

# DAMAGES FOR DECEIT: A CASE STUDY IN THE MAKING OF AMERICAN COMMON LAW

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“We reach the land of mystery when constitution and statute are silent, and the judge must look to the common law for the rule that fits the case.”

BENJAMIN N. CARDOZO, THE NATURE OF THE JUDICIAL PROCESS

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INTRODUCTION

The courts in this country have spent decade after decade—sometimes hundreds of years—setting out rules of decision in resolving common law claims.<sup>1</sup> Considering both process and policy, can we say from state to state whether the courts have made

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1. Rules of decision concern rules and principles. Rules are norms that apply mechanically and categorically; principles are norms that are applied and balanced against each other based on evaluative judgment. Mark P. Gergen, *The Jury’s Role in Deciding Normative Issues in the American Common Law*, 68 *FORDHAM L. REV.* 407, 407 n.1 (1999). The use of this distinction has grown more common since Ronald Dworkin addressed it, see RONALD DWORIN, *TAKING RIGHTS SERIOUSLY* 22–30 (1978), but it existed before then, see, e.g., *infra* note 7 & accompanying text (addressing the nature of “a principle or rule of law”).

*good* common law? The question implicates such broad disciplines as legal history, legal reasoning, law and economics, and the philosophy of law. None seems to answer both parts of the inquiry, however, or to work out how the parts might relate to one another. Some scholars and judges might even regard the question as impertinent. Where common law is longstanding and inertial, what basis is there for asking if the courts have followed the right “process” or made sound “policy”? This Article seeks to reconcile such perspectives in evaluating a given area of common law jurisprudence under distinct, model criteria.

A case study makes sense here where “there is a kind of competitive process at work—the same issues arise under the common law of each of the states, and while resolutions often diverge at first, gradually consensus emerges as the uncommitted judges compare the different resolutions on offer.”<sup>2</sup> This Article takes the common law of damages for fraud on offer in one state and pores over it, exploring the precept that American common law is based on “a common way of thinking about law,” a “shared *process* for deciding cases and resolving disputes.”<sup>3</sup>

The question of the qualities of good common law resonates today in light of literature such as the recent commentary that reconsiders whether common law or statutes constituted the favored rule of law as America was founded and its law expanded.<sup>4</sup> The best law, simple to say, is both “settled” and “right.”<sup>5</sup> The first quality speaks to the custom and certainty in decision-making that explain the very advent of English common law.<sup>6</sup> Oliver Wendell Holmes even concluded that the law is the “prophecies of what the courts

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2. Richard A. Posner, *The Role of the Judge in the Twenty-First Century*, 86 B.U. L. REV. 1049, 1054–55 (2006).

3. MORRIS L. COHEN, *The Common Law in the American Legal System: The Challenge of Conceptual Research*, 81 L. LIBR. J. 13, 29 (1989); accord ARTHUR L. CORBIN, *What Is the Common Law?*, 3 AM. L. SCH. REV. 73, 75 (1912).

4. See JAMES R. MAXEINER, *A Government of Laws Not of Precedents 1776–1876: The Google Challenge to Common Law Myth*, 4 BRIT. J. AM. LEGAL STUD. 137 (2015) (concluding that, contrary to the author’s view of the conventional wisdom, statutes were the favored basis of early American law).

5. Cf. *Burnet v. Coronado Oil & Gas Co.*, 285 U.S. 393, 406 (1932) (Brandeis, J., dissenting) (opining that the doctrine of *stare decisis* “is usually the wise policy, because, in most matters, it is more important that the applicable rule of law be settled than that it be settled right”).

6. See THEODORE F. T. PLUCKNETT, *A CONCISE HISTORY OF THE COMMON LAW* 342 (Liberty Fund ed. 2010). For a summary of such classical accounts of the origin of English common law, see MATTHEW STEILEN, *The Democratic Common Law*, 10 J. JURIS. 437, 449–53 (2011).

will do in fact, and nothing more pretentious.”<sup>7</sup> The second quality, however, concerns evolving questions of justice and social welfare that must bear on the common law if it is to meet our ideals.

The common law of fraud damages is a sturdy basis for a case study under such benchmarks. The typical elements of fraud are satisfied where for personal gain the defendant made an intentional and material misrepresentation of fact that reasonably induced the plaintiff to rely on the misrepresentation and thereby suffer damage.<sup>8</sup> Such “deceit” is a quintessential common law doctrine whose application in commercial matters is inveterate and whose development is relevant to scholars and practitioners alike.<sup>9</sup> Rooted in the essential self-interest most types of lying, “fraud seemingly touches every American industry and commercial endeavor.”<sup>10</sup> By one recent estimate, “combined public- and private-sector fraud costs every household in the United States probably around \$5,000 a year.”<sup>11</sup>

Common law fraud is a core feature of the “law of deception” emerging as a “genus” comprising claims presenting “similar problems of design, function, and justification throughout the category.”<sup>12</sup> Commentators recognize common law fraud as the fulcrum for increasingly frequent claims under consumer protection

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7. Oliver Wendell Holmes, *The Path of the Law*, 10 HARV. L. REV. 457, 461 (1897). Benjamin N. Cardozo more specifically concluded that a “principle or rule of conduct” amounts to “a principle or rule of law” if a court will probably accept it as authoritative when new situations arise in litigation. BENJAMIN N. CARDOZO, *THE GROWTH OF THE LAW* 52 (1924); accord Edwin W. Patterson, *Cardozo’s Philosophy of Law*, 72 U. PA. L. REV. 71, 85 (1939).

8. See, e.g., *Eurycleia Partners, LP v. Seward & Kissel, LLP*, 910 N.E.2d 976, 979 (N.Y. 2009); see also 2 DAN B. DOBBS, *LAW OF REMEDIES* 544 (2d ed. 1993) (explaining that “in the common law of tort, fraud requires a misrepresentation of fact (not mere opinion and not a prediction or promise about the future)”). Tracking New York law, this Article addresses intentional misrepresentation.

9. See, e.g., PETER MACDONALD EGGERS, *DECEIT: THE LIE OF THE LAW* § 8.55, at 217–18 (2009); Paula J. Dalley, *The Law of Deceit, 1790–1860: Continuity Amidst Change*, 39 AM. J. LEGAL HIST. 405, 405–06 (1995).

10. Daniel T. Ostas, *When Fraud Pays: Executive Self-Dealing and the Failure of Self-Restraint*, 44 AM. BUS. L. J. 571, 572 (2007).

11. SEBASTIAN JUNGER, *TRIBE: ON HOMECOMING AND BELONGING* 29 (2016). Junger makes the point in opining on differences between tribal and modern society, drawing a conclusion whose basic morality is touched on below: “What tribal people would consider a profound betrayal of the group, modern society simply dismisses as fraud.” *Id.* at 28; see *infra* Parts I, II, IV; Sections VI.C, IX.E.5.

12. Gregory Klass, *Meaning, Purpose, and Cause in the Law of Deception*, 100 GEO. L. J. 449, 450 (2012).

statutes<sup>13</sup> and of misrepresentations in hiring.<sup>14</sup> Practicing lawyers, for their part, understand that where “fraud has always been part of the human condition,” common law fraud claims will find new and vital applications with each generation.<sup>15</sup> This law is among the primary private means for redressing the creative and increasingly prevalent fraud that social media facilitates.<sup>16</sup>

The damages element of fraud, however, stands out as an area in which the state courts not only have taken different approaches, but also have struggled to rule consistently.<sup>17</sup> Questions such as whether courts are resolving fraud claims in ways that adequately compensate victims, that provide disincentives and punishment for fraudsters, and that provide clarity are more timely than ever. The damages available for fraud are integral to addressing such issues, warranting close scrutiny.<sup>18</sup>

Parts I through III of this Article explain why this area of law in New York in particular warrants study. The spadework in Parts IV through VIII shows both the persistent ambiguity in the state’s law and the questionable policy the courts have been making. Parts IX

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13. See Jean Braucher, *Deception, Economic Loss and Mass-Market Customers: Consumer Protection Statutes as Persuasive Authority in the Common Law of Fraud*, 48 ARIZ. L. REV. 829, 829–30 (2006).

14. See Richard P. Perna, *Deceitful Employers: Common Law Fraud as a Mechanism to Remedy Intentional Employer Misrepresentation in Hiring*, 41 WILLAMETTE L. REV. 233–34, 237 (2005).

15. V. John Ella, *Common Law Fraud Claims: A Critical Tool for Litigators*, 63 BENCH & B. MINN. 18, 19 (2006).

16. See, e.g., Ken Lewis, *How Social Media Networks Facilitate Identity Theft and Fraud*, ENTREPRENEUR’S ORG.: OCTANE MAG. (2014), <https://www.eonetwork.org/octane-magazine/special-features/social-media-networks-facilitate-identity-theft-fraud>. Crowdfunding is a good example—one that will continue to give rise to private litigation, as well as government prosecution, and to prompt academic commentary. See, e.g., Cody R. Friesz, *Crowdfunding & Investor Education: Empowering Investors to Mitigate Risk & Prevent Fraud*, 48 SUFFOLK U. L. REV. 131 (2015); Christopher Moores, *Kickstart My Lawsuit: Fraud and Justice in Rewards-Based Crowdfunding*, 49 U.C. DAVIS L. REV. 383 (2015).

17. See DAN B. DOBBS, HANDBOOK ON THE LAW OF REMEDIES 592 (1973) [hereinafter “DOBBS, HANDBOOK (1973)”] (explaining with respect to damages for fraud that “courts have sometimes reacted erratically”); CHARLES T. MCCORMICK, HANDBOOK ON THE LAW OF DAMAGES § 121, at 450–52 (1935) (reviewing the different formulas among the states for assessing fraud damages and concluding that “[i]n few of the states have the courts seized upon one of these formulas and applied it with entire consistency in all classes of cases”).

18. See, e.g., Klass, *supra* note 12, at 495 (identifying when punitive damages are appropriate, when only compensatory remedies are appropriate, and the utility of similar “regulatory techniques” as among the “larger questions unanswered” in the law of deception); see also Dalley, *supra* note 9, at 410–11 (examining the law of deceit from 1790 to 1860 but devoting little attention to the question of damages).

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and X extract the appropriate criteria for assessing common law quality, evaluate from that perspective how the courts in New York have fared, and then detail how the courts may clarify the rules of decision and strengthen the underlying policy.

## I. GROUNDS FOR THIS CASE STUDY

In considering the operation of common law in general, and the damages for deceit in particular, this Article addresses New York common law for several reasons.

First, complex and high-stakes commercial disputes are prevalent in New York.<sup>19</sup> Both the state and federal courts tout the state's standing in financial matters, pointing to "New York's recognized interest in maintaining and fostering its undisputed status as the preeminent commercial and financial nerve center of the Nation and the world."<sup>20</sup> Recent chief judges of the state's highest court, the New York Court of Appeals, regard it as engaged in the evolution of business-related doctrine in a center of commerce and industry.<sup>21</sup> As for tort damages, the Court of Appeals has grounded its jurisprudence on "policy,"<sup>22</sup> making the state's precedent in this area even more suitable for substantive evaluation.

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19. See, e.g., Howard A. Levine, *Deciding Cases in "The Common Law Tradition": A Productive and Innovative Year for the Court of Appeals in Business and Commercial Litigation*, 48 SYRACUSE L. REV. 355, 356 (1998). With respect to major corporate contracts, for example, New York has been the favored choice for both law and forum. See Theodore Eisenberg & Geoffrey P. Miller, *The Flight to New York: An Empirical Study of Choice of Law and Choice of Forum Clauses in Publicly-Held Companies' Contracts*, 30 CARDOZO L. REV. 1475, 1487–1511 (2009).

20. *Ehrlich-Bober & Co. v. Univ. of Hous.*, 404 N.E.2d 726, 730 (N.Y. 1980); see, e.g., *Tr. for the Certificate Holders of the Merrill Lynch Mortg. Inv'rs v. Love Funding Corp.*, 556 F.3d 100, 109 (2d Cir. 2009) (emphasizing "the importance of New York law to the State's preeminent role in world financial affairs"); *Mashreqbank PSC v. Ahmed Hamad al Gosaibi & Bros.*, 12 N.E.3d 456, 460 (N.Y. 2014) (referring to New York as "a financial capital of the world, serving as an international clearinghouse and marketplace for a plethora of international transactions") (internal quotations omitted).

21. See Levine, *supra* note 19, at 356 (citing remarks from former Chief Judges Charles Breitel, in *Ceremony Marking Retirement of Chief Judge Charles D. Breitel*, 45 N.Y.2d vii, ix (1978), and Judith Kaye, in JUDITH KAYE, COMMERCIAL LITIGATION IN NEW YORK STATE COURTS 1, 1–8 (Robert L. Haig ed., 1995)).

22. See, e.g., *Abbott v. Page Airways, Inc.*, 245 N.E.2d 388, 390 (N.Y. 1969) (explaining that "the policy of this State has been to reduce rather than increase the obstacles to the recovery of damages for negligently caused injury or death"); see also *infra* Section IX.E (addressing the aspects of fraud damages in particular that the Court of Appeals has grounded on "policy").

Second, New York's history is tightly connected to making common law. The Province of New York emerged as an "American prototype" in implementing civil practice<sup>23</sup> and giving the common law "more recognition than in most colonies."<sup>24</sup> In the nineteenth century, state lawmakers and lawyers mounted an unremitting, decade-long refusal to adopt David Dudley Field's comprehensive procedural and substantive civil code.<sup>25</sup> By the early twentieth century, the Court of Appeals was considered the preeminent common law court in the country.<sup>26</sup> During that era, moreover, the court decided several major cases regarding the damages for common law fraud.<sup>27</sup> The development of such law still stands to be assessed. Such analysis is all the more practical where the Court of Appeals recently made clear that the Martin Act, New York's "blue sky" law, does not preempt private parties from asserting common law claims for fraudulent securities and investment practices.<sup>28</sup>

Third, notwithstanding the state's early adoption of and prominence in preserving common law, the question of the damages available for fraud has been particularly troublesome for the New York courts. A distinguished law journal concluded in 1942: "In no state is the law on this subject more uncertain than in New York."<sup>29</sup> A similar observation was gently made thirty years later.<sup>30</sup> And the problem persists. As crucial as it is to commercial deal-making, and as frequently as companies have chosen the state's law to govern disputes, this precedent is part of a legal system that lags behind London's "in terms of predictability and fairness," and whose un-

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23. Deborah A. Rosen, *The Supreme Court of Judicature of Colonial New York: Civil Practice in Transition, 1691–1760*, 5 L. & HIST. REV. 213, 214 (1987).

