



Published in the 2013 July/August issue of the *Hennepin Lawyer*, a membership publication of the Hennepin County Bar Association. Used with permission.  
612-752-6000 thl@hcba.org

# Damages in Fraud Cases, Not Just Out-Of-Pockets

Victims of fraud have traditionally been advised that their recovery is determined by the “out-of-pocket” measure. With increasing regularity, however, Minnesota courts have used an alternative measure in fraud cases where the out-of-pocket measure does not accomplish justice. One such alternative measure is “benefit-of-the-bargain” damages, a measure akin to a typical measure of damages in contract cases.

## GENERAL MEASURE OF FRAUD DAMAGES

In Minnesota, the measure of damages recoverable for fraud has generally been limited

to out-of-pocket damages. “The out-of-pocket rule allows damages to be recovered which are the natural and proximate loss sustained by a party because of reliance on a misrepresentation.”<sup>1</sup> In other words, this measure of damages allows a plaintiff to recover, as suggested by its name, what he or she has spent “out of pocket,” or what he or she has actually lost, in reliance on a misrepresentation. However, the out-of-pocket rule does not allow a plaintiff to recover what he or she might have gained through a transaction had it not been fraudulent. Out-of-pocket damages aim only to reimburse the plaintiff, and therefore they do not give the plaintiff any more than what they actually lost in reliance on the misrepresentation.

The out-of-pocket measure is typically the default for fraud damages. This promotes the goal of awarding damages in fraud cases to restore the status quo ante. The court aims to put the plaintiff back in the position he or she was in before reliance on the misrepresentation. Usually, this is accomplished by reimbursing the plaintiff for money spent or otherwise lost in reliance on the misrepresentation. Awarding more than out-of-pocket damages puts the plaintiff in a better position than he was in before the misrepresentation. In addition, out-of-pocket damages are often less speculative than other forms of damages.<sup>2</sup> This is because it is generally easier to compute losses that have already been realized than it is to compute damages based on what a plaintiff may have gained had a misrepresentation been true. Tort law disfavors speculative damage awards. Therefore, out-of-pocket damages are the general measure of damages in fraud cases.

## EXCEPTIONS TO THE GENERAL RULE

Although the general rule is to award out-of-pocket losses in fraud cases, Minnesota courts have created exceptions and will award alternative forms of damages in some fraud cases. If out-of-pocket damages will not restore the plaintiff to the position he or she was in before his or her reliance on a misrepresentation, courts are able to award alternative forms of damages.<sup>3</sup> This ensures that victims are compensated for their injuries and that fraudulent actors are held responsible for their wrongful acts.



**Vincent Louwagie**  
Contributing Author

Mr. Louwagie, a shareholder of Anthony Ostlund Baer & Louwagie, practices in all areas of commercial litigation, with an emphasis on disputes involving financial transactions. He practices in state and federal courts and in various arbitration forums around the country.



**Andrea Davenport**  
Contributing Author

Ms. Davenport is a third-year student at the University of Wisconsin Law School. She was a summer associate at Anthony Ostlund Baer & Louwagie during the summer of 2012 and is interested in practicing commercial litigation.

Courts award alternative forms of damages in three scenarios. First, courts have awarded alternative forms of damages in cases where plaintiffs were led to believe they had something they did not have.<sup>4</sup> In *Lewis v. Citizens Agency of Madelia, Inc.*, the plaintiff was led to believe she was the beneficiary of her husband's life insurance policy.<sup>5</sup> After plaintiff's husband passed away, she attempted to collect the proceeds of the policy and discovered that what she and her husband had actually been advised to purchase was an annuity.<sup>6</sup> A refund of the premiums she had paid would not put the plaintiff back in the position she had held before her reliance on the misrepresentation, so the court awarded an alternative form of damages. Plaintiff was awarded the proceeds of the life insurance policy.<sup>7</sup> And in *Moe v. Moe*, the plaintiff was led to believe he had a one half ownership interest in certain real property that he did not actually have.<sup>8</sup> The court awarded one half of the value of the property to plaintiff.<sup>9</sup>

Second, courts have awarded alternative forms of damages when a misrepresentation keeps a plaintiff from protecting the value of property that he or she does own.<sup>10</sup> Examples of this include when a previously stable business fails due to its owner's reliance on a misrepresentation, or when reliance on a misrepresentation causes the plaintiff to lose the value of his or her career.<sup>11</sup> In *B.F. Goodrich Co. v. Mesabi Tire Co., Inc.*, the plaintiff relied upon defendant's representation that it would continue to manufacture the type of tire that plaintiff used in its product line when it decided to sign a consignment agreement with the defendant.<sup>12</sup> Shortly thereafter, the defendant stopped manufacturing that type of tire and plaintiff's business failed.<sup>13</sup> The court awarded the difference in the value of plaintiff's business before as opposed to after the misrepresentation.<sup>14</sup> Additionally, in *Hanks v. Hubbard Broadcasting, Inc.*, the court awarded the difference in the value of a news anchor's career before versus after her reliance on defendant's misrepresentation when that misrepresentation caused her to forego another career opportunity and damaged her reputation in the industry.<sup>15</sup>

