsuperscript{206} The contract provided that in the future 80\% of any increases over the initial price secured by the pipeline would be passed on to the owners of the natural gas. The court affirmed the jury finding that awarded 80\% of the ten cent differential to the plaintiffs. A contract that provided for a fixed price in the first year subject to a formula adjustment was slightly changed to a formula contract starting on day one.\textsuperscript{207}

\textsuperscript{203} Penner Cattle, Inc. v. Cox, 2009 Tex. App. LEXIS 3546, *3-4 (Tex. App. Eastland May 21, 2009, pet. filed) ("The trial court awarded Cox breach of contract damages totaling $252,712.14. This represented $34,000 in attorney's fees, direct damages of $43,712.14, and consequential damages in the form of lost profits of $175,000. Cox calculated this by assuming that Penner had timely paid for the cattle's medicine, feed, and transportation and that he had then invested this money in the cattle business. Cox testified that he would have purchased a load of cutting bulls and sold them in 50 to 60 days for a profit of $6,000 to $7,000. Cox testified that he was familiar with the market and that he could have repeated this investment every 60 days. Cox testified that, because over four years had elapsed since the dispute arose, he had lost 25 cattle investment opportunities and a total of $175,000.")

\textsuperscript{204} Southampton Mineral Corp. v. Coastal Oil & Gas Corp., 846 S.W.2d 609,610-611 (Tex. App. Houston 14th Dist. 1993, writ den'd).

\textsuperscript{205} \textit{Id.} at 612.

\textsuperscript{206} Gulftide Gas Corp. v. Cox, 699 S.W.2d 239, 243 (Tex. App.-Houston [1st Dist.] 1985, writ ref'd n.r.e.)

\textsuperscript{207} \textit{Id.} at 245. ("The damage award was also based on fraud in the inducement and performance of the contract. The jury found that appellant falsely and knowingly represented that it had an "agreement" to resell the gas at a base price of $1.95, and that it falsely and knowingly represented that it had a "contract" for $1.95, when the contract price in effect with Allied at all relevant times was $2.05/mcf. Thus, the measure of damages would be the difference between the value received by appellees under the agreement, $1.90/mcf, and the value appellees parted with, or, stated differently, what appellees would have sold the gas for had they known that the actual resale price was to be $2.05/mcf.")
In Fortune, the Supreme Court contradicted the First District in a case with similar facts but a different outcome. There was no necessary formula adjustment in the contract but the gas buyer understated the original sales price of the natural gas again by 10 cents per MCF. At the appellate level, the First District affirmed a damages remedy of the full ten cents. The Supreme Court opinion rejected that remedy as totally hypothetical. There was no evidence that the gas buyer had paid that much in any other contract except that the defendant buyer had passed on the greater price to one other seller for about 10% of the contract volume. The Court remanded the case and warned that in the absence of some evidence of the terms that both parties would have reached in negotiation, the plaintiffs would have lost the case for failure to prove damages. The Court demands proof that the alternate contract claimed by the plaintiffs would have actually happened.

B. Service Contracts

The Court’s opinion in Formosa Plastics is sometimes regarded as the first opinion that affirmed expectancy damages common law fraud. While the Court actually first affirmed expectancy damages for common law claims in Trenholm, its opinion in Formosa was the first opinion that explained why its prior opinions in Delanney and J. Walter Homes did not apply. The case related to a construction contract in which the customer misrepresented the requirements of the construction project and the contractor experienced substantial cost over-runs. The Court’s opinion affirmed expectancy damages but rejected the BOB damage model affirmed by the Thirteenth District. The contractor claimed expectancy damages based on a profit mark-up on the cost overruns, claiming damages on the basis of the contract price that the contractor would have demanded under full information. The Court rejected the measure because there was

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210 Id. (“The evidence showed that, at best, the plaintiffs could have negotiated a price based on the $3.50 Lone Star price for only ten percent of their respective shares of residue gas. Under these circumstances, the plaintiffs’ fraud claims must be remanded to the trial court for another trial.”)
211 Id. citing Formosa Plastics Corp. USA v. Presidio Eng'rs & Contrs., 960 S.W.2d 41, 50(Tex. 1998) (“The bargain that the plaintiffs say they could have struck with Conoco is not "hypothetical," as the dissent argues, S.W.3d at , because of the evidence of the bargain that Conoco did in fact strike with IP. …We acknowledged in Formosa Plastics that if there is evidence of the bargain that would have been struck had the defrauded party known the truth, there can be a recovery for benefit-of-the-bargain damages.”)
212 Case Corp. v. Hi-Class Bus. Sys. of Am., Inc., 184 S.W.3d 760, 779-80 (Tex. App. Dallas 2005, pet. denied) (“However, despite language of the Formosa Plastics opinion suggesting otherwise, recovery under the benefit of the bargain measure requires proof only that the lost bargain would have been made but for the defendant's misrepresentation, not that such a bargain was actually made.”)
213 Trenholm v. Ratcliff, 646 S.W.2d 927, 933 (Tex. 1983)
214 Formosa Plastics Corporation USA v. Presidio Engineers and Contractors, Inc 960 S.W.2d 41, 46 (Tex. 1998) citing Southwestern Bell Telephone Co. v. DeLanney, 809 S.W.2d 493, 494 (Tex. 1991) and Jim Walter Homes, Inc. v. Reed, 711 S.W.2d 617 (Tex. 1986)
215 Formosa Plastics, 960 S.W.2d at 50. (“Burnette’s testimony as to what he would have bid had he known the truth simply does not establish the benefit of any bargain made with Formosa. It is
no evidence that the defendant would have agreed to the contractor’s terms. In the absence of such evidence, the contractor was only entitled to its original expected profit with reimbursement for the cost overruns but no additional profit mark-up.\textsuperscript{216}

Measuring direct damages as the difference between values, the market method, works best in the environment of UCC-type claims in which the assets transacted trade in broad liquid markets that provide immediate opportunities for the plaintiff to quickly ‘cover’ his damages with a minimum of incidental expense. When the transactions relate to services and eclectic assets like business operations, especially smaller business operations, the value difference paradigm becomes impractical.\textsuperscript{217}

One of the ancillary holdings in the \textit{Kajima} opinion is that the market approach does not have to be applied by rote in all cases:

\begin{quote}
We disagree with the basis for Formosa’s contention. As an initial matter, the Arthur Anderson construct, which measures damages at the time the contract is signed, applies to a purchase and sale of a business. As such, it is inapplicable to a construction contract.\textsuperscript{218}
\end{quote}

In both contract and employment cases, courts have adapted the standard model and measure damages as the difference between actual profit and the contractor’s expected profit assuming all misrepresentations are true.\textsuperscript{219}

\textsuperscript{216} Id.

\textsuperscript{217} Buck v. Morrow, 21 S.W. 398, 398 (Tex.Civ.App. 1893, no writ) (“The rule which confines the general damage to the difference between the rental value and the stipulated rent seems to rest upon the assumption that the tenant can go at once into the market and obtain like property. Addison v. Chandler, 11 Mich. 542. Where the reason of the rule does not exist, it would seem that the rule itself should not apply, to the exclusion of all other considerations in estimating the damages. Special damages, in addition, have been allowed in many in-stances.”) and Dunn Section 3.1 page 92 (“The benefit of the bargain and out of pocket rules generally do not fit the loss suffered in these cases, as sales of property are not involved. The courts have been forced to draw upon basic notions of proximate cause to reach just results.”)