24. William B. Stoebuck, *Reception of English Common Law in American Colonies*, 10 WM. & MARY L. REV. 393, 401 (1968).

25. Maxeiner, *supra* note 4, at 235–49 (concluding that by 1888 "adoption had eluded the Civil Code" twenty-three times in New York and that it was "the Association of the Bar of the City of New York that would have none of it").

26. Mark P. Gergen & Kevin M. Quinn, *Common Law Judicial Decision Making: The Case of the New York Court of Appeals 1900–1941*, 60 BUFF. L. REV. 897, 898 (2012).

27. *See infra* Part V.

28. *See* Assured Guar. (UK) Ltd. v. J.P. Morgan Inv. Mgmt. Inc., 962 N.E.2d 765, 767–71 (N.Y. 2011).

29. Note, *The New York Law of Damages in Deceit*, 55 HARV. L. REV. 1019, 1019 (1942) (discussing the state of the law at the time).

30. *See* DOBBS, HANDBOOK (1973), *supra* note 17, at 597 n.16 (observing that the law of fraud damages in New York is uncertain and seemingly flexible).

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predictability is one of the factors that have “caused New York to be viewed negatively” in the arena of financial services.<sup>31</sup>

Fourth, Benjamin Cardozo’s 1921 lectures remain the classic exposition of the essentials of American common law.<sup>32</sup> Cardozo gave the lectures during his tenure on the Court of Appeals, within the period of critical changes in the state’s law of fraud damages. He was “perhaps the leading common law jurist of the time.”<sup>33</sup> His analysis is as authoritative a description of the contours of common law and the judge’s task in making it as this country has produced.<sup>34</sup>

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31. MICHAEL R. BLOOMBERG & CHARLES E. SCHUMER, SUSTAINING NEW YORK’S AND THE US’ GLOBAL FINANCIAL SERVICES LEADERSHIP 73–77 (2007), [http://www.nyc.gov/html/om/pdf/ny\\_report\\_final.pdf](http://www.nyc.gov/html/om/pdf/ny_report_final.pdf). Such dissatisfaction itself dates back to the province’s nascent common law. Lawyer and historian William Smith drew the conclusion that as of 1732: “The state of our laws opens a door to much controversy. The uncertainty with respect to them renders property precarious, and greatly exposes us to the arbitrary decisions of bad judges.” WILLIAM SMITH, THE HISTORY OF THE PROVINCE OF NEW-YORK FROM THE FIRST DISCOVERY TO THE YEAR M.DCC.XXXII 243 (1757). Elaborating, without irony, Smith gave one of the reasons for the plight: among the justices of the peace, there are “instances of some who can neither write nor read.” *Id.* at 244.

32. BENJAMIN N. CARDOZO, THE NATURE OF THE JUDICIAL PROCESS (1921). Cardozo published further lectures addressing such issues, but *The Nature of the Judicial Process* is the seminal and most comprehensive work.

33. Gergen & Quinn, *supra* note 26, at 898.

34. For recent commentary on the preeminence of the lectures in describing the evolutionary nature of common law, see, for example, Lawrence A. Cunningham, *Cardozo and Posner: A Study in Contracts*, 36 WM. & MARY L. REV. 1379, 1380–81 (1995); Nicola Gennaioli & Andrei Shleifer, *The Evolution of Common Law*, 115 J. POL. ECON. 43, 44 (2007); Michael S. Moore, *Four Reflections on Law and Morality*, 48 WM. & MARY L. REV. 1523, 1534 (2007). For an articulation of what judges do and should do in making common law, see, for example, RICHARD A. POSNER, CARDOZO: A STUDY IN REPUTATION 301–32 (1990); Robert C. Berring, *Suggestions for American Judges: Ten Books That Merit Reading*, 10 J. APP. PRAC. & PROCESS 347, 351 (2009); William E. Nelson, *The Imperfections of the Rule of Law*, 67 SMU L. REV. 781, 782–83 (2014); Harry H. Wellington, *The Nature of Judicial Review*, 91 YALE L. J. 486, 486 (1982); Judith S. Kaye, *Cardozo: A Law Classic*, 112 HARV. L. REV. 1026, 1041 (1999) (book review). For an outline of a pragmatic account of common law in the realm of legal realism as a synthesis of several methodologies, see, for example, Michael C. Dorf, *Spandrel or Frankenstein’s Monster? The Vices and Virtues of Retrofitting in American Law*, 54 WM. & MARY L. REV. 339, 343 (2012); Douglas Lind, *The Mismeasurement of Legal Pragmatism*, 4 WASH. U. JUR. REV. 213, 252–53 (2012). U.S. Supreme Court justices, moreover, have cited the lectures with approval in nearly fifty opinions. See, e.g., *Caperton v. A.T. Massey Coal Co.*, 556 U.S. 868, 882–83 (2009). The upshot of such commentary, in humorous terms, is that “in the world of law, Benjamin Cardozo still rocks.” Andrew L. Kaufman, *Forward to BENJAMIN CARDOZO, THE NATURE OF THE JUDICIAL PROCESS* (Quid Pro Books 2010) (1921), *reprinted in* 8 JUD. NOTICE 39, 39 (2012).

Cardozo explains that the law's paramount aim must be to make "public policy" towards "the welfare of society."<sup>35</sup> He limns a general approach that for its continuing granularity takes account of "that social welfare which it is our business to discover."<sup>36</sup> This Article seeks to study the precedent and modern scholarship in that light and thus "carry the torch forward."<sup>37</sup> The article considers many decisions, and in some detail: the gradual modification of common law "must be measured by decades and even centuries."<sup>38</sup>

## II.

### THE INCIPIENT NEW YORK COMMON LAW

#### A. *The Adoption of English Common Law*

The common law of England was central to New York's legal system long before the state's first constitution incorporated it by name in 1777. The moment when colonial New York adopted the common law as part of its legal system is notoriously elusive to pinpoint.<sup>39</sup> By the end of the seventeenth century, however, the Province of New York had clearly moved toward adopting "common-law institutions."<sup>40</sup> The Supreme Court of Judicature in New York was established in 1691 as the province's first centralized court

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35. CARDOZO, *supra* note 32, at 66–67, 71–72, 150.

36. *Id.* at 67; *see also id.* at 94 (concluding that courts must exercise their power "with insight into social values, and with suppleness of adaptation to changing social needs"). Absent the incorporation of such modern inquiry, "vagueness and indeterminacy are pervasive in this analysis, and to a large extent Cardozo knew it." Richard D. Friedman, *Cardozo the [Small r] realist*, 98 MICH. L. REV. 1738, 1755 (2000) (reviewing ANDREW L. KAUFMAN, *CARDOZO* (1998)); *see, e.g.*, WILLIAM E. NELSON, *THE LEGALIST REFORMATION: LAW, POLITICS AND IDEOLOGY IN NEW YORK, 1920–1980* 24 (2001) (in place of "mechanical jurisprudence," Cardozo's approach to the law "substituted a scientific analysis of societal needs in pursuit of law's ultimate end of achieving social justice").

37. CARDOZO, *supra* note 32, at 180. The analysis thus dovetails with asking whether New York has met its professed goal of providing distinct expertise in business matters and in adjudicating business disputes. *See Eisenberg & Miller, supra* note 19, at 1485.

38. CARDOZO, *supra* note 32, at 25.

39. *See, e.g.*, Eben Moglen, *Settling the Law: Legal Development in Provincial New York 166–67* (Mar. 1, 1998) (unpublished draft) (Columbia Law School), <http://moglen.law.columbia.edu/publications/stl.pdf>.

40. *Id.* at 167.

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of “unlimited original jurisdiction.”<sup>41</sup> There followed “a rather sudden increase in reliance on the common law.”<sup>42</sup>

The courts thus adopted English common law procedures and regularly interpreted and applied English precedent. By 1761, common law cases were held binding.<sup>43</sup> In April 1777, as the Continental Army struggled to consolidate the limited and unlikely victories it had secured toward the end of its otherwise calamitous prior year,<sup>44</sup> the first *Constitution of New York* declared “that such parts of the common law of England,” in addition to certain statutes and acts, “shall be and continue the law of this State.”<sup>45</sup> As Alexander Hamilton observed of New York several years later: “In this State, our judicial establishments resemble, more nearly than in any other, those of Great Britain.”<sup>46</sup> The reference to the common law “of England” was eliminated in the second *Constitution of New York*, in 1821,<sup>47</sup> but the reference to “common law” has remained in each of the several subsequent versions.

The state’s highest court established the inchoate claim for fraud under New York common law in 1810, in *Upton v. Vail*.<sup>48</sup> Upton fraudulently represented to Vail that Brown was creditworthy. Upton had a judgment against Brown at the time. In reliance, Vail conveyed goods to Brown on credit. Upton then exe-

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41. HISTORICAL SOC’Y OF THE N. Y. COURTS, “DUELY AND CONSTANTLY KEPT”: A HISTORY OF THE SUPREME COURT OF THE STATE OF NEW YORK, 1691–1847, [http://www.nycourts.gov/history/legal-history-new-york/documents/History\\_Supreme-Court-Duely-Constantly-Kept.pdf](http://www.nycourts.gov/history/legal-history-new-york/documents/History_Supreme-Court-Duely-Constantly-Kept.pdf).

42. Stoebeck, *supra* note 24, at 408 (citing Herbert A. Johnson, *The Advent of Common Law in Colonial New York*, in *LAW AND AUTHORITY IN COLONIAL AMERICA* 74 (George Athan Billias ed., 1965)).

43. *Id.* at 401.

44. *See, e.g.*, DAVID McCULLOUGH, 1776 67–294 (2005); RON CHERNOW, ALEXANDER HAMILTON 76–94 (2004).

45. N.Y. CONST. OF 1777, art. XXXV. The first constitutions of Delaware, Maryland, and New Jersey also adopted “the common law of England.” DEL. CONST. OF 1776, art. 25; MD. CONST. OF 1776, art. III; N.J. CONST. OF 1776, art. XXII. The thesis of James Maxeiner’s recent analysis is that eighteenth and nineteenth century America favored statutory law and that it is a fallacy to state otherwise. *See* Maxeiner, *supra* note 4 & accompanying text. Maxeiner does not acknowledge, however, that any of these states thus incorporated English common law.

46. THE FEDERALIST No. 83 (Alexander Hamilton).

47. N.Y. CONST. OF 1821, art. VII, § 13.

48. 6 Johns. 181 (N.Y. 1810). The Court for the Trial of Impeachments and Correction of Errors, which decided the case, was created as New York’s highest court in 1777. *See* N.Y. CONST. OF 1777, art. XXXII. The court held that status until 1846, when the third *Constitution of New York* created the Court of Appeals, which assumed the ultimate appellate jurisdiction for the state. *See* N.Y. CONST. OF 1846, art. VI, § 2.

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cuted on his judgment against Brown and took the goods that Vail had conveyed.<sup>49</sup> New York's highest court cited English precedent and explained that it turned "upon the application of a principle of natural justice, long recognised in the law, that fraud or deceit, accompanied with damage, is a good cause of action. This is as just and permanent a principle as any in our whole jurisprudence," a "principle of universal law."<sup>50</sup>

Indeed, the claim of fraud arose in ancient law and then in England "underpinned by our moral duty to tell the truth and the social and commercial necessity of deterring untruths drawing the innocent to their harm."<sup>51</sup> In modern terms, fraud is immoral from a deontological perspective because the fraudster deliberately treats the victim as a means to profit himself at her expense.<sup>52</sup> It is immoral from a consequentialist perspective because, among other bad consequences, intentional wrongdoers create social waste and reduce the likelihood of private enforcement of their wrongdoing.<sup>53</sup> Deliberate lies prevent the net benefits to society that follow from commercial activity based on truthful communication.<sup>54</sup>

The court in *Upton* also cited the discussion of analogous facts in the contracts treatise that well-known French jurist Robert Pothier had published decades before.<sup>55</sup> Pothier explains that if the defendant gave the advice honestly, then no liability should lie; but

49. *Upton*, 6 Johns. at 181–82.

50. *Id.* at 182–83 (addressing *Pasley v. Freeman*, 100 Eng. Rep. 450 (1789)). *Pasley* was the "first significant decision on the law of deceit" in England, confirming "the availability of the cause of action to non-contracting parties." EGGERS, *supra* note 9, § 1.5, at 3, § 4.1 at 99. In *Ward v. Center*, 3 Johns. Cas. 271 (N.Y. Sup. Ct. 1808), in dicta, Justice Van Ness of New York's Supreme Court of Judicature had expressed dubiety about the viability of the cause of action set out in *Pasley*, "so long as the provisions of the statute of frauds are considered salutary." *Id.* at 251.

51. EGGERS, *supra* note 9, § 1.4, at 2; *accord id.* at xi; *see also id.* §§ 1.17–25, at 7–10 (describing the original decisions developing the tort).

52. *See, e.g.*, David G. Owen, *The Moral Foundations of Punitive Damages*, 40 ALA. L. REV. 705, 719 (1989) [hereinafter "Owen, *Moral Foundations*"]; EGGERS, *supra* note 9, §§ 2.31–35, at 46–48, §§ 2.41–2.46, at 50–53, § 2.51, at 54, § 2.70, at 61, § 2.77, at 64–65, § 8.42, at 212; *see also infra* Section IX.E (further examining the deontological bases for fraud).

53. *See* EGGERS, *supra* note 9, § 1.4, at 2, §§ 1.17–25, at 7–10; *see, e.g.*, Klass, *supra* note 12, at 451 ("Deceptive behavior is a costly activity that aims primarily at the redistribution rather than the production of value and often causes poor decision making."); *see also infra* Section IX.E (further examining the consequentialist bases for fraud).

54. *See, e.g.*, EGGERS, *supra* note 9, § 1.4, at 2, §§ 1.17–25, at 7–10.