Finally, courts have awarded alternative forms of damages when they are less speculative than out-of-pocket losses.<sup>16</sup> In *Williams v.*

*Heins, Mills & Olson, PLC*, the court awarded benefit-of-the-bargain damages when it found Williams' former employer had misrepresented the percentage of firm income he would be paid.<sup>17</sup> In that case, it was less speculative to calculate what Williams should have received under the agreement, a straight five percent of the firm's income, than it was to calculate Williams' out-of-pocket-damages.

Courts have also awarded consequential economic damages. Generally, consequential economic damages are awarded when the plaintiff has not suffered out-of-pocket damages in reliance on misrepresentations, but due to the misrepresentations they lost the value of some asset they previously held. For example, the plaintiff in *Sports Page, Inc. v. First Union Management, Inc.* was awarded lost profits when the defendant's representation caused plaintiff's business to go bankrupt.<sup>18</sup> Courts explain that awarding out-of-pocket damages will not restore these plaintiffs to the position they were in before the misrepresentation, because out-of-pocket damages cannot revive a bankrupt business or fix a tarnished reputation.

Alternative measures of damages are usually used when plaintiffs do not suffer a substantial amount of out-of-pocket damages. Courts then award alternative measures of damages both to restore plaintiffs to their previous position and to ensure that defendants do not get away with their wrongdoings merely because plaintiff did not suffer a significant enough monetary loss. The *Williams* court embodied this notion when it stated, "appellants effectively seek-through a mechanical application of the out-of-pocket rule a free pass for their wrongful conduct."<sup>19</sup>

The exceptions, however, are not unlimited. If plaintiff will be substantially compensated by out-of-pocket damages, courts may decline to award alternative measures of damages.<sup>20</sup> And Courts have declined to award emotional distress or other forms of non-economic losses for fraud.<sup>21</sup>

## THE LINE BETWEEN CONTRACT DAMAGES AND FRAUD DAMAGES

Benefit-of-the-bargain damages, of course, are typically awarded in contract disputes.

This measure of damages allows a plaintiff to recover the value of what they would have received had the contract been performed, thereby giving plaintiff the benefit of their bargain, the contract. Is the line between contract damages and fraud damages being blurred?

Contract actions are based on an underlying agreement between the parties. Courts generally compensate plaintiffs in these cases by awarding benefit-of-the-bargain damages. On the other hand, tort actions, including fraud, compensate a plaintiff for a civil wrong committed against them. A successful fraud action compensates a plaintiff who detrimentally relies on a representation made by another. This type of action is not based on an agreement between the parties, but rather on an understanding that when one represents false or misleading statements as true, that person should be held liable when another reasonably relies on those representations to their detriment.

Two Minnesota cases specifically address a plaintiff's ability to state both a contract and a tort claim arising out of the same incident.<sup>22</sup> These cases hold that contract actions and fraud actions are still two separate causes of action but it is possible to prove both.


In *Brooks v. Doherty, Rumble & Butler*, Brooks accepted a position at a law firm based on the hiring attorney's allegedly false representation that there was unanimous approval of the decision to hire him.<sup>23</sup> Brooks' employment was terminated shortly after he was hired, and a letter discussing his alleged inadequacies as an attorney was distributed to plaintiff and several other attorneys within the firm. The plaintiff asserted contract and fraud causes of action, claiming that his reputation was permanently damaged. The defendant argued that discharge from employment was actionable only as breach of an employment contract, but not as a tort. The court disagreed with defendant, explaining that a plaintiff may raise two independent causes of action: fraud in the inducement to the contract and breach of the employment contract.

Similarly, in *Hanks v. Hubbard Broadcasting, Inc.*, the court commented on the line

between contract and tort.<sup>24</sup> This case was initiated by a news anchor who chose to remain employed with defendant rather than accept an offer elsewhere based on representations that she would receive more publicity at defendant's station in the near future. When that did not happen, her reputation suffered and her career was damaged. The defendant in *Hanks* argued that to allow recovery of tort damages would be to "improperly transform a deficient contract claim into a fraud claim."<sup>25</sup> The court disagreed, stating that, "[a]llowing the fraud finding to stand in this case...does not impermissibly expand a contract claim into a tort claim. Extra-contract damages are recoverable when there is an independent tort."<sup>26</sup> If there is an independent tort, the plaintiff must prove damages for the tort separate from general damages resulting from the breach of the employment contract, so damages are not duplicative.