\textsuperscript{219} Formosa Plastics Corp. USA v. Presidio Eng'rs & Contrs., 960 S.W.2d 41, 49 (Tex. 1998) and see Formosa Plastics Corp., USA v. Kajima Intl, Inc., 216 S.W.3d 436, 458 (Tex. App.--Corpus Christi 2006, pet. denied) (“There is evidence to support the jury’s award of approximately $15 million based on the difference between the value of that with which Kajima parted and the value Kajima actually received. See Formosa Plastics Corp. USA., 960 S.W.2d at 49. Hutchison testified that the “as planned” cost of the job under normal conditions was roughly $17 million, but that the abnormal conditions concealed by Formosa resulted in an additional $18 million being spent to complete the project. Accordingly, Kajima parted with approximately $35 million and actually received only $10 million. The jury’s award of approximately $15 million was well under the $25 million difference between the value of that with which Kajima parted and the value Kajima received.”)
Employment cases similarly depart from the standard difference in market value approach to direct damages except that damages sometimes need to be distinguished between the direct damages of salaries and perquisites versus the consequential damages of bonuses or profit sharing. Thus a contingency fee for a litigator was found to be a lost profit and a special damage. Alternatively, in two cases contingency fees were found to be direct damages. The Third District held that a bonus fee to a professional conditioned on a damages award exceeding a certain dollar amount was direct damage.

A plaintiff employee without a contract has few options or remedies for fraudulent inducement. Such plaintiffs are rarely awarded lost wages or bonuses. Many times, they are left with claims only for reliance damages: by electing to deny the contract, the plaintiff can claim expenditures made and losses incurred to take the new job.

Claims of fraudulent inducement by lenders do not apply the Perry Equipment model literally. In a literal application, the lender would assert direct damages for the discount in the loan that would be appropriate for the undisclosed risk that the borrower had misrepresented. Actual loan losses in excess of direct damages would then be claimed as consequential damages. In this case, Section 549 of the Restatement of Torts intervenes and suggests treating actual loan losses (measured ex post) as direct damages as they are experienced. Interestingly, very few lenders ever

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220 Miller v. Kennedy & Minshew, Professional Corp., 142 S.W.3d 325, 350 (Tex. App.--Fort Worth 2003, pet. denied) (“The evidence also supports the jury's finding that appellees were entitled to recover $500,000 as benefit-of-the-bargain damages. Benefit-of-the-bargain damages are simply the difference between the value as represented and the value received. 60 Under this measure of damages, the defrauded party may recover lost profits that he would have made if the bargain actually struck had been performed.”) See also Coffel v. Stryker Corp., 284 F.3d 625,638 (5th Cir. Tex. 2002).


222 But see Sanchez v. Johnson & Johnson Med., Inc., 860 S.W.2d 503, 514-15(Tex. App.--El Paso 1993), aff'd in part and rev'd in part on other grounds, 924 S.W.2d 925 (Tex. 1996) (“Nevertheless, as in the instant case, when there has been fraud in the employment relationship, damages in the form of lost wages and benefits would appear to be the only appropriate remedy. In addition, with the availability of consequential damages seemingly limited, to deny Appellant recovery would allow Appellee to commit fraud with impunity. Appellant's Point of Error No. Thirteen is sustained.”) and Columbia/HCA Healthcare Corp. v. Cottey, 72 S.W.3d 735, 746-47 (Tex. App.--Waco 2002, no pet.)

223 Carr v. Christie, 970 S.W.2d 620, 625 (Tex. App.-Austin 1998, pet. denied)

224 As the riskiness of the loan credit increases, the appropriate interest should also increase. In the bond market, if a fixed rate bond requires a yield greater than the coupon rate, the bond’s price declines below 100% and therefore sells at a discount.

225 See Restatement of the Law, Second, Torts § 549 Measure of Damages for Fraudulent Misrepresentation, comment a and American Title Co. v. BOMAC Mortgage Holdings, L.P., 196 S.W.3d 903, 911 (Tex. App.-Dallas 2006, no pet.) Quote from Section 549 of Restatement
claim expectancy damages which would include lost interest and principle as direct damages.\textsuperscript{226}

Claims from borrowers against fraudulent lenders are generally entitled to the difference in borrowing costs.\textsuperscript{227} Claims from borrowers that cannot obtain alternative financing are alternatively entitled to expectancy damages but their claims may evoke concerns about disproportionate expectancy damages, that the plaintiffs are making speculative claims. The proof required of these plaintiffs may reflect the courts’ concern that such claims would otherwise resemble the wishful pleading of \textit{Bayless} or \textit{Penner}.\textsuperscript{228} Cases emphasize the need for plaintiff borrowers to detail the foreseeability of the plaintiff’s damages, requiring the plaintiff to prove that the lender was specifically aware of the borrower’s plans for the loan proceeds and aware of the fact that the borrower would be unable to borrow elsewhere.\textsuperscript{229} On a practical basis, the first awareness should be much easier to prove than the second. Most loan agreements or loan applications include sections on the borrower’s proposed use of proceeds; in some loans, the borrower is even restricted from applying the loan outside of the declared uses. On the other hand, few creditors ordinarily think of their roles as ‘lenders of last resort’; they want to lend money to credits that are sufficiently creditworthy to be able to obtain the loan elsewhere.

\section*{C. Expectancy Claims In Business Acquisitions}

Even after the Supreme Court has handed down numerous opinions that distinguish the BOB and OOP approaches, the opinions of various courts of appeal have demonstrated confusion by failing to adequately distinguish between the two approaches in business acquisitions. There have been four opinions handed down since 2000 that include a common business pattern\textsuperscript{230}: the plaintiff has a business or venture and then

\begin{footnotesize}
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\item \textsuperscript{226} Dunn, Section 3.4 page 100 cites Commercial National Bank v.\ Federal Deposit Insurance Corp., 131 Ill. App. 3d 977, 984 (1985) fraudulently induced loan, damages assessed the full amount of the loan and interest lost from the date of the loan up to trial.
\item \textsuperscript{227} Berens v. Resort Suites-Scottsdale, Inc., 2001 Tex. App. LEXIS 3175, *15 (Tex. App. Houston 14th Dist. May 17, 2001 writ den’d)(“It also found that by the time RSSI found a replacement loan, rates had increased and the cost of a replacement loan was $767,231 and awarded that amount in damages with both appellants jointly and severally liable. It also awarded RSSI $317,822 prejudgment interest.”)
\item \textsuperscript{228} See notes 202 and 203 and accompanying text.
\item \textsuperscript{229} Basic Capital Mgmt. v. Dynex Commer., Inc., 254 S.W.3d 508, 521-22 (Tex. App. Dallas, 2008) pet. granted Basic Capital Mgmt., Inc. v. Dynex Commer., Inc., 2009 Tex. LEXIS 166 (Tex. Apr. 17, 2009)(“In summary, in the event of a breach of contract to lend money, the borrower can recover consequential damages, i.e., expenses and lost profits, if the breaching lender knew, at the time it entered into the contract: (1) that the contracted financing was for a specific venture; and (2) that in the event of its breach the borrower probably would be unable to obtain other financing in a manner that would permit the borrower to carry out that venture.
\item \textsuperscript{230} There are two additional cases in which the plaintiff plead a comparable fact pattern. The opinion in Barnes has already been discussed previously and was shown to make a poorly substantiated claim for lost profits. See note 3 and accompanying text. The second alternative is Swanson in which the plaintiff made a substantiated claim for $15 million of direct damages under the OOP approach and the court of appeals affirmed that award as well as $35 million in punitive damages. The basis for the $15 million claim was the value of the plaintiff’s interest conveyed in
\end{itemize}
\end{footnotesize}
forms a new entity or partnership with a new partner who seizes control and then either destroys the business or takes it away from the original owners. Direct damages under the BOB approach should be measured by comparing the value of the plaintiff's business on the date of the contract under the new agreement and compare that to the value of the plaintiff’s share of the business as represented; under the OOP approach, direct damages would be measured as the difference between the value of the plaintiff’s share of the business immediately before the contract and the value of the plaintiff’s share of the business upon the execution of the contract. In all but the second example, the plaintiff claimed to apply the OOP approach but damages were actually measured or awarded under the BOB approach. In the second case, the Court affirmed lost profits for a plaintiff that failed to plead special damages.