55. 6 Johns. at 183–84 (citing ROBERT POTHIER, TRAITÉ DU CONTRAT DE MANDAT, in TRAITÉS DE DROIT CIVIL, APPLIQUÉES À L'USAGE DE BARREAU, ET DE JURISPRUDENCE FRANCOISE, art. 21 (1761)).

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if he gave the recommendation “in bad faith,” then he must “indemnify the creditor.”<sup>56</sup> Against this background, the Supreme Court of Judicature issued two other illustrative early decisions addressing the damages for common law fraud in New York.

*B. The Cases of the Diseased Sheep*

1. *Jeffrey v. Bigelow & Tracy*<sup>57</sup>

In September 1831, in what is now Peterboro, New York, Stevens sold a flock of 507 sheep to Jeffrey. Stevens was an agent for the business of Bigelow & Tracy. He knew that some of the sheep in the flock had a contagious disease but declined to inform Jeffrey, who mixed the new flock with his existing flock of 548 sheep. By the winter of 1832, approximately 236 of the new flock and 118 of his previous flock had died of the disease. Two-thirds of the lambs born to the combined flock died. By the winter of 1833, four dozen more sheep had died, and the entire flock was infected with the disease.<sup>58</sup>

Jeffrey sued Bigelow & Tracy and Stevens for fraud. The jury awarded \$1525 in damages<sup>59</sup> (equivalent to approximately \$41,200 today<sup>60</sup>). Denying the defendants’ motion for a new trial, the Supreme Court of Judicature held that they were liable for “not the mere difference between a diseased sheep and a healthy one, but the damage sustained by communicating the disease to the plaintiff’s flock.”<sup>61</sup> The court cited the analogous facts (involving cows) in a contracts treatise that Robert Pothier co-authored.<sup>62</sup> In it, citing English common law, the authors distinguish a debtor’s simple failure to fulfill his obligations from a debtor’s fraud. The authors conclude that the damages in the former case “ought not to be taxed and liquidated with rigour, but with a certain degree of moderation.”<sup>63</sup> In the latter case, however, “the debtor is liable, indiscriminately, for all the damages and interests” that the plaintiff has “suffered in consequence.”<sup>64</sup> In cases of fraud, the authors advise,

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56. *Id.* (quoting POTHIER, *supra* note 55, art. 21).

57. 13 Wend. 518 (N.Y. Sup. Ct. 1835).

58. *Id.* at 518–19.

59. *Id.* at 518.

60. See *Inflation Calculator* (from Google Play).

61. *Jeffrey*, 13 Wend. at 523.

62. *Id.* at 523–24 (citing 1 ROBERT JOSEPH POTHIER & DAVID EVANS, A TREATISE ON THE LAW OF OBLIGATIONS OR CONTRACTS 97 (1806)).

63. POTHIER & EVANS, *supra* note 62, at 94, 98–99.

64. *Id.* at 97.

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the judge should “use a certain degree of indulgence in the estimate of damages interests.”<sup>65</sup>

The decision in *Jeffrey* was well known for a time. The Supreme Court of Judicature described it in 1854 as “the famous case of the diseased sheep.”<sup>66</sup> Decades later, addressing the “damages recoverable for a breach of warranty or for a false representation,” the U.S. Supreme Court cited *Jeffrey* with approval as one of the decisions making such a seller “responsible for the damages resulting from a communication of the disease to the buyer’s other animals.”<sup>67</sup>

## 2. Crain v. Petrie<sup>68</sup>

Some ten years after *Jeffrey*, the Supreme Court of Judicature again considered the consequences of fraud in a case involving diseased sheep in upstate New York.<sup>69</sup> Petrie had a contract with another butcher in Little Falls, Gage, to sell some of the hams and shoulders of the sheep that Petrie might slaughter in 1840 and 1841.<sup>70</sup> Petrie purchased sheep from Crain, who declined to inform Petrie that the sheep were diseased. Everyone found out that the sheep were diseased. Gage refused to fulfill his bargain, even for healthy sheep, and other town residents refused to buy from Petrie. Petrie lost “a large quantity of mutton which was good and well cured.”<sup>71</sup> He sued Crain for fraud, for all of the lost sales, and the jury found in his favor.<sup>72</sup>

On appeal, the court held that the damages for which a defendant in Crain’s position could be liable “must appear to be the legal and natural consequences arising from the tort, and not from the

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65. *Id.* at 99.

66. *Sharon v. Mosher*, 17 Barb. 518, 522 (N.Y. Gen. Term 1854); *see, e.g.*, *Faris v. Lewis*, 41 Ky. (2 B. Mon.) 376 (Ky. Ct. App. 1842) (citing, *inter alia*, *Jeffrey*, 13 Wend. 518, as authority that on a claim for fraud in the purchase of a diseased horse, the plaintiff is entitled to recover the value of both the horse purchased and his own horses who subsequently contracted and died from the same disease).

67. *Dushane v. Benedict*, 120 U.S. 630, 637 (1887).

68. 6 Hill 522 (N.Y. Sup. Ct. 1844).

69. Sheep farming has been popular in upstate New York for a long time. In one town in the Catskills in 1845, for example, the populations were 1400 people and 6700 sheep. *See* FARMING HISTORY OF BOVINA, <http://farmingbovinany.org/history> (last visited Aug. 16, 2016).

70. *Crain*, 6 Hill at 523. Home to “the largest and best example of crystal silica gems in the world,” Little Falls changed its name to “Rockton” in 1850, but for some reason went right back to “Little Falls” in 1851. *See* CITY OF LITTLE FALLS, LITTLE FALLS HISTORY, <http://www.cityoflittlefalls.net/index.cfm?section=history> (last visited Aug. 19, 2016).

71. *Crain*, 6 Hill at 523.

72. *Id.*

wrongful act of a third party remotely induced thereby. In other words, the damages must proceed wholly and exclusively from the injury complained of.”<sup>73</sup> The court explained with respect to Gage’s conduct that the damages “arose out of a wrongful breach of contract, for which the plaintiff was entitled to an adequate remedy against Gage.”<sup>74</sup> With respect to other people in town, the damages “resulted from a want of confidence in the care, skill or integrity of the plaintiff himself, the people assuming that he might sell the meat of diseased sheep for a good and merchantable article.”<sup>75</sup>

These decisions thus preview central issues. If the holding in *Crain* seems harsh, as it was not enough for the fraud to have been even a substantial factor in causing the loss, the court nevertheless did regard consequential damages as recoverable in principle.<sup>76</sup> The holding in *Jeffrey v. Bigelow & Tracy*, moreover, seems unobjectionable, as it was likely and foreseeable to both the defendants and their agent that selling the plaintiff sheep with a contagious disease would harm and devalue the plaintiff’s current sheep.<sup>77</sup> A court interpreting New York law today, however, might not permit Jeffrey to recover the damages he was awarded.<sup>78</sup>

In addition, certain issues that *Jeffrey* does *not* address may be just as weighty—namely, how much money the defendants made from selling the sheep, and whether the damages award would serve to deter similar fraud. If a defendant’s revenues from the sale exceed the amount he must pay in damages for fraud, such an iniquitous result must not follow as a matter of tort law from any exhaustive conception of “natural justice.”<sup>79</sup> As early as 1831, moreover, the Supreme Court had concluded that for fraud in the sale of goods, “damages are given, as well as to compensate the plaintiff, as to punish the fraud of the defendant.”<sup>80</sup>

### III.

#### POTENTIAL RECOVERIES—EXAMPLES

The cases of the diseased sheep implicate only some of the main types of recoveries a plaintiff might seek for economic harm

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73. *Id.* at 524.

74. *Id.*

75. *Id.*

76. *Id.* at 523-24.

77. 13 Wend. 518 (N.Y. Sup. Ct. 1835).

78. *See infra* Part VIII.

79. *Upton v. Vail*, 6 Johns. 181, 182–83 (N.Y. 1810).

80. *Allen v. Addington*, 7 Wend. 9, 25–26 (N.Y. Sup. Ct. 1831), *rev’d on other grounds*, 11 Wend. 374 (N.Y. 1833).

resulting from fraud.<sup>81</sup> The following sketches, each assuming reasonable reliance on the misrepresentation, may be a helpful guide:

*Out-of-Pocket Costs.* Defendant fraudulently induces Plaintiff to enter into a joint venture with him. She spends \$1000 in reliance. The parties make nothing. She seeks \$1000.

*Benefit of the Bargain.* Defendant fraudulently induces Plaintiff to enter into a joint venture through which the parties each would have made \$2000 only if the misrepresentation had been true. The parties make nothing. She seeks \$2000.

*Natural and Foreseeable Consequences.* Defendant fraudulently induces Plaintiff to enter into a joint venture, misrepresenting that he is not a lawyer and knowing that the job she intends to continue, at \$1000 per month, does not permit her to work with lawyers. She spends nothing in reliance but is fired for the joint venture, which makes nothing. She foreseeably needs three months to get another job. She seeks \$3000.

*Forgone Business Opportunities.* Defendant fraudulently induces Plaintiff to enter into a joint venture. She does so instead of entering into a joint venture with someone else through which she would have made \$4000. The parties make nothing. She seeks \$4000.

*Forgone Legal Claims.* Defendant fraudulently induces Plaintiff to enter into a joint venture and, as a condition, to release her claim for breach of contract against someone else for \$5000 in lost profits. The parties make nothing. She seeks \$5000.

*Disgorgement of Profits.* Defendant fraudulently induces Plaintiff to enter into a joint venture. She spends \$5000 in reliance, and the joint venture makes nothing, but the fraud allows him otherwise to make \$6000. She seeks \$6000.

*Punishment.* Defendant fraudulently induces Plaintiff to enter into a joint venture. She spends \$7000 in reliance. The parties make nothing. She seeks \$7000 in compensation and \$7000 in punitive damages.

Which of these types of recoveries have the courts allowed plaintiffs to make under New York law, what can we say of the process by which the courts have reached their conclusions, and which *should* the courts or juries award?

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81. A plaintiff could try to seek damages for emotional distress, but for fraud only a very few courts—and none in New York—“have sustained or approved the emotional harm claim.” DOBBS, *supra* note 8, at 562. Accordingly, this Article focuses on economic harm.

IV.  
THE BUDDING NEW YORK LAW: 1845–1918

In 1848, in *Whitney v. Allaire*, the Court of Appeals held that the “measure of damages in an action upon a warranty, and for fraud in the sale of personal property, are the same. In either case they are determined by the difference in value between the article sold, and what it should be according to the warranty or representation.”<sup>82</sup> The court explained: “This rule of compensation is founded upon sound principles of morality. It compels the fraudulent vendor to make good the representations, upon the faith of which the vendee entered into the contract. This is but just.”<sup>83</sup>

Such emphasis on “morality” and what is “just” evokes *Upton v. Vail* and was characteristic of the continuing “Americanization” of the common law from its original application in the colonies.<sup>84</sup> The law in pre-revolutionary communities consistently enforced values of a “moral nature.”<sup>85</sup> On the criminal side, taking Massachusetts as the most well-documented example, prosecutions for all manner of fraud were common.<sup>86</sup> The criminal law was concerned with fraud and lying in general as matters with religious connotations.<sup>87</sup> A good part of the civil law “was likewise concerned with religious and moral values.”<sup>88</sup> A civil claim for fraud, plainly put, was one of the common causes of action “whose essence was recovery of damages for a lie.”<sup>89</sup>

The New York state courts continued to apply such reasoning for many decades. As of 1884, in *Krumm v. Beach*,<sup>90</sup> the Court of Appeals affirmed that a plaintiff is entitled to the “benefit of the bargain” of the misrepresentation, or “the difference in value between the article sold and what it should be according to the warranty or representation.”<sup>91</sup> As in *Whitney*, the court couched the measure of damages as justified on moral grounds.<sup>92</sup> The court re-

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82. 1 N.Y. 305, 312 (1848).

83. *Id.* at 312–13.

84. WILLIAM E. NELSON, *AMERICANIZATION OF THE COMMON LAW* (1994).

85. *Id.* at 36.

86. *Id.* at 38.

87. *Id.* at 39.

88. *Id.* at 40.

89. *Id.* at 41.

90. 96 N.Y. 398 (1884).

91. *Id.* at 407.

92. *Id.* (“Often the profit secured above the price paid is the sole motive for the purchase . . . . To the entire benefit of his bargain he is entitled. If there had been no fraud he would have had it; he should not lose it because the other party has been dishonest.”).

affirmed the measure several years later, explaining that “the party defrauded is entitled to be made pecuniarily as well off as if the representations had been true.”<sup>93</sup> As the court said in the beginning of the twentieth century, in *Ettlinger v. Weil*, the “measure of damages is the difference between the market value of the premises if they had been as represented and their actual market value.”<sup>94</sup> The rationale is that “the plaintiff, as the injured party, was entitled to the benefit of the bargain he supposed he was making.”<sup>95</sup>

The Court of Appeals also held that plaintiffs are entitled to damages based on the value of legal claims that they were defrauded into forgoing. In *Urtz v. New York Central and Hudson River Railroad Co.*, the plaintiff’s husband was killed in a railroad accident.<sup>96</sup> She alleged that an agent of the railroad defrauded her into settling her claim against the railroad for \$500, allegedly far less than it was worth. Citing *Krumm*, the court explained:

The basic principle underlying all rules for the measurement of damages in actions for fraud and deceit is indemnity for the actual pecuniary loss sustained as a direct result of the wrong . . . . The question is what was the value of that with which plaintiff parted and what was the value of that which she received?<sup>97</sup>

In *Krumm*, however, the court regarded the benefit of the bargain of the misrepresentation as “full indemnity” for the plaintiff.<sup>98</sup> The court in *Urtz* gave “indemnity” a different meaning, calling it the difference between “the value of that with which plaintiff parted” and “the value of that which she received.”<sup>99</sup> The court addressed the nature of the proof required for her to prove the value of her settled claim and framed the relevant question: “What under all the conditions and circumstances was this claim of the plaintiff, valid under the true, yet opposed and contradicted, state of facts, worth for purpose of sale, transfer or cancellation, if anything at all, above the \$500?”<sup>100</sup>

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93. *Vail v. Reynolds*, 23 N.E. 301, 301 (N.Y. 1890) (citing *Krumm*, 96 N.Y. 398; *Whitney v. Allaire*, 1 N.Y. 305, 305 (1848)).