## CONCLUSION

The exceptions to the out-of-pocket damages rule are designed, generally, to provide a

reasonable measure of damages to a victim of fraud. Civil litigators are well advised to keep these lesser-known and lesser-considered measures in mind when determining what causes of action to plead. What might, at first blush, be viewed as a defective contract claim, or a fraud claim with small or no damages, may be revived by an alternative measure of fraud damages. 

<sup>1</sup> *Lewis v. Citizens Agency of Madelia, Inc.*, 235 N.W.2d 831, 835 (Minn. 1975).

<sup>2</sup> See *Williams v. Heins, Mills & Olsen, PLC*, 2010 WL 3305017, \*6 (Minn. Ct. App. Aug. 24, 2010).

<sup>3</sup> See *Lewis* at 835; *B.F. Goodrich Co. v. Mesabi Tire Co., Inc.*, 430 N.W.2d 180, 183 (Minn. 1988).

<sup>4</sup> See *Lewis* at 196-197 (plaintiff led to believe she had a life insurance policy on her husband when what she really had was an annuity); *Moe v. Moe*, 2005 WL 354028, \*1 (Minn. Ct. App. Feb. 15 2005) (plaintiff led to believe he owned an interest in certain real property that he did not have); *Williams* at \*1 (plaintiff-attorney led to believe he had a right to a greater amount of firm distributions than he had).

<sup>5</sup> *Lewis v. Citizens Agency of Madelia, Inc.*, 306 Minn. 194 (1975).

<sup>6</sup> *Lewis* at 833.

<sup>7</sup> *Id.* at 835.

<sup>8</sup> *Moe v. Moe*, 2005 WL 354028, \*1 (Minn. Ct. App. Feb. 15 2005).

<sup>9</sup> *Id.* at \*8.

<sup>10</sup> See *B.F. Goodrich; Sports Page, Inc. v. First Union Management, Inc.*, 438 N.W.2d 428 (Minn. Ct. App. 1989).

<sup>11</sup> See *B.F. Goodrich; Sports Page; Brooks v. Doherty, Rumble & Butler*, 481 N.W.2d 120 (Minn. Ct. App. 1992); *Hanks v. Hubbard Broadcasting, Inc.*, 493 N.W.2d 302 (Minn. Ct. App. 1992).

<sup>12</sup> *B.F. Goodrich* at 181.

<sup>13</sup> *Id.*

<sup>14</sup> *Id.* at 183.

<sup>15</sup> *Hanks* at 310-11.

<sup>16</sup> See *Williams*.

<sup>17</sup> *Id.*

<sup>18</sup> *Sports Page* at 433.

<sup>19</sup> *Williams* at \*6.

<sup>20</sup> *Vesta State Bank v. Independent State Bank of Minnesota*, 1996 WL 653967, \*6 (Minn. Ct. App. Nov. 12, 1996).

<sup>21</sup> *Kanner v. Fairmont Foods of Minnesota*, 2000 WL 31790, \*4 (Minn. Ct. App. Jan. 18, 2000).

<sup>22</sup> See *Brooks; Hanks*.

<sup>23</sup> *Brooks* at 123.

<sup>24</sup> See *Hanks*.

<sup>25</sup> *Hanks* at 307.

<sup>26</sup> *Id.*



Michael G. Mullin

- 1,600+ Mediations Successfully Completed
- Mediating Over 250 Disputes/Year
- More than 90% of Disputes Settled

- Distinguished Fellow, International Academy of Mediators (IAM)
- Fellow, American College of Civil Trial Mediators (ACCTM)
- Charter Member, National Academy of Distinguished Neutrals
- Certified Member, American Academy of ADR Attorneys
- International Who's Who of Commercial Mediation
- American Board of Trial Advocates (ABOTA)
- Three Decades of Civil Litigation Experience
- Mediating cases throughout the United States

Schedule your mediation online:

[www.KutakRock.com/Mediation/Mullin](http://www.KutakRock.com/Mediation/Mullin)

Jessica L. Roe



- Qualified under Rule 114 as Civil Adjudicative/Evaluative Neutral
- Labor and Employment Law Specialist, Minnesota State Bar Association
- More than 18 Years of Litigation and ADR Experience
- More than 95% of Disputes Settled

See complete biography online:

[www.KutakRock.com/Jessica-Roe](http://www.KutakRock.com/Jessica-Roe)

U.S. Mediation Law Firm of the Year

ACQ Global Awards 2012

**KUTAK  
ROCK** LLP  
ATTORNEYS

16 Offices Nationwide | (612) 334-5000