In Rogers v. Alexander, the original owners of a successful business entered into a contract in late January of 2003 and left the company at the end of June of 2003. The new partner promised to manage the company’s accounting and administration while directing substantial new business to the operation. The Dallas Court of Appeals affirmed the award of approximately $2.5 million based on the appraised value of the business in June, 2003. The plaintiffs introduced no evidence of the company’s value in January, 2003 (under any assumption) and no proof of the salvage value of the plaintiffs’ interest. More importantly, the plaintiffs’ interest in the company was appraised after the contract was executed and capitalized the company’s financial performance after the new partner had started to direct new business to the company. Finally, the damages included lost profits in the form of undistributed profits. The measure of damages would be irrelevant even if the plaintiffs were entitled to claim expectancy damages. Without values as of the contract date, before the impact of the new partner, it is difficult to reconcile the resulting damages with the OOP approach. In addition, the Fifth District affirmed that the investment agreement between the plaintiffs and defendant was void. The court’s explanation of why voiding the investment agreement and awarding the plaintiffs the value of the entire company on June 30, 2003 is not duplicative remains unclear.

In Khalaf v. Williams, the plaintiff contractor agreed in 1980 to build a country and western club at cost in exchange for a 30 percent share of the club. When the plaintiff, Williams, discovered that the club was incorporated without providing for his 30 percent interest, he quit. In the six years of motion practice before the actual trial, Williams asserted a cause of action for fraud but he filed no pleading for special

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231 Rogers v. Alexander, 244 S.W.3d 370, 377-78 (Tex. App.--Dallas 2007, no pet. h.)
232 Id. at 387.
233 Id. at 390.
234 Id.
235 For an example of how equitable relief can duplicate lost value in claims for intellectual property, see DSC Communications v. Next Level Communications, 107 F.3d 322, 329-330 (5th Cir. 1997)
236 Khalaf v. Williams, 814 S.W.2d 854, 856 (Tex. App.--Houston [1st Dist.] 1991, no writ)
damages.\textsuperscript{237} The First District mistakenly found adequate substantiation for the damage award of $185,032 on the basis of the expert’s review of the club’s income tax returns for 1980 to 1984 and a financial statement for the club as of October, 1985. The First District affirmed the damages in part because the expert found that the value of 30 percent of the club’s income was $90,000 to $450,000. This evidence of lost profits is irrelevant without having plead for special damages.\textsuperscript{238} The First District alternatively substantiates the jury finding on the expert’s assertion that the value of 30 percent of the value of the club assets was $250,000. This assertion is also irrelevant as the supporting evidence for the assertion was the October, 1985 financial statement which was issued five years after the contract was executed.\textsuperscript{239}

In \textit{Westheimer}\textsuperscript{240}, the plaintiff owner of a location for an adult entertainment establishment agreed to enter into a contract with an experienced manager who would pay the plaintiff a share of the operation’s profits.\textsuperscript{241} The First District held that the award of $465,000 could be substantiated on one of two bases: that the plaintiff had a historical cost basis in the property of $600,000 or that sufficient damages were established, including $346,068.07 of lost profits which are only available under the BOB approach.\textsuperscript{242} Finally, the only evidence recited to justify a zero salvage value was that the plaintiff had received no distributions.\textsuperscript{243}

The fact pattern of the fourth case is a little different but reveals similar confusion. In \textit{Matrix Oncology}, the plaintiff owned 40% of an LLC which the plaintiff and defendant (who owned 60% of the LLC) decided to dissolve.\textsuperscript{244} The plaintiff agreed to sell its 40% interest for $600,000 and a fee of $3 million contingent on whether the contemporaneous merger discussions between the defendant partner and an identified suitor were successfully completed.\textsuperscript{245} After the plaintiff sold its interest in the LLC, the former partner agreed to merge with a different, unidentified merger partner who had been negotiating to buy the partner at the same time as the other, acknowledged suitor. The jury awarded damages of $3 million which prompted the defendant to object that the jury had awarded expectancy damages in the form of the contingency fee even though

\textsuperscript{237} \textit{Id.} at 858. (“Williams asked for actual damages for his cause of action for breach of contract, but Williams did not ask for actual damages for his cause of action for fraud. However, Williams requested exemplary damages for his cause of action for fraud. Williams’ first amended cross-action also contained a general prayer “for such other and further relief . . . [he] may be justly entitled.”)
\textsuperscript{238} Sherrod v. Bailey, 580 S.W.2d 24, 28 (Tex. Civ. App. -- Houston [1st Dist.] 1979, writ ref’d n.r.e.) (“When items of special damage are claimed, they shall be specifically stated.” Rule 56, Texas Rules of Civil Procedure.”)
\textsuperscript{239} Khalaf , 814 S.W.2d at 857.
\textsuperscript{240} \textit{Texas Westheimer Corp. v. 5647 Westheimer Associates}, 68 S.W.3d 15, 21 (Tex. App.--Houston [1st Dist.] 2001, pet. denied)
\textsuperscript{241} \textit{Id.}
\textsuperscript{242} \textit{Id.} at 26. (“In our opinion, the jury could have reasonably concluded that $464,963.83 was a proper amount to compensate plaintiff for its out-of-pocket losses as a result of defendant's fraud.” )
\textsuperscript{243} \textit{Id.}
\textsuperscript{244} \textit{Matrix Oncology, L.P. v. Priority Healthcare Corp.}, 2009 U.S. App. LEXIS 14183, * 6-7 (5th Cir. Tex. June 30, 2009)
\textsuperscript{245} \textit{Id.}
the defendant had only been found liable for negligent misrepresentation which is not entitled to expectancy damages.\textsuperscript{246} The Fifth Circuit affirmed the damage award based on the hindsight observation that the plaintiff’s expert had testified that the plaintiff’s 40% interest was worth between $2.3 to $4.2 million. This observation technically complies with the Perry Equipment paradigm but it makes little sense: why would the owner of a business interest worth $2.3 to $4.2 million to sell for a mere $600,000 and a contingency fee of $3 million?

D. Disconnected Values

The damage analysis in \textit{Matrix Oncology} raises an important characteristic of damages models for fraud: the values substantiated by either party at trial bear no necessary relationship to the case facts. The plaintiff’s range of values in Matrix Oncology may justify the verdict, even applying the OOP approach, but they seem super-imposed on the case as an afterthought. Furthermore, the examples of juries accepting disconnected values may constitute additional evidence, however anecdotal, that juries tend to punish liars.

The defendant’s recourse to disconnected values is to provide alternative valuation opinions and to pursue a rigorous line of cross-examination against the principal parties. In \textit{Matrix Oncology} defendant’s counsel should force the plaintiff CEO to make one or more of the following admissions for the plaintiff:

(1) He made what appears to be a foolish bargain;

(2) When he made the bargain he had no accurate idea of the fair market value of the interest in the LLC; or

(3) He didn’t believe at the time that the LLC was worth as much as $2.3 to $4.2 million.\textsuperscript{247}

Such a line of cross examination would contrast the valuation evidence with the case facts and possibly even impact affect the jury’s opinion on liability.

Consider a different case in which a buyer contracts to buy an apartment project for $2,915,000 only to find that a third party signed an earlier contract to purchase the property for $2,615,000.\textsuperscript{248} The property was eventually sold to the third party and the plaintiff sued for expectancy damages according to the BOB approach. The jury found direct expectancy damages of $2 million.\textsuperscript{249}

\textsuperscript{246} \textit{Id.} at *25-26
\textsuperscript{247} The case opinion did not disclose whether or not such a cross examination did or did not occur.
\textsuperscript{248} Ryan Mortgage Investors v. Fleming-Wood, 650 S.W.2d 928, 936 (Tex. App.--Fort Worth 1983, writ ref’d n.r.e.).
\textsuperscript{249} \textit{Id.} (“No objection was ever made at trial when evidence was introduced concerning the value of the complex. Appellants themselves introduced evidence that the complex was worth $4,585,000.00 as townhomes and $3,100,000.00 as apartments.”)
The defective foundation case summarized in the introduction, Carpenter v. Holmes Builders, consists of values and damages that seem similarly possible but unlikely. The defendant built the home for $641,000 while the jury found damages to the house of $657,000 in addition to other damages of $1,411,000. Few details were provided about the necessary repairs except that it can be noted that there is no evidence that the plaintiffs had major difficulty in living in their house; that difficulties ensued only when they attempted to sell the house.