94. 77 N.E. 31, 32 (N.Y. 1906).

95. *Id.*

96. 95 N.E. 711, 711 (N.Y. 1911).

97. *Id.* at 712; *see also* *Gould v. Cayuga Cnty. Nat’l Bank*, 99 N.Y. 333, 337–42 (1885) (applying a similar analysis in framing the issues for the jury to resolve regarding a fraudulently compromised legal claim).

98. 96 N.Y. at 407.

99. 95 N.E. at 712.

100. *Id.* at 713.

In *Ochs v. Woods*, decided in 1917, the plaintiff alleged that the defendant owed him commissions for his services in securing a tenant and then defrauded him into accepting the agreement of a third-party corporation to pay him the commissions.<sup>101</sup> The corporation was insolvent and unable to pay.<sup>102</sup> Citing *Krumm*, the Court of Appeals stated: “The basic principle underlying all rules for the measurement of damages for deceit is indemnity for the actual loss sustained as the direct result of the wrong.”<sup>103</sup> The court then framed the relevant question in that regard: “What was the value of that with which the plaintiff parted and what was the value of that which he received?”<sup>104</sup> That measure of damages, again, was *not* the one that the court in *Krumm* had described.

## V.

### THE PIVOTAL DECADE: 1919–1928

New York state courts decided three cases in 1919 that underscored the uncertainty in the state’s law regarding fraud damages. The Court of Appeals decided two of the cases, trying to clarify the rules of decision but leaving significant questions unresolved under the controlling precedent.

#### A. *Ritzwoller v. Lurie*<sup>105</sup>

The plaintiff alleged that in January 1907, the defendant, a corporation, fraudulently induced him to join the business.<sup>106</sup> The court held that he properly alleged fraud but could not show damages, where “there is no allegation which indicates that if he had not taken the contract which he did with the corporation he would have done better anywhere else or under any other contract he could have secured.”<sup>107</sup> Without citation, the court thus reasoned that under different allegations, a plaintiff might state a claim for recovering the value of a forgone business opportunity.

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101. 117 N.E. 305, 306 (N.Y. 1917).

102. *Id.*

103. *Id.* at 307 (citing *Krumm*, 96 N.Y. 398; *Urtz*, 95 N.E. 711).

104. *Id.*

105. 225 N.Y. 464 (1919).

106. *Id.* at 466.

107. *Id.* at 468–69.

*B. Wood v. Dudley*<sup>108</sup>

The Appellate Division, First Department,<sup>109</sup> concluded that the plaintiff's "measure of damage is the difference between the actual value of that which he received, and what would have been the value had it in fact been as it was represented to be."<sup>110</sup> Under that approach, "the wrongdoer does not escape harmless, but he is required to make good his fraudulent representation."<sup>111</sup> The court went on to cite *Ochs v. Woods*<sup>112</sup> as if that decision were consistent with the foregoing requirement,<sup>113</sup> which it was not.

In its analysis, moreover, the court brought out the difference between New York law as *Krumm* and *Wood* had described it and the corresponding federal general common law.<sup>114</sup> In *Smith v. Bolles*, cited in *Ochs*, the U.S. Supreme Court addressed the measure of damages for fraud in the sale of stock.<sup>115</sup> The Court held that the defendant "was bound to make good the loss sustained, such as the moneys the plaintiff had paid out and interest, and any other outlay legitimately attributable to defendant's fraudulent conduct; but this liability did not include the expected fruits of an unrealized speculation."<sup>116</sup> In other words, "[w]hat the plaintiff might have gained is not the question, but what he had lost by being deceived into the purchase."<sup>117</sup> In short, whereas the court in *Wood* said the defendant must "make good his fraudulent representation,"<sup>118</sup> the Court in *Bolles* said the defendant must "make good the loss sustained."<sup>119</sup>

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108. 188 A.D. 136 (N.Y. App. Div. 1919).

109. In 1894, the fourth *Constitution of New York* decreed that the state legislature "shall divide the State into four judicial departments" and that "an Appellate Division of the Supreme Court" shall operate as the intermediate appellate court for each department. N.Y. CONST. of 1894, art. VI, § 2. That structure continues today.

110. *Wood*, 188 A.D. at 144 (citing *Krumm*, 96 N.Y. 398).

111. *Id.*

112. 117 N.E. 305 (N.Y. 1917). *Ochs* stands for the proposition that the measure of damages is the difference between "the value of that with which the plaintiff parted" and "the value of that which he received." *Id.* at 307.

113. *See Wood*, 188 A.D. at 144–45.

114. In *Erie Railroad v. Tompkins*, 304 U.S. 64 (1938), the Court overruled *Swift v. Tyson*, 41 U.S. 1 (1842), and concluded that federal courts do not have the power to create federal general common law when resolving state common law claims. *Erie*, 304 U.S. at 65–80.

115. 132 U.S. 125 (1881).

116. *Id.* at 129–30.

117. *Id.* at 129.

118. 188 A.D. at 144.

119. 132 U.S. at 129.

The *Bolles* Court's reasoning underscores the inconsistency of this early jurisprudence. Following its admonition that the plaintiff could not recover based on an unrealized speculation, the Court stated that the "damage to be recovered must always be the natural and proximate consequence of the fact complained of," citing Simon Greenleaf's treatise on evidence.<sup>120</sup> In a section the Court did not cite, however, Greenleaf notes that the benefit-of-the-bargain measure of damages applies in cases of both warranty and deceit in the sale of goods.<sup>121</sup> That measure of damages is the one that *Whitney* cites, not the out-of-pocket measure that *Bolles* describes.

C. *Reno v. Bull*<sup>122</sup>

The plaintiff purchased \$5500 of bonds on the misrepresentation that they were secured by first mortgages, then discovered the fraud years later and brought suit. The Court of Appeals stated: "The purpose of an action for deceit is to indemnify the party injured. All elements of profit are excluded. The true measure of damage is indemnity for the actual pecuniary loss sustained as the direct result of the wrong."<sup>123</sup> The court did not acknowledge *Ritzwoller v. Lurie*, issued months earlier.<sup>124</sup> The court stated:

It is true there are expressions in the opinions, and especially in the one delivered in the *Whitney* case, to the effect that the rule of damages in an action on warranty in the sale of personal property is the same as the rule in actions for fraud. Such expressions were unnecessary to the decisions and, therefore, cannot be considered as settling the rule of law on that subject. If, however, it could be held otherwise, then such authorities must be held overruled by subsequent decisions of this court.<sup>125</sup>

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120. *Id.* at 130 (citing 2 SIMON GREENLEAF, A TREATISE ON THE LAW OF EVIDENCE § 256, at 265–66 (1883)). Just two years earlier, the Court had cited *Jeffrey v. Bigelow & Tracy*, 13 Wend. 518 (N.Y. Sup. Ct. 1835), with approval. See *Dushane v. Benedict*, 120 U.S. 630, 637 (1887). That citation is a further basis for concluding that in alluding to what the plaintiff "might have gained," *Bolles*, 132 U.S. at 129, the *Bolles* Court did not mean to preclude the recovery of consequential damages. See also *supra* Section II.B.1 (discussing *Jeffrey*) and *infra* Section IX.B (discussing the significance of that phrasing in *Bolles*).

121. GREENLEAF, *supra* note 120, § 262, at 276–77 & n.(a) (citations omitted).

122. 124 N.E. 144 (N.Y. 1919).

123. *Id.* at 146 (citing *Urtz v. N.Y. Cent. & Hudson River R.R. Co.*, 95 N.E. 711 (N.Y. 1911); *Ochs v. Woods*, 117 N.E. 305 (N.Y. 1917)).

124. 225 N.Y. 464 (1919). Judge McLaughlin wrote the decision in *Reno*; Chief Judge Hiscock, who wrote the decision in *Ritzwoller*, concurred in *Reno*.

125. *Reno*, 124 N.E. at 146.

The court thus distinguished between the measure of damages for fraud claims and warranty claims. Accordingly, and oddly, after *Reno* a plaintiff suing for a fraudulent representation that did not take the form of a warranty stood to recover less than if he could have sued for simple breach.<sup>126</sup>

The court in *Reno* found support in the rule “in the Federal courts,”<sup>127</sup> citing *Smith v. Bolles*<sup>128</sup> and *Sigafus v. Porter*.<sup>129</sup> *Sigafus* held that it would adhere to *Bolles*, consistent with the “principle . . . recognized by the English Court of Appeal in the leading case of *Peek v. Derry*.”<sup>130</sup> In *Peek*, several justices of the Chancery Division of the Court of Appeal agreed that if the plaintiff was fraudulently induced to purchase stock for £4000, then his damages must be the difference between the £4000 and the value of the shares when purchased.<sup>131</sup> *Reno* also found support for that rule “in many of the states.”<sup>132</sup> Echoing *Sigafus*, the court in *Reno* likewise offered that the damages rule it adopted is “the rule in England.”<sup>133</sup>

#### D. Questions After *Reno v. Bull*

The decision in *Reno* left open decisive issues. The New York courts have failed to resolve them in the succeeding one hundred years, notwithstanding the efforts of the Court of Appeals to try to clarify the matters.<sup>134</sup> New York courts continue to cite *Reno*.<sup>135</sup> The

126. See, e.g., DOBBS, *supra* note 8, at 549 (explaining with respect to out-of-pocket damages: “Anomalously, where this limit applies, the plaintiff will be better off to recover for contract or warranty breach than for deliberate fraud.”). R

127. *Reno*, 124 N.E. at 146.

128. 132 U.S. 125 (1881).

129. 179 U.S. 116 (1900).

130. *Id.* at 124 (citing *Peek v. Derry* (1887) 37 Ch 541).

131. See *Peek*, 37 Ch at 590–94. In *Derry v. Peek*, (1889) 14 App. Cas. 337 (HL), the House of Lords reversed the Chancery Division’s “formulation of the cause of action,” EGGERS, *supra* note 9, § 1.47, at 17–18, but not its analysis of damages. The reversal set forth “the template and exemplar of the law of deceit” under English common law. *Id.* § 1.50, at 19. R

132. *Reno*, 124 N.E. at 146 (citing decisions from six states). The court did not make clear if it meant to cite the majority rule, which by a sizable margin was the benefit-of-the-bargain measure. See Charles T. McCormick, *Damages in Actions for Fraud and Deceit*, 28 ILL. L. REV. 1050, 1052–53 (1934). That measure remains the test in the substantial majority of states. See LAW OF REMEDIES, *supra* note 8, § 9.2(1), at 549. In contrast to the Court of Appeals, the Second Circuit has recognized which measure is the majority test. See *Osofsky v. Zipf*, 645 F.2d 107, 114 (2d Cir. 1981) (considering the federal securities laws and noting that “the benefit-of-the-bargain measure of compensatory damages is recognized as the preferable measure in common law fraud actions”). R

133. *Reno*, 124 N.E. at 146 (citing *Peek*, 37 Ch 541).

134. See *infra* Section VII.C.

decision was also a basis for the Court of Appeals' reaffirmation of the out-of-pocket measure of damages almost eighty years later.<sup>136</sup> Several overlapping questions thus remain timely.

First, how literally is one to take the rule in *Reno* that "all elements of profit are excluded"?<sup>137</sup> The court cited no authority for that proposition, and taken literally, it cannot be reconciled with the precedent from which the court drew.<sup>138</sup> The decision in *Ochs v. Woods* is an example.<sup>139</sup> The plaintiff sought proper damages where, because of the deceit, he "abandoned his legal right" to the commissions he had earned "for its nearly valueless substitute."<sup>140</sup> The court did not suggest that he could recover only his out-of-pocket expenditures in earning the commissions, a recovery that would exclude "profit," at least in the strict economic sense. If "profit" in *Reno* instead means the benefits the plaintiff would have enjoyed only if the representation were true, the court did not make the point clear. The courts have not construed the limitation on "profit" to have only that meaning, and such a rule is problematic on its own terms.<sup>141</sup> The latent ambiguity has proven pernicious, in particular with respect to "lost profits."<sup>142</sup>

Second, did *Reno* preclude a plaintiff from recovering consequential damages of the sort permitted in *Jeffrey v. Bigelow & Tracy*<sup>143</sup> and contemplated in *Crain v. Petrie*<sup>144</sup>? In *Sigafus v. Porter*, cited in *Reno*, the U.S. Supreme Court held that "the defendant was liable to respond in such damages as naturally and proximately resulted from the fraud."<sup>145</sup> The Court of Appeals' post-*Reno* decision in *Foster v. DiPaolo*, however, suggests a contrary result.<sup>146</sup> The defendant fraudulently induced the plaintiff to purchase bad apple cider from him. The plaintiff asserted that as a result he lost the profits he would have made on contracts with third parties to sell

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135. See, e.g., *Liaros v. Vaillant*, No. 93 Civ. 2170 (CSH), 1998 WL 20001, at \*3 (S.D.N.Y. Jan. 20, 1998); *Cont'l Cas. Co. v. PriceWaterhouseCoopers*, 933 N.E.2d 738, 742 (N.Y. 2010); *Pine St. Assocs. v. Hicks*, No. 651440-2011, 2012 WL 1946822, at \*7 (N.Y. Sup. Ct. May 24, 2012).

136. See *infra* Section VII.C.

137. *Reno*, 124 N.E. at 146.

138. See *supra* Section V.C.

139. 117 N.E. 305 (N.Y. 1917).

140. *Id.* at 307.

141. See *supra* Part VIII; Sections IX.C.1, IX.E.1.

142. See *infra* Parts VI–IX.

143. 13 Wend. 518 (N.Y. Sup. Ct. 1835).

144. 6 Hill 522 (N.Y. Sup. Ct. 1844).

145. 179 U.S. 116, 123 (1900).

146. 140 N.E. 220 (N.Y. 1923). As in *Reno*, 124 N.E. 144, Judge McLaughlin wrote the decision in *Foster* and Chief Judge Hiscock concurred.

them the cider.<sup>147</sup> This is an example of consequential damages. Surveying the precedent, the court stated: “The true measure of damages in an action for fraud . . . does not include profits which he could have made on contracts with third parties.”<sup>148</sup>

Only a few years later, however, citing *Jeffrey*, the Court of Appeals in *Hotaling v. Leach & Co.* specified that a plaintiff is entitled to recover “consequential damages” resulting from the fraud.<sup>149</sup> The defendant fraudulently induced the plaintiff to purchase a corporate bond by exaggerating the assets securing it and by concealing the weakness of the company. The court reasoned that the fraud induced the plaintiff to hold the bond, and thus allowed recovery of the difference between the price paid and the amount received on liquidation of the company.<sup>150</sup> The court emphasized the different types of damages that fraud may cause: “Proximate damages may not be fixed by arbitrary rule. Sometimes other damages flow from fraud in inducing a purchase, besides the difference between the price paid and the value of the article received.”<sup>151</sup>

Third, after these decisions, further questions concerning the exclusion of “all elements of profit” persist. Can the plaintiff recover consequential damages in which some profit inheres? The court in *Hotaling* did not address that question directly, but did cite Theodore Sedgwick’s treatise on damages.<sup>152</sup> Sedgwick explains that the “rules concerning consequential damages,” set out in the first volume of the treatise, “are uniformly applied in cases of fraud as well as all others.”<sup>153</sup> He cites a case in which the plaintiff recovered the value of the “probable earnings” of his stallions that were incapacitated by the “distemper” that the defendant’s horse communicated to them.<sup>154</sup> Sedgwick further concludes in the first volume that the availability of lost profits, a function of the certainty that they would have been realized, is a factual question.<sup>155</sup> As to personal property, for example, he distinguishes between “the average or usual value of the use of the chattel during the time the plaintiff lost the use of it” and the profits merely “hoped for” from

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147. *Foster*, 140 N.E. at 220.

148. *Id.*

149. 159 N.E. 870, 873 (N.Y. 1928).

150. *Id.*

151. *Id.*

152. *Id.* (citing, inter alia, THEODORE SEDGWICK, MEASURE OF DAMAGES § 441 (9th ed. 1920)).

153. Sedgwick, *supra* note 152, § 441.

154. *Id.*

155. *Id.* §§ 177, 195.

its use.<sup>156</sup> He explains: "If the owner had an established custom of letting the chattel for hire, so that the jury could determine what income he had from it, he may recover that income, which is analogous to the profit of an established business."<sup>157</sup>

Fourth, how important would it be for the New York common law of fraud damages to continue to track the common law in England? The question has some bite where English common law in this area has developed to reflect markedly different policy than the corresponding law in New York.<sup>158</sup>

## VI.

### THE GROWING UNCERTAINTY: 1930–1982

The Court of Appeals repeatedly affirmed the out-of-pocket rule for fraud damages in the middle part of the twentieth century.<sup>159</sup> The varying interpretations of the court's precedent, however, resulted in inconsistency in the lower state courts.

#### A. *Forgone Legal Claims*

In a discrete area of consistency, the state courts repeatedly reasoned that a plaintiff may recover damages based on the value of legal claims forgone in reliance on fraud. In *Brick v. Cohn-Hall-Marx Co.*, decided in 1937, the defendant contracted to pay the plaintiffs certain royalties.<sup>160</sup> Years later, after the statute of limitations on a claim for breach of contract had expired, the plaintiffs alleged that the defendant had failed to pay the correct royalties. Seeking to avoid the limitations problem, they characterized their action as one for fraud. They alleged that "the books of the defendant contained false and fraudulent entries and that the defendant falsely and fraudulently represented to the plaintiff that it had fairly and justly paid all that was due under the contract."<sup>161</sup> The Court of Appeals disagreed with the plaintiffs' characterization but explained that

if before the statute expired the defendant had assured the plaintiffs that it had already sent a check or had paid, and the plaintiffs, relying upon such assurance, let the time elapse in

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156. *Id.* § 195.

157. *Id.*

158. *See infra* Parts IX–X.

159. *See, e.g.*, *Hanlon v. MacFadden Publ'ns, Inc.*, 99 N.E.2d 546, 551 (N.Y. 1951) (citing *Reno v. Bull*, 124 N.E. 144 (N.Y. 1919)); *Sager v. Friedman*, 1 N.E.2d 971, 974 (N.Y. 1936).

160. 11 N.E.2d 902, 903 (N.Y. 1937).

161. *Id.*

which suit could be brought, we would then have an instance of extraneous fraud not in any way growing out of the contract.<sup>162</sup>

In that circumstance, the plaintiffs “would have a cause of action for the damages caused by the fraud in inducing them to let the Statute of Limitations arise.”<sup>163</sup>

The lower state courts would advance the analysis in that direction. The underlying facts in *Griffel v. Belfer*, decided and affirmed in 1960, were again that the defendant contracted to pay the plaintiff certain royalties.<sup>164</sup> He alleged that the defendant later fraudulently induced him to forego his claim for breach of that contract in favor of a cash settlement of lesser value.<sup>165</sup> The First Department concluded that he stated a claim for fraud.<sup>166</sup> The court assessed his prospective damages on the supposition that he could recover the “fair consideration” of his claim,<sup>167</sup> without excluding any profit inherent in the receipt of the royalties.

The subsequent decision in *Dupuis v. Van Natten* was to the same effect.<sup>168</sup> The plaintiff had been injured in an automobile accident. He asserted a claim for negligence after the statute of limitations had passed.<sup>169</sup> He alleged that the insurer of the prospective defendant in that negligence action fraudulently induced him to file his claim too late.<sup>170</sup> The Third Department stated: “Where failure to commence an action before the expiration of the negligence statute of limitations is due to fraud practiced upon the plaintiff, a cause of action will lie for the loss sustained in consequence thereof.”<sup>171</sup>

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162. *Id.* at 904.

163. *Id.*

164. 209 N.Y.S.2d 67, 69 (N.Y. App. Div. 1960) (per curiam), *aff'd per curiam*, 179 N.E.2d 518 (N.Y. 1961).

165. *Id.*

166. *Id.*

167. *Id.* (having earlier cited *Gould v. Cayuga Cnty. Nat'l Bank*, 99 N.Y. 333 (1885); *Urtz v. N.Y. Cent. & Hudson River R.R. Co.*, 95 N.E. 711 (N.Y. 1911)).

168. 402 N.Y.S.2d 242, 242–43 (N.Y. App. Div. 1978).

169. *Id.*

170. *Id.* at 243.

171. *Id.* (citing *Brick v. Cohn-Mall-Marx Co.*, 11 N.E.2d 902 (N.Y. 1937)). Similarly, in *Tucci v. DiPaola*, 354 N.Y.S.2d 498 (N.Y. App. Div. 1974), the plaintiff alleged that an insurance company fraudulently induced him to release a claim under his policy. The Fourth Department reasoned: “If plaintiff was induced to release a valuable claim through defendant’s fraudulent misrepresentations, then defendant is liable for whatever damages he suffered as a result of the fraudulent representations.” *Id.* at 499 (citing *Reno v. Bull*, 124 N.E. 144 (N.Y. 1919)).

### B. *The Nature of Pecuniary Loss*

In *Dress Shirt Sales, Inc. v. Hotel Martinique Associates*, the plaintiffs were lessees of space in defendants' hotel under a lease prohibiting subletting without defendants' consent.<sup>172</sup> The plaintiffs asked the defendants to consent to a sublease to the operator of a restaurant. The defendants refused, saying they did not want that kind of restaurant in their hotel and declining to inform the plaintiffs that defendants themselves were negotiating with the restaurant operator to lease the plaintiffs' space. Accordingly, the defendants proposed to the plaintiffs a cancellation of their lease. The plaintiffs agreed to pay \$30,000 for the cancellation. Two weeks later, the defendants leased the space to the restaurant operator for a higher rent than the plaintiffs had been paying.<sup>173</sup>

The court addressed whether the defendant's misrepresentation concerning their refusal to accept the sublease "resulted in damage."<sup>174</sup> The court stated that "any loss must be measured by the difference between the actual value of the remainder of the term and the price plaintiffs paid for it by reason of the lessor's deceit."<sup>175</sup> The court observed that the defendants "had an unqualified contractual privilege to refuse to accept" the restaurant operator.<sup>176</sup> On that basis, the court reasoned that "plaintiffs would have had no remedy if defendants had simply said nothing and remained adamant in refusing to accept" the operator "until plaintiffs gave in and paid for a cancellation of the lease."<sup>177</sup> Having addressed *Urtz v. New York Central & Hudson River R.R. Co.*<sup>178</sup> and *Ritzwoller v. Lurie*,<sup>179</sup> the court concluded that "this case falls within the policy of our consistent refusal to allow damages for fraud based on the loss of a contractual bargain, the extent, and, indeed, in this case, the very existence of which is completely undeterminable and speculative."<sup>180</sup>

The decision presents two key questions. The first is what the court meant in referring to "the loss of a contractual bargain." Some courts have interpreted the decision as referring to an alter-

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172. 190 N.E.2d 10, 11 (N.Y. 1963).

173. *Id.*

174. *Id.* at 12.

175. *Id.* (citing *Hanlon v. Macfadden Publ'ns, Inc.*, 99 N.E.2d 566 (N.Y. 1951); *Sager v. Friedman*, 1 N.E.2d 971 (N.Y. 1936)).

176. *Id.*

177. *Id.*

178. 95 N.E. 711 (N.Y. 1911).

179. 225 N.Y. 464 (1919).

180. *Dress Shirt*, 190 N.E.2d at 12-13.

native and prospective third-party contractual bargain.<sup>181</sup> On the facts, however, the court was referring to the contract between the parties. The question was whether, with respect to the actual value of the remainder of the plaintiffs' lease, they could have "outwaited" the defendants instead of paying the \$30,000 to cancel the lease.<sup>182</sup> The court reasoned that although the misrepresentation may have given "a false impression of defendants' obstinacy in insisting on holding plaintiffs to their bargain," where the defendants had complete control over whether to cancel the lease, the court could not say that \$30,000 was more than the "true value" of the remainder of the term.<sup>183</sup>

The second question is whether the court accurately characterized the key precedent. The court stated that in *Urtz* "we disallowed as too speculative a recovery based on the difference between the amount given for the release and the worth of plaintiff's unresolved claim as it stood when the release was given."<sup>184</sup> But *Urtz* held that the trial court erred in instructing the jury to consider the plaintiff's subjective view of her claim instead of its objective validity.<sup>185</sup> The court thus reversed and ordered a new trial to determine the value of the unresolved claim.<sup>186</sup> The court in *Dress Shirt* then stated that in *Ritzwoller* "we upheld a dismissal of a cause of action for an accounting for damages for fraudulently inducing plaintiff to abandon an allegedly profitable contract of employment for one allegedly less profitable."<sup>187</sup> But *Ritzwoller* reasoned that the plaintiff had not *alleged* any facts indicating "that if he had not taken the contract which he did with the corporation he would have done better anywhere else or under any other contract he could have secured."<sup>188</sup>

If such questions were not challenging enough, the New York courts also issued a trio of refractory decisions during this period in which they interpreted *Reno v. Bull*<sup>189</sup> as consistent with *Ettlinger v. Weil*,<sup>190</sup> which set forth the benefit-of-the-bargain measure that *Reno*

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181. *See infra* Section VII.D.2.

182. *Dress Shirt*, 190 N.E.2d at 12.

183. *Id.*

184. *Id.*

185. *See Urtz v. N.Y. Cent. & Hudson R.R. Co.*, 95 N.E. 711, 712-14 (N.Y. 1911); *see also supra* Part IV (discussing *Urtz*).

186. *Urtz*, 95 N.E. at 714.

187. *Dress Shirt*, 190 N.E.2d at 12.

188. *Ritzwoller v. Lurie*, 225 N.Y. 464, 468-69 (1919); *see also supra* Section V.A (discussing *Ritzwoller*).

189. 124 N.E. 144 (N.Y. 1919).

190. 77 N.E. 31 (N.Y. 1906).

expressly overruled.<sup>191</sup> The courts held that for fraud in the sale of property, the measure of damages is the benefit-of-the-bargain rule—that the “‘difference between the market value of the premises if they had been as represented and their actual market value’ is the true measure of damages.”<sup>192</sup> Although no subsequent decisions have endorsed this retrograde description of the law, the Court of Appeals did affirm the most recent of these decisions—without opinion, and thus without acknowledging or correcting the arrant oversight.

### C. *Fading Indignation with Fraud*

With respect to several aspects of damages, the New York courts in this period would treat claims such as breach of contract and negligence as more serious intrusions on plaintiffs’ rights and social welfare than what the Court of Appeals would describe as “ordinary” fraud claims.

#### 1. Consequential Damages

Notwithstanding the Court of Appeals’ language in *Hotaling v. Leach & Co.*,<sup>193</sup> no New York court appears to have held in any decision published between 1928 and 1982 that “consequential damages” are available for fraud.<sup>194</sup> The absence of any such citation is remarkable given the frequency with which the courts in New York addressed fraud claims and contemplated “consequential damages” for other causes of action, such as breach of contract.<sup>195</sup>

If we assume that the courts considered the question, the plain explanation is that they did not interpret *Hotaling* to permit conse-

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191. *Reno*, 124 N.E. at 146.

192. *Skrine v. Staiman*, 30 A.D.2d 707, 708 (N.Y. App. Div. 1968), *aff’d per curiam*, 23 N.Y.2d 946 (1969). The court quotes *Saklaris v. Envagelista*, 21 Misc. 2d 781, 783 (N.Y. Sup. Ct. 1956) (which cites only *Ettlinger*, 77 N.E. 31, for the rule of damages), and *Stillman v. Garmaize Realty Corp.*, 123 N.Y.S.2d 24, 26–27 (N.Y. Sup. Ct. 1953) (which cites *Ettlinger*, 77 N.E. 31, and *Reno*, 124 N.E. 144).

193. 159 N.E. 870 (N.Y. 1928); *see also supra* Section V.D (discussing *Hotaling*).