Assume that a plaintiff has entered into a contract to buy a ranch for $1,200 per acre. The day before closing he is told that the seller can not complete the sale because there was an outstanding right of first refusal on the property for any offers that the seller received in excess of $1,000 per acre. As the plaintiff was totally unaware of the right of first refusal, he sues for fraudulent inducement and seeks expectancy damages. How much would you expect the ranch to appraise for (assuming no right of first refusal) ? Many observers would expect a value near $1,200 an acre because that is the amount that the plaintiff agreed to pay when he was unaware of the outstanding option. Is there a minimum that you would expect in the defendant’s appraisal? Would it make sense for the appraisal to be less than $1,000 per acre (which was the trigger price for the option?) In 1983, the Fourteenth District affirmed the jury’s award on the basis of $1,800 an acre which was close to the average of the defendant’s appraisal of $900 an acre and the plaintiff’s appraisal of $2,500.

From a national perspective, Dunn has noted this widespread phenomenon and offers the explanation of the Arizona Supreme Court “The fact that plaintiffs may have negotiated a very advantageous purchase price with defendants Lux should have no bearing on their right to recover damages for fraud.” Of course, such

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251 Id.
252 Id. at *9-11.
253 For purposes of this example, the sales price of $1200 was estimated as this case fact was never disclosed. Citizens State Bank of Dickinson v. Bowles, 663 S.W.2d 845, 849 (Tex. App.--Houston [14th Dist.] 1983, writ dism’d). See also Momentum Motor Cars, Ltd. v. Williams, 2004 Tex. App. LEXIS 9940, *15 (Tex. App. Corpus Christi Nov. 10, 2004,writ denied) citing Jack Roach Ford v. De Urdanavia, 659 S.W.2d 725, 728 (Tex. App.-Houston [14th Dist.] 1983, no pet.). (“However, sale or contract price constitutes some evidence of market value and is sufficient to support a represented value.”)
254 Carrel v. Lux, 101 Ariz. 430, 441; 420 P.2d 564; 1966 Ariz. LEXIS 367 (1966). See also J. F. Rydstrom., “Out of Pocket” or “Benefit of Bargain” as proper rule of damages for fraudulent representations inducing contract for the transfer of property 13 A.L.R.3d 875 § 3[d] The “benefit of the bargain” rule—Effect of fact that value of property received equals or exceeds price paid (“It sometimes happens that notwithstanding the defendant's fraudulent representations, the property received by the defrauded party, while not as represented, does in fact equal or exceed in value the price paid therefor. Under such circumstances, it has been argued that it would be improper, even under the "benefit of the bargain" rule, to allow the defrauded party a further recovery. Such an allowance is, however, perfectly consistent with the theory of that rule, and has frequently been approved by the courts.”)
acknowledgement and acceptance of the notion of the benefit of a great bargain would not excuse the plaintiff’s appraiser from a potentially scathing cross examination.

In sum, the Perry Equipment paradigm of distinguishing the two approaches to measuring direct damages is best applied to asset transactions and is either inapplicable or difficult to apply in numerous fact patterns, especially service contracts. Furthermore, even though the basic paradigm for measuring expectancy damages has not changed significantly in the last 85 years, courts are experiencing difficulty in distinguishing the two approaches in cases relating to business entity transactions.

VIII. Special Damages

There are some structural differences between the three forms of special damages (incidental, consequential and reliance). Incidental damages generally include expenses and expenditures made by the plaintiff to cope with or mitigate the immediate problems caused by the fact that the asset transacted was misrepresented.255 In practice, consequential damages are frequently described in a broader context, leaving potential overlap between consequential and incidental damages:

Consequential damages include items of expense reasonably incurred to minimize the effects of the fraud, damages caused to other property suffered because of the fraud, travel expenses incurred to deal with the problem, commissions paid or added tax burdens, other items of loss or expense not adequately reflected in the general damages recovery based on market value of the property itself. If the defendant's misrepresentations to the plaintiff impel the plaintiff to litigate with third persons, then the reasonable expenses of that litigation, including the plaintiff's own attorney fees, are recoverable as items of damages consequent upon the misrepresentation.256

255 Wade & Sons, Inc. v. Am. Std. Inc., 127 S.W.3d 814, 825-26 (Tex. App.--San Antonio 2003, pet. denied)TEX. BUS. & COM. CODE ANN. § 2.715 (Vernon 1994)(a) ("Incidental damages resulting from the seller's breach include expenses reasonably incurred in inspection, receipt, transportation and care and custody of goods rightfully rejected, any commercially reasonable charges, expenses or commissions in connection with effecting cover and any other reasonable expense incident to the delay or other breach.") and The Restatement ( Second) of Contracts § 347 cmt. c (1981) offers the following definition: ("Incidental losses include costs incurred in a reasonable effort, whether successful or not, to avoid loss, as where a party pays brokerage fees in arranging or attempting to arrange a substitute transaction.")

256 Dobbs, supra note 32, 9.2(3)

See also Section 2.715 of the UCC which defines consequential damages:

(b) Consequential damages resulting from the seller's breach include
   (1) any loss resulting from general or particular requirements and needs of which the seller at the time of contracting had reason to know and which could not reasonably be prevented by cover or otherwise; and
   (2) injury to person or property proximately resulting from any breach of warranty.
Section 347 of the Restatement of Contracts, relating to expectancy damages, offers the following definition of special damages which may be limited to claims for expectancy damages:

c. Other loss. Subject to the limitations stated in §§ 350-53, the injured party is entitled to recover for all loss actually suffered. Items of loss other than loss in value of the other party's performance are often characterized as incidental or consequential. Incidental losses include costs incurred in a reasonable effort, whether successful or not, to avoid loss, as where a party pays brokerage fees in arranging or attempting to arrange a substitute transaction. See Illustration 3. Consequential losses include such items as injury to person or property resulting from defective performance. See Illustration 4. The terms used to describe the type of loss are not, however, controlling, and the general principle is that all losses, however described, are recoverable.

Consequential damages would therefore include additional losses to the plaintiff, including lost profits and further loss in market value of the asset transacted such as envisioned in *Perry Equipment* or discussed previously. Caselaw is clear that incidental and consequential damages must be specially pleaded which would presumably apply to reliance damages also.

The Restatement of Contracts defines reliance damages as follows:

As an alternative to the measure of damages stated in § 347, the injured party has a right to damages based on his reliance interest, including expenditures made in preparation for performance or in performance, less any loss that the party in breach can prove with reasonable certainty the injured party would have suffered had the contract been performed.

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257 Restatement (Second) of Contracts § 347 cmt. c (1981)
258 See notes 104 to 106 and accompanying text.
259 Perry Homes v. Alwattari, 33 S.W.3d 376, 383-84 (Tex. App.--Fort Worth 2000, pet. denied) (“Out-of-pocket loss and benefit-of-the-bargain are not the exclusive measures of recoverable damages under the DTPA. Henry S. Miller Co. v. Bynum, 836 S.W.2d 160, 162 (Tex. 1992); Kish v. Van Note, 692 S.W.2d 463, 466 (Tex. 1985) (op. on reh'g). Under the DTPA in effect at the time the Alwattaris filed suit, a prevailing consumer could recover all "actual damages" for economic loss sustained by the consumer as a result of the deceptive trade practice. …Such damages include diminution in market value occurring after repairs. Ludt v. McCollum, 762 S.W.2d 575, 576 (Tex. 1988). Thus, we overrule that part of issue three challenging the damages awarded to the Alwattaris for the diminution in the fair market value of their house after repairs.”) See also notes 142 and 146 to 147 and accompanying text.
262 Restatement Second of Contracts, § 349 Damages Based on Reliance Interest. See also Dobbs 12.3(1) Page 51 (“The object of reliance damage awards is to protect the plaintiff against actual losses resulting from contracting even while denying him the gains or expectancy he would
For the purposes of overall damages strategy, three key issues on proposed special damages should be evaluated:

Whether the special damage is available in general;\textsuperscript{263}

Whether the special damage is excluded by one’s choice for measuring direct damages,\textsuperscript{264} and

Whether the proposed special damage is duplicative with other special damages.\textsuperscript{265}

While it has been widely acknowledged that the common law anticipates the finding of non-speculative special damages that are the foreseeable result\textsuperscript{266} of a misrepresentation\textsuperscript{267}, some forms of special damage are subject to exclusion depending on the plaintiff’s approach to direct damages. The Restatement of Contracts clearly provides that a claim for reliance damages is an alternative to a claim for expectancy damages.\textsuperscript{268} The Texas Supreme Court has applied this principle in the scrutiny of have had upon performance.”); Hart v. Moore, 952 S.W.2d 90, 97 (Tex. App.--Amarillo 1997, pet. denied). See see also Quigley v. Bennett, 227 S.W.3d 51, 56 (Brister, J., concurring and dissenting) and Fretz Constr. Co. v. Southern Nat'l Bank of Houston, 626 S.W.2d 478, 483 (Tex. 1981) ("Damages recoverable in a case of promissory estoppel are not the profit that the promisee expected, but only the amount necessary to restore him to the position he would have been in had he not acted in reliance on the promise.")


\textsuperscript{264} See Kish v. Cowboy Pools, 692 S.W.2d 463; 466 (1985) and D.S.A., Inc. v. Hillsboro Indep. Sch. Dist., 973 S.W.2d 662 (Tex. 1998)

\textsuperscript{265} Playboy Enters., Inc. v. Editorial Caballero, S.A. de C.V., 202 S.W.3d 250, 270-71 (Tex. App.--Corpus Christi 2006, pet. denied)

\textsuperscript{266} Dunn, supra note 55, ("Section 1.1 “The proximate cause test is not only a limitation on recoverable damages beyond which the courts may not go. It is also the grant of a charter to the courts to award damages up to the extent of proximate causation. The test becomes particularly important in cases dealing with claims for fraud in transactions other than sales of property and cases where substantial consequential damages are claimed. Here, without the familiar benefit-of-the-bargain and out-of-pocket-loss rules as a guide, the courts are set adrift with no other test to determine whether damages are recoverable. The advocate with that kind of case should use the proximate cause test to establish a damage claim—or to rebut one.")

\textsuperscript{267} Formosa Plastics Corp. USA v. Presidio Eng'rs & Contrs., 960 S.W.2d 41, 49 n1(Tex. 1998) citing Arthur Andersen & Co. v. Perry Equip. Corp., 945 S.W.2d 812, 817 (Tex. 1997) (“It is possible that, in the proper case, consequential damages could include foreseeable profits from other business opportunities lost as a result of the fraudulent misrepresentation.”) See also El Paso Development Company v. Ravel, 339 S.W.2d 360, 364 (Tex.Civ.App.-El Paso, 1960, writ ref'd n.r.e.)

\textsuperscript{268} Restatement of the Law, Second, Contracts § 349 Damages Based on Reliance Interest (“As an alternative to the measure of damages stated in § 347, the injured party has a right to damages based on his reliance interest, including expenditures made in preparation for...
reliance damages for duplication with expectancy damages, especially claims for lost profits. Claims under the OOP approach can be scrutinized to ensure that such damage claims don’t rely on an underlying expectation that the misrepresentation were true.\textsuperscript{269}

Given the Court’s opinion in \textit{D.S.A.}, however, costs to repair or refurbish the misrepresented asset to meet misrepresented specifications are not admissible under the OOP approach. In that opinion, the Court rejected the plaintiff’s claim for the costs to repair the construction to meet the misrepresented specifications. The Court held that the plaintiff was only entitled to the difference in consideration paid and the value of the construction as rendered.\textsuperscript{270}

As noted above, there has been substantial litigation about the nature of consequential damages in a breach of contract when such damages are waived in a contract that is the subject of a breach of contract claim.\textsuperscript{271} To date, such disputes over the exact definition of incidental or consequential damages have not been wide spread in claims for fraudulent inducement. However, in light of the Court’s opinion in \textit{D.S.A.},\textsuperscript{272} it might be reasonable to expect future disputes as to whether certain damages can be found as either individual or consequential damages under the OOP approach as opposed to the BOB approach.

The discussion of potential damages under the OOP approach in the Restatement of Torts does not seem to be as restrictive as the \textit{D.S.A.} opinion assumes. Sub-section (1)(a) of Section 549 provides that the plaintiff under the OOP approach is entitled to special damages defined as “pecuniary loss suffered otherwise as a consequence of the recipient’s reliance upon the misrepresentation.”\textsuperscript{273}

Comment d offers further explanation of the OOP approach:

d. Although the most usual form of financial loss caused by participation in a financial transaction induced by a fraudulent misrepresentation is the

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\textsuperscript{269} D.S.A., Inc. v. Hillsboro Indep. Sch. Dist., 973 S.W.2d 662, 664 1998 Tex. LEXIS 131 (Tex. 1998) (“HISD did not meet its burden of proving the independent injury required under section 552 of the Restatement. HISD’s theory of recovery and charge to the jury did not attempt any distinction between its out-of-pocket damages and the benefit of the bargain. See Arthur Andersen & Co. v. Perry Equip. Corp., 945 S.W.2d 812, 817 (Tex. 1997) (defining the out-of-pocket and benefit-of-the-bargain measures of recovery). Instead, by seeking recovery for its costs to replace the roof, repair the plumbing, and re-grade the parking lots, HISD in essence asked for the benefit of its bargain -- in this case, the reasonable costs needed to bring the school up to the “bargained-for” standard. Consequently, HISD is not entitled to any recovery under the theory of negligent misrepresentation.”)


\textsuperscript{271} See notes 9 and 183 and accompanying text.


\textsuperscript{273} Restatement Second of Torts, § 549 Measure of Damages for Fraudulent Misrepresentation
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lessened value of the subject matter due to its falsity, the loss may result from a purchaser’s use of the article for a purpose for which it would be appropriate if the representation were true but for which it is in fact harmfully inappropriate. So, too, it may be the expense to which he has gone in preparation for a use of the article for which it would have been appropriate if the representation had been true.274

Comment d could be read to closely resemble at least part of what would normally be considered expectancy damages. However, the language can be reconciled with avoiding the expectancy approach by concluding that the damages justified in comment d could have been avoided if the plaintiff had known the truth underlying the defendant’s misrepresentations. Knowing the truth to the defendant’s misrepresentations would have lead the plaintiff to avoid the damages detailed in comment d.

IX. Reliance Damages

Our understanding of reliance damages can suffer from semantic confusion similar to that of damages under the OOP approach. When a case opinion recites that the plaintiff claims damages incurred in reliance on the defendant’s misrepresentation, it is not necessarily referring to reliance damages. Numerous case opinions refer to consequential damages as damages incurred in reliance on the defendant’s misrepresentation.275

Reliance damages can be duplicative with expectancy damages, depending on which type of reliance damages are claimed. Dobbs distinguishes between essential reliance and incidental reliance damages:

Essential reliance is that reliance necessary or essential for the plaintiff’s performance of his promises under the contract. If he contracted to

274 Restatement Second of Torts, § 549 Measure of Damages for Fraudulent Misrepresentation, comment a:

Loss may result from a recipient’s reliance upon a fraudulent misrepresentation in a business transaction in one of several ways. The most usual is when the falsity of the representation causes the article bought, sold or exchanged to be regarded as of greater or less value than that which it would be regarded as having if the truth were known. The rule applicable in this situation is that stated in Clause (a). The damages so resulting, being those which normally result from a misrepresentation in such transactions, are often called general damages.

See also comment b.

275 Trenholm v. Ratcliff, 646 S.W.2d 927,933 (Tex. 1983)(“that Trenholm’s damages directly and naturally resulted from reliance on the misrepresentation.”); Duval County Ranch Co. v. Wooldridge, 674 S.W.2d 332, 336 (Tex. App. -- Austin 1984, no writ) (“He obtained the loans in reliance upon the false representations made to him, and defendants’ failure to comply with this promise is shown by the evidence to have caused Wooldridge’s default on the loans, resulting in damage to his credit and business by the judgment taken against him by Manges’ bank.”); El Paso Development Company v. Ravel, 339 S.W.2d 360, 365 (Tex.Civ.App.-El Paso, 1960, writ ref’d n.r.e.); Hiller v. Mfrs Prod. Research Group of N. Am., 59 F.3d 1514,1518 (5th Cir. Tex. 1995)
produce unique machinery for the defendant, then expenses in making dies for the machinery would be essential reliance expenses. …essential reliance expenses are elements in the computation of the plaintiff’s expectancy; the amount that the plaintiff will gain from completion of the contract on both sides depends on the amount of these essential expenses. So the plaintiff must not recover both essential reliance expenses and expectancy damages.

Incidental reliance expenses could include any kind of collateral outlay by the plaintiff, but it would not include expenses of performing his own promises to the defendant.276

Relying on this distinction, only essential reliance damages would be duplicative with expectancy damages.

Section 349 of the Restatement Second of Contracts describes reliance damages as an alternative to the expectancy damages provided in section 347.277 The Restatement also provides that if the defendant can prove that plaintiff’s completion of the contract would have resulted in a loss, that loss must be offset against the reliance damages claimed.278 Similarly, full expectancy damages are said to act as a maximum limit or ceiling on the amount of reliance damages possible.279 Less explicit but equally applicable is that only cash expenditures or expenses may be found as reliance damages.

One of the clearest examples of reliance damages was in a case in which a borrower claimed that a lender agreed to the loan orally and told the borrower to commence the renovations that was envisioned in the borrower’s proposed use of proceeds. No contract was ever executed and the putative borrower asserted a claim for

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277 Mistletoe Express Serv. of Oklahoma City, Oklahoma v. Locke, 762 S.W.2d 637, 638-39 (Tex.App.--Texarkana 1988, no writ); see also Dobbs 12.3(1) page 50 (“Reliance loss damages generally. When the defendant breaches an enforceable, bargained-for promise, the plaintiff has the option of claiming and recovering reliance expense or loss rather than the expectancy.”)
278 See Restatement (Second) of Contracts § 349 comment a (1981). See also Mistletoe Express Serv. of Oklahoma City, Oklahoma v. Locke, 762 S.W.2d 637, 639 (Tex.App.--Texarkana 1988, no writ)
279 Dobbs, supra note 32, 12.3(1) Page 55.
280 Iron Mountain Bison Ranch, Inc. v. Easley Trailer Mfg., Inc., 42 S.W.3d 149, 158-59 (Tex. App.--Amarillo 2000, no pet.) (“As appellee notes in its brief, the proof it offered as to damages was the quote sheet price amounts and the bills of sale. These were not represented to be expenditures, costs to produce the trailers or amounts to restore appellee to its position before it manufactured the trailers. The quote sheet prices were purported to be merely the price agreed upon for manufacturing and sale of the trailers by appellee. The evidence of reliance damages is legally insufficient. Appellants’ issue is sustained.”)
reliance damages for the monies expended in anticipation of the loan (supposedly net of any benefit to the plaintiff). 281

Reliance damages would seem to be the least likely to include opportunity cost claims that are not related to cash outlays or expenditures but there are at least two case opinions that defy this reasoning. First is the case of the legal assistant who agreed to take a cut in salary for a share in a contingency fee. The agreement was not documented, precluding benefit of the bargain damages, but the court affirmed an award for the foregone wages. 282 In the second case, the plaintiff orally contracted for the defendant to furnish and haul rock. The defendant failed to deliver 40,000 tons of rock and the plaintiff was forced to expedite the job with a third party for $6.59 as opposed to the $5.50 per ton that the plaintiff would have incurred if it had adequate notice. The court inexplicably justified the recovery of a ‘partial expectancy interest’ in this promissory estoppel case. 283 Normally it seems unlikely that such a theory would prevail to justify special damages for either reliance damages or consequential damages when the plaintiff elects the OOP approach.

An interesting case opinion on promissory estoppel was handed down in 2008 that disagrees with the theory behind these prior two cases. The case related to a claim of negligence by a pipeline company against an excavator for rupturing the pipeline and polluting nearby land. 284 The promissory estoppel issue arose only in relation to the plaintiff’s claim for legal fees.

The plaintiff claimed reliance damages on the basis of the pipeline rupture damages that resulted from the pipeline company’s relying on the defendant’s promise to avoid the marked pipeline. The Third District rejected the claim as disguised expectancy damages:

The pipeline company did not expend any money in reliance on the assurances from the excavator, the result of the plaintiff’s reliance was inaction from which damages and losses followed. CITGO’s damages are not reimbursement for any amounts it expended in reliance on the promises, but compensation for consequential losses CITGO claimed it incurred when appellants failed to perform their promises. Such damages are in the nature of expectancy damages: they place CITGO in the position

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282 Central Texas Micrographics v. Leal, 908 S.W.2d 292, 298-99 (Tex. App.--San Antonio 1995, no writ)

283 Frost Crushed Stone Co. v. Odell Geer Constr. Co., 110 S.W.3d 41, 44 (Tex. App.--Waco 2002, no pet.) ("Damages recoverable in a case of promissory estoppel are not the profits that the promisee expected, but only the amount necessary to restore him to the position in which he would have been had he not relied on the promise.")

it claims it would have been had the promises been kept. Such damages are not recoverable through promissory estoppel.\textsuperscript{285}

One case offers the opportunity to compare reliance and compensatory damages. A venture was formed to build and operate gas stations that also offered food courts. After getting started, the venturers had extensive negotiations with Shell Oil about possible investment. The plaintiff claimed that Shell agreed to fund the investment but acknowledged that no written investment agreement was ever executed, precluding expectancy damages. The jury found reliance damages of $1.7 million (money spent on developing the company) and that the Plaintiff suffered consequential damages of $4 million (representing the plaintiff’s lost opportunity to obtain $4 million of investment from an identified, alternative source) and consequential damages of $1.667 million in debts that the plaintiff incurred and was unable to repay “as a natural, probable and foreseeable consequence of Shell’s conduct.”\textsuperscript{286}

The Fifth District rejected the reliance damages because most of the $1.7 million was spent before Shell had any contact with the plaintiff.\textsuperscript{287} However, the court of appeals accepted the jury’s finding on the $1.67 of consequential damages despite Shell’s assertion that “there is no evidence or insufficient evidence that (1) the amount of debts awarded by the jury were incurred by Main Street and (2) that Main Street’s inability to pay any debt was caused by Shell.”\textsuperscript{288} The court provided the following justification:

Main Street's theory at trial was that its reliance on Shell's promises and representations caused the destruction of its business and resulted in its inability to pay its debts. Blair testified that Main Street's failure to pay these debts was caused by its reliance on Shell's promises. Because there is evidence that Main Street is ultimately responsible for these debts and its inability to pay them was caused by Shell's conduct, we conclude that the evidence is legally and factually sufficient to support the jury's award on this element of damage.\textsuperscript{289}

As it applies to that case, the opinion fails to explain how Main Street’s inability to pay debts in bankruptcy is a loss to Main Street, as opposed to Main Street’s creditors. As a general matter, the substantiation of damages based on the evidence of debt is troubling because just as all cash flow is fungible, debts to general creditors are

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\item[\textsuperscript{285}] Id. at 927-28.
\item[\textsuperscript{286}] Shell Oil Prods. Co. v. Main St. Ventures, L.L.C., 90 S.W.3d 375, 385 (Tex. App.--Dallas 2002, pet. dism'd by agr ) ("Simply stated, the question before the jury required the money to be spent in reliance on promises or representations made by Shell. Because the above evidence is no evidence Main Street spent $1.7 million in reliance on Shell's promises and representations, we reverse the trial court's judgment and render judgment that Main Street take nothing on this element of damage.") But see MCN Energy Enters. v. Omagro de Colombia, L.D.C., 98 S.W.3d 766, 772 (Tex. App.--Fort Worth 2003, pet. denied)
\item[\textsuperscript{287}] Shell Oil Prods., 90 S.W.3d at 385.
\item[\textsuperscript{288}] Id.
\item[\textsuperscript{289}] Id. at 386.
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not necessarily the result of specific expenditures that comply with the standards for special damages. Absent further evidence, it is possible that the debt could be the result of the reliance damages that the court otherwise rejected, also suggesting the potential for duplicative damages.