194. Without using that phrase, two lower-court decisions toward the end of the period appear to reason that the plaintiff may recover damages arguably separate from the pecuniary loss referenced in *Reno*, 124 N.E. at 146. *See Mills Studio, Inc. v. Chenango Valley Realty Corp.*, 221 N.Y.S.2d 684, 687–88 (N.Y. App. Div. 1961); *Werblud v. Mehadrin Dairy Corp.*, 11 Misc. 2d 167, 168–69 (N.Y. Sup. Ct. 1957).

195. Between 1928 and 1982, as one rough barometer, the New York state courts alone referred to “consequential damages” in over 700 written decisions. *Search Results*, WESTLAWNEXT, <https://a.next.westlaw.com> (searching “consequential damages” and filtering case results for New York state courts between 1928 and 1982).

quential damages for fraud. Instead, either they interpreted the decision to apply only to securities sales<sup>196</sup> or they implicitly concluded that “consequential damages” are no different than the “pecuniary loss” calculated based on “the difference between ‘the value of that with which plaintiff parted and what was the value of that which he received.’”<sup>197</sup> Either way, such reasoning would overlook the indication in *Hotaling*, per Sedgwick’s treatise, that consequential damages are available for fraud as for other claims.<sup>198</sup>

A subtler explanation is that as the middle of the century passed, the New York state courts seemed to be moving away from the moral indignation with which they had regarded fraud in the nineteenth century and with which the colonies had treated such misconduct.<sup>199</sup> The courts’ apparent disinclination to interpret *Hotaling* to permit a plaintiff to recover damages that were a consequence of the fraud may reflect a collective shift in view as to the gravity of the tort in relation to the many new and increasingly complex matters the courts were asked to address.

## 2. Punitive Damages

Punitive damages, like the claim of fraud, are “fundamentally a creature of the common law.”<sup>200</sup> New York decisions early in the nineteenth century referred to extra-compensatory damages as ““smart-money””<sup>201</sup> or ““consideration in amends for the pain which [the victim] has unjustly suffered.””<sup>202</sup> The terms came to be synonymous with “punitive damages.”<sup>203</sup> In addition to decisions awarding such damages for other torts, New York courts issued decisions that presupposed the propriety of punitive damages for fraud.<sup>204</sup>

196. See, e.g., Note, *supra* note 29, at 1019; see also *infra* Section VII.D.2 (addressing “holder” claims of the sort at issue in *Hotaling*, 159 N.E. 870). R

197. *Cowart v. Lang*, 298 N.Y.S. 875 (N.Y. App. Div. 1937) (citing *Hotaling*, 159 N.E. 870, and quoting *Ochs v. Woods*, 117 N.E. 305 (N.Y. 1917)).

198. See *supra* Section V.D.

199. See *infra* Section VI.C.2.

200. David G. Owen, *A Punitive Damages Overview: Functions, Problems and Reform*, 39 VILL. L. REV. 363, 366 (1994); accord John M. Leventhal & Thomas A. Dickerson, *Punitive Damages: Public Wrong or Egregious Conduct?*, 76 ALB. L. REV. 961, 962–64 (2013).

201. Leventhal & Dickerson, *supra* note 200, at 964 (quoting *Wort v. Jenkins*, 14 Johns. 352, 352 (N.Y. Sup. Ct. 1817)). R

202. *Id.* (alteration in original) (quoting MARJORIE M. WHITEMAN, *DAMAGES IN INTERNATIONAL LAW* 520 (1937)).

203. *Id.*

204. See, e.g., *Northrop v. Hill*, 61 Barb. 136, 137 (N.Y. Gen. Term. 1871), *aff'd*, 57 N.Y. 351 (1874); see also *Allen v. Addington*, 7 Wend. 9, 25–26 (N.Y. Sup. Ct. 1831) (“It is not the value of the goods only that a jury are authorized to give in

Other decisions set out a qualified rule.<sup>205</sup> At least once the Court of Appeals passed on the question as unnecessary to the disposition of the appeal.<sup>206</sup> With the arrival of the twentieth century, the First Department concluded that such damages were not available for fraud, “except perhaps where the wrong involves some violation of duty springing from a relation of trust or confidence, or presents other extraordinary or exceptional circumstances clearly indicating malice and calling for an extension of the doctrine.”<sup>207</sup>

Surveying precedent in 1961, the Court of Appeals considered several rationales for punitive damages and concluded:

Although they have been refused in the “ordinary” fraud and deceit case, we are persuaded that, on the basis of analogy, reason and principle, there may be a recovery of exemplary damages in fraud and deceit actions where the fraud, aimed at the public generally, is gross and involved high moral culpability.<sup>208</sup>

The court’s reasoning thus turned on the express premise that “ordinary” fraud does not involve any high moral culpability and the implied premise that medium or low moral culpability, so to speak, does not warrant punishment through the common law. This line of thinking is a long way from the authority founded on the fraudster’s self-evident immorality and the role of the common law in redressing and even punishing it.<sup>209</sup> Whatever confluence of factors led the court to restrict the availability of punitive damages, as discussed below, they may also have been embedded as the courts interpreted the loss for which a plaintiff could recover actual damages for fraud.<sup>210</sup>

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a case like this; damages are given, as well to compensate the plaintiff, as to punish the fraud of the defendant.”), *rev’d on other grounds*, 11 Wend. 374 (N.Y. 1833).

205. *See, e.g.*, *Lane v. Wilcox*, 55 Barb. 615, 619–20 (N.Y. Gen. Term 1864) (holding that “a rule allowing exemplary damages cannot be applied” to frauds committed without malice).

206. *See Chrysler v. Canaday*, 90 N.Y. 272, 280 (1882).

207. *Oehlhof v. Solomon*, 73 A.D. 329, 332 (N.Y. App. Div. 1902).

208. *Walker v. Sheldon*, 179 N.E.2d 497, 498–99 (N.Y. 1961).

209. *See supra* Parts I, II, IV.

210. Without even citing *Walker*, 179 N.E.2d 497, for example, one federal court in this period concluded that the “pecuniary loss” standard of damages *itself* means that “punitive damages must be excluded.” *Gross v. Diversified Mortg. Inv’rs*, 431 F. Supp. 1080, 1094 (S.D.N.Y. 1977).

## 3. The Wrongdoer Rule

The Pothier and Evans contracts treatise, cited in *Jeffrey v. Bigelow & Tracy*,<sup>211</sup> concluded that the court should exercise “indulgence” in assessing the plaintiff’s proof of fraud damages.<sup>212</sup> Applying such a rationale, the Court of Appeals repeatedly held in cases for breach of contract during the nineteenth century that where the defendant’s wrongdoing caused damages, the court should not refuse an award on the basis of uncertainty in the amount. One of the seminal cases concerned lost profits.<sup>213</sup> The court acknowledged: “It is very true that there is great difficulty in making an accurate estimate of future profits.”<sup>214</sup> The court explained, however, that it was not “the more inclined to refuse to make the inquiry, by reason of its difficulty, when we remember that it is the misconduct of the defendants which has rendered it necessary.”<sup>215</sup> The court stated the precept more directly later in the century: “A person violating his contract should not be permitted entirely to escape liability because the amount of the damages which he has caused is uncertain.”<sup>216</sup>

In the next century, however, coupled with the courts’ reluctance to award consequential damages for such misconduct, perhaps only one lower state court in New York applied the doctrine to fraud.<sup>217</sup> In addition, it appears that the Court of Appeals has never done so and that no other court has done so in decades. Instead, what has been called “the wrongdoer rule” became and remains a mainstay on claims for breach of contract.<sup>218</sup>

The lesser concern with “ordinary” fraud cemented itself amid a trend in New York common law after World War II that Professor

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211. 13 Wend. 518, 523–24 (N.Y. Sup. Ct. 1835).

212. POTHIER & EVANS, *supra* note 62, at 99.

213. Bagley v. Smith, 10 N.Y. 492, 495–500 (1853).

214. *Id.* at 499.

215. *Id.*

216. Wakeman v. Wheeler & Wilson Mfg. Co., 101 N.Y. 205, 209 (1886).

217. See, e.g., Mills Studio, Inc. v. Chenango Valley Realty Corp., 221 N.Y.S.2d 684, 687–88 (N.Y. App. Div. 1961).

218. See, e.g., Berley Indus. v. City of New York, 45 N.Y.2d 683, 687 (1978); Site Five Hous. Dev. Fund Corp. v. Estate of Bullock, 112 A.D.3d 479, 481 (N.Y. App. Div. 2013) (citing *Wakemen*, 101 N.Y. at 209); Cole v. Macklowe, 105 A.D.3d 604, 605 (N.Y. App. Div. 2013) (citing *Randall v. 43rd St. Estates Corp.*, 215 N.E.2d 494 (N.Y. 1966)); see also *Ho Myung Moolsan Co. v. Manitou Mineral Water, Inc.*, No. 07 Civ. 07483 (RJH), 2010 WL 4892646, at \*11–12 (S.D.N.Y. Dec. 2, 2010) (acknowledging the “wrongdoer rule” as applying in cases of breach of contract). See generally *Dunkel v. McDonald*, 70 N.Y.S.2d 653, 656 (N.Y. App. Div. 1947) (describing the wrongdoer rule in addressing a claim for violation of the General Business Law of New York), *aff’d per curiam*, 81 N.E.2d 323 (N.Y. 1948).

William E. Nelson has considered. He concludes that “as a motive force for legal change in fraud doctrine,” certain “concerns for freedom and opportunity and upward mobility . . . triumphed over the nineteenth-century norms of personal and business morality that had lingered into the first half of the century.”<sup>219</sup> He addresses the standards governing whether a fraud occurred, but his analysis applies with equal force in the concomitant area of damages when he observes that “traditional moral standards were beginning to erode”; that “the law was beginning to place less weight on ethical values of honesty and full disclosure”; and that a certain business reality appeared to have “come to outweigh the older moral values that had underlain the classical law of fraud.”<sup>220</sup> In addition (although Professor Nelson does not call out the parallel), the erosion of moral standards in connection with fraud occurred during the reformation of negligence law as an “area of doctrinal change . . . facilitating *easier* recovery of damages.”<sup>221</sup> In later alluding to “the broadening of tort liability concepts to reflect economic, social and political developments” in the mid-twentieth century, the Court of Appeals was certainly not speaking to fraud damages.<sup>222</sup>

By the end of this period, the Court of Appeals set out a tidy, chary standard, affirming as an infrangible rule that “all elements of profit are excluded from a computation of damages in an action grounded in fraud.”<sup>223</sup> Yet the same year, for what appears to be the first time, a New York state court concluded that under *Hotaling v. Leach & Co.*,<sup>224</sup> a plaintiff may recover “consequential damages” for fraud.<sup>225</sup> The damages at issue, however, concerned only the money the plaintiff expended in reliance on the misrepresentation.<sup>226</sup> The rules remained ripe for clarification.

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219. NELSON, LEGALIST REFORMATION, *supra* note 36, at 176–77.

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220. *Id.* at 177; *see also* LAWRENCE M. FRIEDMAN, AMERICAN LAW IN THE 20TH CENTURY 44–79 (2002) (discussing several of the business-oriented trends of the twentieth century).

221. NELSON, LEGALIST REFORMATION, *supra* note 36, at 196 (emphasis added).

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222. *Havas v. Victory Paper*, 402 N.E.2d 1136, 1138 (N.Y. 1980).

223. *AFA Protective Sys., Inc. v. AT&T*, 442 N.E.2d 1268, 1269 (N.Y. 1982) (citing *Reno v. Bull*, 124 N.E. 144 (N.Y. 1919)).

224. 159 N.E. 870 (N.Y. 1928).

225. *Clearview Concrete Prods. Corp. v. S. Charles Gherardi, Inc.*, 453 N.Y.S.2d 750, 755 (N.Y. App. Div. 1982) (citing, *inter alia*, *Hotaling*, 159 N.E. 870); *accord* *Castle Cook, Inc. v. Lincoln Merch.*, 477 N.Y.S.2d 390, 390 (N.Y. App. Div. 1984).

226. *Clearview*, 453 N.Y.S.2d at 755.

VII.  
THE CONTINUING QUANDARY: 1980–PRESENT

A. *The Case of the Lost Harvest*

In early 1981, in Cato, New York, Calmar Farms took delivery of a harvesting machine, or combine, that it had purchased from Allis-Chalmers Corporation.<sup>227</sup> Within eight months, the machine suffered over one hundred mechanical failures and necessitated a corresponding number of parts replacements.<sup>228</sup> The failures and breakdowns prevented the farm from timely or effectively harvesting its 1981 corn crop.<sup>229</sup> The loss was 5130 tons of corn.<sup>230</sup> The farm sued Allis-Chalmers for fraud, alleging misrepresentations and knowing concealment of material facts regarding the combine.<sup>231</sup>

The Fourth Department analogized the facts to those in *Jeffrey v. Bigelow & Tracy*<sup>232</sup> and recognized that *Hotaling v. Leach & Co.*<sup>233</sup> described a flexible measure, permitting consequential damages.<sup>234</sup> Acknowledging *Reno v. Bull*,<sup>235</sup> moreover, the court explained:

As stated, plaintiff here does not seek profits based on the bargain it was fraudulently induced to make but the loss sustained because it made the bargain. Any profits that might be included in its recovery would not be profits from an anticipated resale of the machine or from an expected increase in the value of plaintiff's investment in it as in *Reno* but rather profits that plaintiff would normally receive from its corn crop if sold at market value as a return on its investment in labor, seed, fertilizer and other expenses in the crop.<sup>236</sup>

The court's reasoning educes lurking factual questions. The nature of these inquiries bears on the subsequent decisions treating a plaintiff's prospective recovery for fraud as "inherently" speculative

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227. *Cayuga Harvester, Inc. v. Allis-Chalmers Corp.*, 465 N.Y.S.2d 606, 609 (N.Y. App. Div. 1983).

228. *Id.* at 607.

229. *Id.* at 609.

230. *Id.* at 611 n.1. New York grows a fair amount of corn. The state says that in 2007, for example, it produced the fourth-most sweet corn in the country. See THOMAS P. DINAPOLI & KENNETH B. BLEIWAS, OFFICE OF THE COMPTROLLER OF THE STATE OF N.Y., THE ROLE OF AGRICULTURE IN THE NEW YORK STATE ECONOMY (Feb. 2010), <http://www.osc.state.ny.us/reports/other/agriculture21-2010.pdf>.

231. *Cayuga*, 465 N.Y.S.2d at 618.

232. 13 Wend. 518 (N.Y. Sup. Ct. 1835).

233. 159 N.E. 870 (N.Y. 1928).

234. *Cayuga*, 465 N.Y.S.2d at 618–19.

235. 124 N.E. 144 (N.Y. 1919).

236. *Cayuga*, 465 N.Y.S.2d at 619.

and indeterminable.<sup>237</sup> To determine by strict logic what benefits the farm would have enjoyed but for its purchase of the faulty combine, for example, the jury would have to consider issues such as whether the farm already had a combine when it bought the new one; whether the old combine worked well, and if not how much it would have cost to fix it; whether the farm could have purchased a different combine from someone else at the time it bought the new combine, and if so at what price; and the farm's track record in harvesting and selling the crop in prior years.

The difference between *Cayuga* and the decisions precluding the plaintiff from recovering the "benefit of the bargain" is reflected in *Kensington Publishing Corp. v. Kable News Co.*<sup>238</sup> A publisher alleged "fraudulent representations by defendant that the rate contained in the agreement between the parties was the best rate defendant paid to any other publisher."<sup>239</sup> After the defendant paid other publishers a higher rate, the plaintiff argued that if the defendant had adhered to its agreement, it would have paid the plaintiff more than it did.<sup>240</sup> The First Department concluded that the plaintiff "sought to recover in essence the benefit of what would have been the more favorable contract."<sup>241</sup> Citing the exclusion of profits, the court concluded that no such recovery was available.<sup>242</sup>

In *Alpert v. Shea Gould Climenko & Casey*, decided a few years later, the court first stated that the "recovery of consequential damages naturally flowing from a fraud is limited to that which is necessary to restore a party to the position occupied before commission of the fraud."<sup>243</sup> The court then insisted that *Cayuga* "is not to the contrary," opining that "the Fourth Department found that the destruction of the plaintiff's crop was a direct result of defendants' fraud and placed plaintiff in a far worse position than had it not

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237. See *infra* Section VII.D.2.

238. 474 N.Y.S.2d 524 (N.Y. App. Div. 1984).

239. *Id.* at 526.

240. *Id.*

241. *Id.*

242. *Id.* (citing *Hanlon v. Macfadden Publ'ns, Inc.*, 99 N.E.2d 566 (N.Y. 1951); *Sager v. Friedman*, 1 N.E.2d 971 (N.Y. 1936); *Reno v. Bull*, 124 N.E. 144 (N.Y. 1919)); see also *Delcor Labs., Inc. v. Cosmair, Inc.*, 564 N.Y.S.2d 771, 772 (N.Y. App. Div. 1991) (similarly holding that where the plaintiff might have enjoyed profits only if the misrepresentation had been true, lost profits are unrecoverable as benefit-of-the-bargain damages); accord *Mawere v. Landau*, 15 N.Y.S.3d 120, 124 (N.Y. App. Div. 2015); *Revell v. Guido*, 2 N.Y.S.3d 252, 258 (N.Y. App. Div. 2015); *Zivian v. McNulty*, 523 N.Y.S.2d 168, 169 (N.Y. App. Div. 1988); *Orbit Holding Corp. v. Anthony Hotel Corp.*, 503 N.Y.S.2d 780, 783 (N.Y. App. Div. 1986).

243. 160 A.D.2d 67, 71 (N.Y. App. Div. 1990) (citing, inter alia, *Cayuga Harvester, Inc. v. Allis-Chalmers Corp.*, 465 N.Y.S.2d 606 (N.Y. App. Div. 1983)).

purchased the equipment.”<sup>244</sup> That description of the consequences of the fraud, however, was not *necessarily* true. If it had not bought the new combine, the farm (as it was a farm) would have presumably been facing the substantial *likelihood* of harvesting corn later that year (necessitating its use of some *other* combine) and then selling it. The court in *Cayuga* thus did more than leave it to the jury to put the farm back into a strictly pre-fraud position; it went beyond, leaving it to the jury to look to what results would have naturally flowed to the farm’s benefit from that position.

*B. The Current “Rule in the Federal Courts”*

The Court of Appeals in *Reno v. Bull* looked to the rule “in the Federal courts” in adopting the out-of-pocket rule.<sup>245</sup> Since the federal courts were not to make federal general common law after *Erie Railroad v. Tompkins*,<sup>246</sup> their ostensible task in interpreting state common law is to predict how the state’s highest court would rule.<sup>247</sup> For the common law of fraud damages, the federal decisions for decades did just that. During that period, the federal courts identified the damages for fraud as following the rule in *Reno*.<sup>248</sup> The stark exception was *Oosterhuis v. Palmer* in 1943, over twenty years after *Reno*.<sup>249</sup> In that decision, the Second Circuit failed to cite *Reno* at all and inexplicably invoked the benefit-of-the-bargain rule, concluding that “the damages for misrepresentation are the difference between the value of the thing as represented and as it was in actual fact.”<sup>250</sup> As it turns out, that decision pre-saged problems in the post-*Erie* era.

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244. *Id.* at 72 (citing *Cayuga*, 465 N.Y.S.2d 606).

245. 124 N.E. 144, 146 (N.Y. 1919) (citing *Sigafus v. Porter*, 179 U.S. 116 (1900); *Smith v. Bolles*, 132 U.S. 125 (1881)); *see supra* Section V.C.

246. 304 U.S. 64, 65-80 (1938).

247. *See, e.g.*, *Phansalkar v. Andersen Weinroth & Co.*, 344 F.3d 184, 199 (2d Cir. 2003).

248. 124 N.E. at 146; *see, e.g.*, *Toho Bussan Kaisha, Ltd. v. Am. President Lines, Ltd.*, 265 F.2d 418, 421-22 (2d Cir. 1959); *Idrees v. Am. Univ. of the Caribbean*, 546 F. Supp. 1342, 1350 (S.D.N.Y. 1982); *Ainger v. Mich. Gen. Corp.*, 476 F. Supp. 1209, 1233 (S.D.N.Y. 1979); *Fairchild, Arabatzis & Smith, Inc. v. Prometco (Produce & Metals) Co.*, 470 F. Supp. 610, 617-18 (S.D.N.Y. 1979); *Gross v. Diversified Mortg. Inv’rs*, 431 F. Supp. 1080, 1094 (S.D.N.Y. 1977); *Berkowitz v. Baron*, 428 F. Supp. 1190, 1197 (S.D.N.Y. 1977); *Jones Mem’l Tr. v. Tsai Inv. Servs.*, 367 F. Supp. 491, 500 (S.D.N.Y. 1973).

249. 137 F.2d 322 (2d Cir. 1943).

250. *Id.* at 326 (citing *Ochs v. Woods*, 117 N.E. 305 (N.Y. 1917); *Urtz v. N.Y. Cent. & Hudson River R.R. Co.*, 95 N.E. 711 (N.Y. 1911); *Wood v. Dudley*, 188 A.D. 136 (N.Y. App. Div. 1919)).

After *Cayuga*, the unitary precedent in the state and federal systems ramified. Federal courts addressed the damages recoverable for fraud in a series of decisions disconnected from the New York state courts. The line of federal cases in question began in 1984 with *Soper v. Simmons International, Ltd.*<sup>251</sup> To avoid the Statute of Frauds, the plaintiffs contended that the defendants misrepresented their intention to pay the plaintiffs a finder's fee.<sup>252</sup> Citing a Court of Appeals decision and a contracts treatise, the court concluded that fraud damages include "the costs incurred by the plaintiff in reliance on the promise by incurring expenses in preparation or in performance or in passing up other business opportunities."<sup>253</sup> The decision the court cited was *Channel Master Corp. v. Aluminum Ltd. Sales*.<sup>254</sup> In concluding that the plaintiff had brought a fraud (rather than contract) claim, the court in *Channel* noted the allegation that "the plaintiff refrained from securing commitments for future supplies from others and was thereby injured in its business."<sup>255</sup> The court in *Soper* interpreted *Channel* to hold that such damages were recoverable for fraud.<sup>256</sup>

The reasoning in *Soper* is tenuous. *Channel* did not hold that a plaintiff is entitled to recover for fraud the damages alleged in that case. Instead, having noted all of the relevant allegations, the court turned solely to analyzing whether they asserted fraud.<sup>257</sup> Although New York state courts have cited *Channel* as setting forth the elements of fraud, they do not appear to have cited the decision as identifying the recoverable damages. In fact, the court in *Channel* did not cite (let alone analyze) any of its own precedent, or the precedent of any lower court, on the question of fraud damages. *Soper* thus appeared unlikely to stand as persuasive precedent for New York law.

But that is just what happened. In *Fort Howard Paper Co. v. William D. Witter, Inc.*, in a footnote and citing only *Soper*, the Second Circuit in 1986 stated that the law of fraud in New York "permits recovery for a plaintiff's reliance interest, i.e., 'the costs incurred . . . in preparation or in performance or in passing up other

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251. No. 84 Civ. 70 (LBS), 1984 WL 426 (S.D.N.Y. May 30, 1984).

252. *Id.* at \*3.

253. *Id.* at \*4 (citing, inter alia, E. ALLEN FARNSWORTH, CONTRACTS § 12.1, at 812-14 (1982)).

254. 151 N.E.2d 833 (N.Y. 1958).

255. *Id.* at 834-35.

256. See *Soper*, 1984 WL 426, at \*4. The court also cited two cases holding that a plaintiff is entitled to recover expenses incurred in reliance on the fraud. See *id.*

257. See *Channel*, 151 N.E.2d at 835-36.

business opportunities.’”<sup>258</sup> The court reiterated that proposition a few years later, citing only *Fort Howard*.<sup>259</sup> The proposition then fructified in the district courts. In *Trans World Airlines, Inc. v. 47th Street Photo, Inc.*, the court stated that New York’s out-of-pocket rule permits recovery for “the costs incurred . . . in preparation or in performance or in passing up other business opportunities.”<sup>260</sup> Many other courts followed suit.<sup>261</sup>

### C. *The More Recent Controlling Precedent*

In *Lama Holding Co. v. Smith Barney Inc.*, decided in 1996, the Court of Appeals considered anew the damages for common law fraud.<sup>262</sup> Commentators regarded the decision as noteworthy,<sup>263</sup> and the lower courts continue to cite it.<sup>264</sup> The holding, however, would result in continued uncertainty.

The corporate plaintiff and its owners alleged that Smith Barney defrauded them by failing to disclose important information concerning Smith Barney’s sale of plaintiff’s stock to a third party, Primerica. The plaintiff alleged that if it had the information, it could have worked out an alternative arrangement with Primerica.<sup>265</sup> The court concluded that the loss of an alternative contractual bargain “cannot serve as a basis for fraud or misrepresentation damages because the loss of the bargain was ‘undeterminable and

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258. 787 F.2d 784, 793 n.6 (2d Cir. 1986) (quoting *Soper*, 1984 WL 426, at \*3–4).

259. See *Ostano Commerzanstalt v. Telewide Sys.*, 880 F.2d 642, 648 (2d Cir. 1989) (citing *Fort Howard*, 787 F.2d at 793 n.6).

260. No. 88 Civ. 1936 (PNL), 1990 WL 481956, at \*9 (S.D.N.Y. Apr. 16, 1990) (quoting *Soper*, 1984 WL 426, at \*3–4). The court also cited *Morris v. Lewis*, 75 A.D.2d 844 (N.Y. App. Div. 1980), which holds only that a plaintiff is entitled to recover the difference between the amount he paid as a result of the fraud and the value of what he received. *Id.*

261. In *Academic Industries, Inc. v. Untermeyer Mace Partners, Ltd.*, the court cited *Ostano*, 880 F.2d 642, for its description of recoverable damages. No. 90 Civ. 1052 (LBS), 1992 WL 73473, at \*2 (S.D.N.Y. Apr. 1, 1992). The courts did the same in *Enzo Biochem, Inc. v. Johnson & Johnson*, No. 87 Civ. 6125 (KMW), 1992 WL 309613, at \*12 (S.D.N.Y. Oct. 15, 1992), and *I.M. Oberman Assocs. v. Republic Financial Services, Inc.*, No. 92 Civ. 1843 (MBM), 1993 WL 88209, at \*5 (S.D.N.Y. Mar. 25, 1993).

262. 668 N.E.2d 1370 (N.Y. 1996).

263. See, e.g., *Levine*, *supra* note 19, at 359 (identifying *Lama*, 668 N.E.2d 1370, as among the “important decisions” during or just before the court’s 1996 term).

264. See, e.g., *Washington v. Kellwood Co.*, No. 05cv10034 (MHD), 2015 WL 6437456, at \*30 (S.D.N.Y. Oct. 14, 2015); *Connaughton v. Chipotle Mexican Grill, Inc.*, 23 N.Y.S.3d 216, 218–20 (N.Y. App. Div. 2016); *Hecker v. Paschke*, 19 N.Y.S.3d 570, 570 (N.Y. App. Div. 2015).

265. See *Lama*, 668 N.E.2d at 1372.

speculative.’”<sup>266</sup> The court set out this proposition: “Damages are to be calculated to compensate plaintiffs for what they lost because of the fraud, not to compensate them for what they might have gained.”<sup>267</sup> The court concluded that “there can be no recovery of profits which would have been realized in the absence of fraud.”<sup>268</sup>

These statements raise both substantive and semantic issues. *Lama*’s simultaneous invocation of *Cayuga* and *AFA* is surprising in that *Cayuga* considered profits to be recoverable fraud damages,<sup>269</sup> and *AFA* made the sweeping statement that “all elements of profit are excluded from a computation of damages in an action grounded in fraud.”<sup>270</sup> Indeed, taken literally, *Lama*’s rule of decision renders *Cayuga* irreconcilable with *Foster* and *AFA*. *Cayuga* contemplated that if the defendant had not defrauded the farm into buying the malfunctioning combine, then the farm would have harvested and sold its corn for profit.<sup>271</sup> Contrary to the language in *Lama*, the court in *Cayuga* thus did conclude that the farm was entitled to seek a recovery of “profits which would have been realized in the absence of fraud.”<sup>272</sup>

The analysis in *Lama* presents further challenges. The alternative contractual bargain that the court describes as speculative and indeterminable, citing *Dress Shirt*, was a prospective third-party contract that the plaintiff alleged the fraud precluded it from pursuing. The prospective bargain at issue in *Dress Shirt*, however, was based on the existing contract between the parties.<sup>273</sup> The distinction bears on the rule of decision. A jury could reasonably conclude that the plaintiff would have entered into a third-party contract of the sort that the plaintiff had regularly executed, for example, or was demonstrably close to executing. Such a likelihood is different from the prospect that he would have negotiated a result with his contractual counterparty for which there was no precedent and no reliable evidence for what could have happened. The final aspect of *Lama* worth noting here is that the Court of Appeals cited no precedent from the federal courts in its analysis of damages. On the one

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266. *Id.* at 1374 (quoting *Dress Shirt Sales, Inc. v. Hotel Martinique Assocs.*, 190 N.E.2d 10, 13 (N.Y. 1963)).