X Equitable Remedies

Remedies in equity can be uniquely advantageous, at least in theory. A significant challenge in pleading remedies in equity is that they are regarded as obscure and they are poorly understood not only by the Bar but also by most jurists.\textsuperscript{290} Texas case law, especially relating to unjust enrichment, is no exception. For example, a number of Texas appellate courts currently assert or hold that unjust enrichment is not a cause of action but only a remedy for the cause of action of constructive trust or restitution.\textsuperscript{291} These opinions fail to acknowledge the distinction between unjust enrichment in equity or at law\textsuperscript{292} or even the holdings of the Texas Supreme Court relating to the applicable limitations period for the cause of action of unjust enrichment.\textsuperscript{293} Fortunately, Texas case law on rescission and constructive trusts, the

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\textsuperscript{290} See Andrew Kull, Rationalizing Restitution, 83 Cal. L. Rev. 1191, 1195 (1995) ("Few American lawyers, judges, or law professors are familiar with even the standard propositions of the doctrine, and the few who are continue to disagree about elementary issues of definition.") and Douglas Laycock, The Scope and Significance of Restitution, 67 Tex. L. Rev. 1277, 1279 (1989) ("Despite its importance, restitution is a relatively neglected and underdeveloped part of the law. In the mental map of most lawyers, restitution consists largely of blank spaces with undefined borders and only scattered patches of familiar ground. Few law schools teach a separate course in restitution; no restitution casebook is in print; and scholarship in the field is largely devoted to specific applications.").

\textsuperscript{291} See Friberg-Cooper Water Supply Corp. v. Elledge, 197 S.W.3d 826, 832 (Tex. App.--Fort Worth 2006), rev'd on other grounds, 240 S.W.3d 869 (Tex. 2007) (quoting Walker v. Cotter Props., Inc., 181 S.W.3d 895, 900 (Tex. App.--Dallas 2006, no pet.) and Barnett v. Coppell N. Tex. Court, Ltd., 123 S.W.3d 804, 816-17 (Tex. App.--Dallas 2003, pet. denied) ("Barnett pleaded both unjust enrichment and quantum meruit; unjust enrichment, however, is not an independent cause of action. See Oxford Finance Cos. v. Velez, 807 S.W.2d 460, 465 (Tex. App.--Austin 1991, writ denied). Rather, it is an element of an action for restitution. Oxford Fin. Co., 807 S.W.2d at 465 ("an action for restitution based on unjust enrichment will lie 'to recover money received on a consideration that has failed in whole or in part.'") (citing Barrett v. Ferrell, 550 S.W.2d 138, 143 (Tex. Civ. App.-Tyler 1977, writ ref'd n.r.e.)).") but see Bank of Saipan v. CNG Fin. Corp., 380 F.3d 836, 843 (5th Cir. Tex. 2004) citing Heldenfels Bros., Inc. v. City of Corpus Christi, 832 S.W.2d 39, 41-42 (Tex. 1992) and Tex. Jur. Restitution & Constructive Trusts § 6 (3d ed. 2003); McNair v. City of Cedar Park, 993 F.2d 1217, 1220 (5th Cir. 1993 citing Staats v. Miller, 150 Tex. 581, 582, 243 S.W.2d 686, 687 (1951); Dobbs, supra note 32, §4.1(2) (stating that unjust enrichment may be its own cause of action); Restatement (Third) of Restitution & Unjust Enrichment §1 cmt. h (Discussion Draft 2000) ("The identification of unjust enrichment as an independent basis of substantive liability in common-law legal systems was the central achievement of the first Restatement of Restitution. That conception of the subject is carried forward here."); Laycock, Scope and Significance, at 1277 ("The law of restitution offers substantive and remedial principles of broad scope and practical significance.").

\textsuperscript{292} Tri-State Chemicals, Inc. v. Western Organics, Inc., 83 S.W.3d 189, 194,n1 (Tex. App.--Amarillo 2002, pet. denied) and How Restitution and Unjust Enrichment Can Improve Your Corporate Claim 26 Rev. Litig. 265, 276 (Spring, 2007) ( Distinguishing six different sources of jurisdiction for claims of unjust enrichment.)

\textsuperscript{293} Elledge v. Friberg-Cooper Water Supply Corp., 240 S.W.3d 869, 869 (Tex. 2007)
\end{footnotesize}
principal remedies in equity for fraud, do not vary outside the normal range of interpretation embodied in the Restatement of Restitution.

Both the plaintiff and defendant to litigation in equity also need to be aware that a court sitting in equity exercises unusually broad discretion, so-called 'equitable discretion.' A court in equity has the discretion to decide if the plaintiff has jurisdiction in a court in equity by determining if the plaintiff could otherwise secure an adequate remedy in a court sitting at law. This discretion was first established during the reign of James I to resolve the dysfunctional competition between courts at law and courts in equity for jurisdiction in the same cases.\(^{294}\) Once the claim is granted jurisdiction in equity, the judge has the authority to pursue 'total equity' which authorizes a judge to fashion his judgments and remedies to suit his sense of the total justice of the case and therefore is not restricted to the limits of the parties' pleadings.\(^{295}\)

The equitable remedy of rescission is based on the concept that the plaintiff and defendant should be restored to their condition prior to executing the contract (subject to equity.) Rescission is also said to be available to plaintiffs with less rigorous causes of action such as claims by disappointed buyers.\(^{296}\) Under appropriate circumstances the plaintiff is entitled to claim special damages,\(^{297}\) sometimes including pre-contract expenses\(^{298}\) as well as punitive damages.\(^{299}\) Perhaps the unique advantage of rescission is that the remedy is not subject to proof of causation. For example, damage theorists conclude that if a plaintiff that is induced to buy stock due to financial fraud may not have a claim for damages if the decline in the stock price is due to an intervening event.\(^{300}\) Even in such extreme circumstances the remedy of rescission would permit the total refund of the investor’s money.\(^{301}\) One disadvantage to rescission

\(^{294}\) How Restitution and Unjust Enrichment Can Improve Your Corporate Claim, supra note 291, at 289-293.

\(^{295}\) Counting the Beans: Unjust Enrichment and the Defendant's Overhead, supra note 184, at 511.

\(^{296}\) Dobbs, supra note 32, §9.3(2), at 583 ("A number of cases have permitted the plaintiff to rescind for a misrepresentation, and thus to avoid all losses associated with the transactions, including those losses not resulting from the misrepresentation."); 2 Dobbs, Law of Remedies, supra note 11, § 9.1, at 547 ("Rescission is readily available and perhaps somewhat more readily available in some cases than damages; rescission may be permitted for some kinds of wholly innocent misrepresentation even though damages might not."); and Smith v. Nat'l Resort Cmty., Inc., 585 S.W.2d 655, 658 (Tex. 1979).


\(^{298}\) United Enters. v. Erick Racing Enters., 2002 Tex. App. LEXIS 9271, * 5-7 (Tex. App. Amarillo Dec. 31, 2002) ( Holding that plaintiff’s closing costs were appropriate damages.)


\(^{300}\) Dobbs, supra note 32, § 9.3(2) at page 583

\(^{301}\) Dobbs, supra note 32, § 9.1, at 547 ("Rescission is readily available and perhaps somewhat more readily available in some cases than damages; rescission may be permitted for some kinds of wholly innocent misrepresentation even though damages might not."); Restatement (Third) of Restitution & Unjust Enrichment §13 cmt. c (Tentative Draft No. 1, 2001) ("A transfer is not
is that some courts have denied the claim if the defendant has changed her position such as when the asset is no longer available to be returned for the purchase price. Occasionally, however, courts allow economic or financial rescission which allows for rescission on a monetary basis.  

One of the best examples of the singular effectiveness of rescission or specific restitution is described in a unusual Ninth Circuit opinion. In that case, the defendant wrongfully obtained control of the plaintiff’s inactive website, www.sex.com, that greatly appreciated in value and generated cash large flow after the defendant began to operate the website. Under the remedy of specific restitution, the court ordered the return of the web site as well as $40 million of unjust enrichment and $25 million of punitive damages.

While courts have provided general guidelines for when a court should grant a constructive trust, the actual criteria are much more subjective and flexible.

subject to invalidation for misrepresentation, fraudulent or otherwise, unless the misrepresentation induced the transfer. Subject to this test of causation, a transfer induced by fraud is subject to rescission without regard to materiality; whereas a transfer induced by innocent misrepresentation is subject to rescission only if the misrepresentation was material.). See also Randall v. Loftsgarden, 278 U.S. 647, 659 (1986) (“We may therefore infer that Congress chose a rescissory remedy when it enacted § 12(2) in order to deter prospectus fraud and encourage full disclosure as well as to make investors whole. Indeed, by enabling the victims of prospectus fraud to demand rescission upon tender of the security, Congress shifted the risk of an intervening decline in the value of the security to defendants, whether or not that decline was actually caused by the fraud. See Thompson, The Measure of Recovery under Rule 10b-5: A Restitution Alternative to Tort Damages, 37 Vand. L. Rev. 349, 369 (1984) (hereinafter Thompson); Loss, at 1133. Thus, rescission adds an additional measure of deterrence as compared to a purely compensatory measure of damages.”)

302 Dallas Farm Machinery Co. v. Reaves, 158 Tex. 1, 14-15, 307 S.W.2d 233, 241-42 (Tex. 1957) (“The money recovery awarded in this case was the market value of the trade-in machinery which petitioner had sold. It was awarded in lieu of a return of the trade-in machinery. There was evidence supporting the trial court’s finding that the fair market value of the machinery was $2100.00, and it was not error to award respondent a recovery of $2094.00 in lieu of the return of the trade-in machinery.”) and Nelson v. Najm, 127 S.W.3d 170, 177 (Tex. App.--Houston [1st Dist.] 2003, pet. denied)

303 Dobbs, supra note 32, supra note 11, §4.4 (“Specific restitution is not the result of an incantation. It does not matter whether the words constructive trust or reformation are used. If the plaintiff traces his real property into the hands of the defendant and the plaintiff is entitled to restitution, then specific restitution is appropriate. If a court wants to speak of recission rather than constructive trust, an order requiring specific restitution is still appropriate.”)

304 Kremen v. Network Solutions, Inc., 337 F.3d 1024 (9th Cir. 2003)

305 See the discussion of Kremen v. Network Solutions, Inc., 337 F.3d 1024 (9th Cir. 2003) and Kremen v. Cohen, 325 F.3d 1035, 1037-39 (9th Cir. 2003) in How Restitution and Unjust Enrichment Can Improve Your Corporate Claim, supra note 291, at 265, 269-70.

306 Junker v. Eddings, 396 F.3d 1359, 1367 (Fed. Cir. 2005) (“Texas permits a constructive trust to be imposed if there is either "(1) breach of an informal relationship of special trust or confidence arising prior to the transaction in question, or (2) actual fraud." )

307 Ginther v. Taub, 675 S.W.2d 724,728 (Tex. 1984) citing Meadows v. Bierschwale, 516 S.W.2d 125, 131 (Tex. 1974) (“In Meadows we further stated that a transaction may, depending on the circumstances, provide the basis for a constructive trust where one party to that transaction holds funds which in equity and good conscience should be possessed by another.”)
The unique advantage of a constructive trust is that it allows the plaintiff to ‘prime’ the security interest of secured creditors or bankruptcy courts.\(^{308}\) In the form of a constructive trust or equitable lien, a claim for unjust enrichment can achieve seniority to most other creditors, including secured lenders, life insurance policies, tax liens, and even homestead provisions.\(^{309}\) A constructive trust can even “prime” or supersede statutes of descent.\(^{310}\) Professor Kull claims that the only real advantage of a constructive trust occurs when the defendant is on the verge of bankruptcy.

XI. Avoiding or Minimizing the Minefield

The easiest way for business participants to avoid the minefield of fraudulent inducement is to embrace the practice of negotiating a reliance waiver clause in contracts.\(^{311}\) Depending on circumstances, a blanket waiver seems unlikely to become popular; more likely is a negotiation process in which the parties to a contract explore the areas of positive or negative assurance that are important and foreseeable to the transaction. Significant representations would then be added or modified in the specific language of the contract. Misunderstandings that would otherwise result in claims for fraudulent inducement would thereby be waived or converted to claims for breach of warranty or contract.

Assuming that fraudulent inducement claims cannot be avoided, the damages minefield can best be minimized by ruthless attention to the details of the case and the guidelines for the requirements in relevant case opinions.\(^{312}\) This process lends itself to establishing grids or tables that would distinguish each component of a damage claim by the damages method, approach and type of damage (direct, incidental, consequential and reliance damages).

Defendants would therefore benefit by comparing a model of the required substantiation for each type of damage for each approach and method with a grid of the evidence offered by the plaintiff to satisfy each of those requirements. The grids or tables can be footnoted with all supporting evidence to check for missing details and labeled to show damages that are potentially duplicative.

XII. Conclusions

\(^{309}\) Dobbs, supra note 32, §4.3(1), at 568; Restatement (First) of Restitution § 202 (1937); TMG II v. United States, 1 F.3d 36, 39 (D.C. Cir. 1993) and Hamblet v. Coveny, 714 S.W.2d 126, 129 (Tex. App. - Houston [1st Dist.] 1986, writ ref'd n.r.e.)
\(^{310}\) Pope v. Garrett, 211 S.W.2d 559, 561 (Tex. 1948)
\(^{311}\) See notes 116 to 199 and accompanying text.
\(^{312}\) E.g. Burke v. Union Pac. Res. Co., 138 S.W. 3d 46, 69 (Tex. App.-Texarkana 2004, pet. dn'd) ( Plaintiff failed to include veterinary costs as source of damages and substantiate ownership of cattle that died.)
Fraudulent inducement is a powerful cause of action that allows the plaintiff to name defendants otherwise difficult to reach and to stack punitive damages on top of expectancy damages. It also provides for an unusual range of remedies, financial or equitable. Financial remedies can be measured as loss of value, loss of profits or as special damages for expenditures and losses. Alternative methods, alternative approaches and elections abound. The comparative suitability of these options for the case facts and trial limitations need to be reviewed. Additional determinants of the plaintiff’s strategy could include the advantage of ex ante or ex post measures, the difficulty of proving causation and the defendant’s ability to pay the judgment. The resulting damages strategy can, in turn, change either party’s discovery process, selection of experts and motion practice.

Whether the Texas judiciary applies greater scrutiny to cases of fraudulent inducement and whether that scrutiny is due to a traditional fear of speculative damages measures or a fear of impressionable juries that might tend to punish fraudfeasors is itself speculative. Definite proof is unlikely to be established. Whether or not these traditional fears have been significant to the case law, it is nevertheless true that many of the appellate opinions in this area of remedies were prompted by the weak state of practice for submitting jury instructions and substantiating the plaintiff’s measure of damages. To be fair to litigators, it also seems clear that some appellate opinions manifest significant confusion on these issues among the judiciary as well.

While *Perry Equipment* adds some clarity to the measurement of direct damages and distinguishing direct from special damages, it leaves many issues unresolved. More clarity and discussion is needed on issues like how the difference between asset transactions and service contracts affects the measure of damages or when the damages that naturally and usually result from a misrepresentation are not direct damages and how far out in time or in the chain of future transactions a special damage can be claimed.