267. *Id.* at 1373 (citing *Cayuga Harvester, Inc. v. Allis-Chalmers Corp.*, 465 N.Y.S.2d 606 (N.Y. App. Div. 1983)).

268. *Id.* (citing *AFA Protective Sys., Inc. v. AT&T*, 442 N.E.2d 1269 (N.Y. 1982); *Foster v. DiPaolo*, 140 N.E. 220 (N.Y. 1923)).

269. 465 N.Y.S.2d at 618–19.

270. 442 N.E.2d at 1269.

271. *See supra* Part VII.

272. *Lama*, 668 N.E.2d at 1373.

273. *See supra* Section VI.C.

hand, the court's own jurisprudence on the question was extensive. On the other hand, in developing that law, the court had been careful to take note of what the federal courts had held.<sup>274</sup>

Most recently, in *Continental Casualty Co. v. Price-WaterhouseCoopers, LLP*, decided in 2010, the Court of Appeals stated: "In a fraud action, a plaintiff may recover only the actual pecuniary loss sustained as a direct result of the wrong."<sup>275</sup> The court explained that such loss is calculated as the "'difference between the value of the bargain which a plaintiff was induced by fraud to make and the amount or value of the consideration exacted as the price of the bargain.'"<sup>276</sup> As in prior decisions, taken literally, this crisp rule would preclude any recovery for consequential damages (and does not acknowledge the prospect of punitive damages). At the same time, the court's reference to "the amount or value of the consideration exacted" is tantamount to the language in *Urtz v. New York Central & Hudson River Railroad Co.*<sup>277</sup> and *Ochs v. Woods*.<sup>278</sup> Such phrasing in these cases encompassed the plaintiff's forgone legal claims, and might be applied to permit the plaintiff to recover for his foregone business opportunities. Such an interpretation of *Continental Casualty*, however, would run up against *Lama Holding Co. v. Smith Barney Inc.*<sup>279</sup>

#### D. *Conflicting Precedent in the State Courts*

The reasoning in *Lama* thus neither reconciled the conflicting precedent nor provided clear guidance.<sup>280</sup> The succeeding state decisions remain marked by inconsistent interpretation of the rules of decision that the Court of Appeals had set forth over the decades. As in *Lama*, moreover, the decisions fail to cite any significant precedent from the federal courts. In tension with the formulation of the damages rule for fraud, that omission also stands out against the background that state courts have cited federal precedent for the very *elements* of a claim for common law fraud.<sup>281</sup> The inconsistency has taken three main forms.

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274. *See supra* Section V.C.

275. 933 N.E.2d 738, 742 (N.Y. 2010).

276. *Id.* (quoting *Sager v. Friedman*, 1 N.E.2d 971, 974 (N.Y. 1936)).

277. 95 N.E. 711, 712 (N.Y. 1911).

278. 117 N.E. 305, 307 (1917).

279. 668 N.E.2d 1370, 1372-74 (N.Y. 1996).

280. *Id.*

281. *See, e.g.*, *Swersky v. Dreyer & Taub*, 643 N.Y.S.2d 33, 36 (N.Y. App. Div. 1996) (citing *Banque Arabe et Internationale D'Investissement v. Md. Nat'l Bank*, 57 F.3d 146, 153 (2d Cir. 1995)). Commentators have observed that the Court of Appeals has regularly cited federal opinions, but without specifying whether the

## 1. Consequential Damages

The state courts have made a patchwork of rules on this front. In general they acknowledge that the plaintiff may recover “consequential damages” for fraud, but they distinguish between such damages and “lost profits,” which they regard as unrecoverable.<sup>282</sup> They note that the distinction between the two categories can be “blurry.”<sup>283</sup> They seem to regard consequential damages as limited to expenditures made in reliance on the fraud, on the premise that the “recovery of such consequential damages is limited to the amount necessary to restore the plaintiffs to the position they occupied before commission of the fraud.”<sup>284</sup> On the basis of that restoration principle, they have further concluded that the plaintiff cannot recover any expenditures incurred “after discovering the fraud.”<sup>285</sup> The courts thus preclude the plaintiff from recovering certain losses the fraud caused, regardless of when they occurred in relation to when the plaintiff learned of the fraud. The rules also conflate the element of reliance with the question of consequential damages, which should concern whether the defendant foresaw or should have foreseen the losses the plaintiff has suffered.<sup>286</sup>

The decision in *Orbit Holding Corp. v. Anthony Hotel Corp.* is an example of the shoals in applying the restoration principle.<sup>287</sup> The defendants defrauded the plaintiff into buying a hotel, misrepresenting that a ground-floor restaurant was only a month-to-month tenant. After the purchase, the plaintiff brought a holdover proceeding against the tenant, who in fact had a ten-year lease. The plaintiff then brought and settled a dispossession proceeding against the tenant under a buyout provision of the lease.<sup>288</sup> The First Department concluded that the plaintiff could not recover the

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court was doing so in applying federal or state law. See William H. Manz, *The Citation Practices of the New York Court of Appeals: A Millennium Update*, 49 BUFF. L. REV. 1273, 1278 (2001).

282. See, e.g., *Imaging Int'l v. Hell Graphic Sys., Inc.*, No. 005062/1992, slip op. at \*8 (N.Y. Sup. Ct. Oct. 29, 2007).

283. See, e.g., *id.* (noting that “the line between lost profits and consequential damages is sometimes blurry”).

284. *Huang v. Sy*, No. 15155/90, slip op. at \*11 (N.Y. Sup. Ct. Feb. 28, 2008); accord *Superior Tech. Res., Inc. v. Lawson Software, Inc.*, No. 2003-10104, slip op. at \*15 (N.Y. Sup. Ct. Dec. 7, 2007); *Shalam v. KPMG LLP*, No. 112732/05, slip op. at \*12 (N.Y. Sup. Ct. Sept. 8, 2006).

285. See, e.g., *Imaging Int'l*, slip op. at \*8; accord *Katehis v. Sovereign Assocs.*, No. 150624/14, slip op. at \*9 (N.Y. Sup. Ct. Aug. 11, 2014).

286. See *infra* Part IX.

287. 503 N.Y.S.2d 780 (N.Y. App. Div. 1986).

288. *Id.* at 781.

profits it could have made by leasing the ground-floor space upon purchase, but could recover the cost of settling the dispossession proceeding. The court reasoned that the expenditure was necessary “to restore plaintiff to the position it reasonably believed it held as of the closing.”<sup>289</sup> The expenditures *were* a natural and foreseeable consequence of the fraud, but to be precise, the restoration principle is intended to place the plaintiff in the position he held at the time of the fraud, regardless of his view of that position.

## 2. Forgone Business Opportunities

The courts are split on whether a plaintiff may recover the value of forgone business opportunities. In *Mihalakis v. Cabrini Medical Center*, the First Department appeared to reason that the plaintiff’s right to such a recovery was only a matter of the right evidence.<sup>290</sup> The plaintiff alleged that the defendant fraudulently represented that it would provide her with an internship program meeting certain standards.<sup>291</sup> Alleging that she was not provided with such a program, she sought her lifetime prospective earnings as a physician.<sup>292</sup> She further alleged that if she had known the truth, she would have selected another hospital at which to do her internship.<sup>293</sup> The court held that she could not recover under either theory, reasoning that her “future earnings as a doctor were lost not because of any inherent inadequacies in Cabrini’s internship program, but because of plaintiff’s failure to complete that program.”<sup>294</sup> The court concluded that “there is no causal relationship between the alleged representations and plaintiff’s failure to become a doctor.”<sup>295</sup>

The same court took a similar approach in subsequent cases. In *Hoeffner v. Orrick, Herrington & Sutcliffe LLP*, for example, the plaintiff alleged that a law firm made false representations about its partnership process to induce him to remain there as an associate, at a time when another firm had made him an offer, including a signing bonus.<sup>296</sup> The court reasoned that “if plaintiff proves his claims, he will be entitled to the difference between the immedi-

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289. *Id.* at 783.

290. 151 A.D.2d 345 (N.Y. App. Div. 1989).

291. *Id.* at 345–46.

292. *Id.* at 345.

293. *Id.* at 346.

294. *Id.*

295. *Id.* (citing *Hanlon v. Macfadden Publ’ns, Inc.*, 99 N.E.2d 566 (N.Y. 1951); *Reno v. Bull*, 226 N.Y. 546 (1919); *Ritzwoller v. Lurie*, 225 N.Y. 464 (1919)).

296. 878 N.Y.S.2d 717, 718 (N.Y. App. Div. 2009).

ately payable portion of the other firm's offer, such as the signing bonus, and the sum he received from the defendant law firm immediately after agreeing to remain with defendant."<sup>297</sup> The court further explained, however, that the plaintiff's damages "may not include any amount based on continued employment with the other firm, since the duration and success of his career with that firm are speculative."<sup>298</sup> In *Rather v. CBS Corp.*, the court contemplated the recovery of the value of forgone business opportunities when the damages are sufficiently determinable "to satisfy the *Lama* standard."<sup>299</sup> The court examined the record and concluded that the plaintiff "never identified a single opportunity with specified terms that was actually available to him and which he declined to accept" because of the alleged fraud.<sup>300</sup>

In other decisions, however, the same court has ruled out such damages as a matter of law. In *Moezinia v. Damaghi*, the plaintiff alleged that the defendant fraudulently procured his signature in order to take \$150,000 of the \$260,000 that he had previously given the defendant for investing in a New York real estate venture and invest the \$150,000 in a Texas investment vehicle instead.<sup>301</sup> The court held that a claim of fraud would not permit "a recovery of profits which might have been made had the defendant invested the other \$150,000 in the New York real estate."<sup>302</sup> Similarly, in *Alpert v. Shea Gould Climenko & Casey*, the court concluded: "It is also well settled that the victim of fraud may not recover the benefit of an alternative agreement overlooked in favor of the fraudulent one."<sup>303</sup> In *Geary v. Hunton & Williams*, the plaintiff sought the loss of enhanced earnings potential that he alleged he would have real-

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297. *Id.*

298. *Id.* at 718–19 (citing *Lama Holding Co. v. Smith Barney, Inc.*, 668 N.E.2d 1370 (N.Y. 1996)).

299. 68 A.D.3d 49, 59 (N.Y. App. Div. 2009).

300. *Id.*; see also *Manas v. VMS Assocs.*, 53 A.D.3d 451, 454 (N.Y. App. Div. 2008) ("[T]he damages recoverable for being fraudulently induced to enter a contract are meant to indemnify the loss suffered through that inducement, e.g., damages for foregone opportunities.") (citing *Coppola v. Applied Elec. Corp.*, 288 A.D.2d 41 (N.Y. App. Div. 2001)).

301. 152 A.D.2d 454, 455–57 (N.Y. App. Div. 1989).

302. *Id.* at 457 (citing *Reno v. Bull*, 124 N.E. 144 (N.Y. 1919); *Clearview Concrete Prods. Corp. v. S. Charles Gherardi, Inc.*, 453 N.Y.S.2d 750 (N.Y. App. Div. 1982)).

303. 160 A.D.2d 67, 67 (N.Y. App. Div. 1990) (citing *Kensington Publ'g Corp. v. Kable News Co.*, 474 N.Y.S.2d 524, 526 (N.Y. App. Div. 1984)). *Kensington*, however, addressed only a benefit-of-the-bargain scenario—a claim that "had defendant adhered to its representations," it would have paid the plaintiff "additional funds." 474 N.Y.S.2d at 526.

ized had defendant's banking-litigation practice been as substantial as allegedly represented, or if he had accepted a job with a different employer.<sup>304</sup> As in *Moezinia* and *Geary*, the court applied a bright-line rule: "The damages plaintiff seeks are not recoverable under the out-of-pocket rule, which bars recovery of profits that would have been realized in the absence of fraud, including the loss of an alternative bargain overlooked in favor of the fraudulent one, as inherently speculative and undeterminable."<sup>305</sup>

In *Starr Foundation v. American International Group, Inc.*, in turn, the same court addressed a charitable foundation's allegations that AIG defrauded it into holding its AIG shares.<sup>306</sup> The foundation contended that it would have sold stock if AIG had made different disclosures than it made, which would have resulted in a different market for the stock, which would have increased the value of the foundation's stock—the total value of which would have depended on exactly which stock, and how much of it, the foundation would have sold at the hypothetical price in the hypothetical market. The court concluded: "A lost bargain more undeterminable and speculative than this is difficult to imagine."<sup>307</sup> The court interpreted *Lama* to hold that "under the out-of-pocket rule 'the loss of an alternative contractual bargain . . . cannot serve as a basis for fraud or misrepresentation damages because the loss of the bargain was 'undeterminable and speculative.'"<sup>308</sup>

*Starr* is among the several decisions addressing "holder" claims for fraud.<sup>309</sup> *Starr* appears implicitly to accept that a plaintiff bring-

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304. 257 A.D.2d 482, 482 (N.Y. App. Div. 1999).

305. *Id.* (citing *Lama Holding Co. v. Smith Barney Inc.*, 668 N.E.2d 1370, 1373 (N.Y. 1996); *Alpert*, 160 A.D.2d 67; *Mihalakis v. Cabrini Med. Ctr.*, 151 A.D.2d 345 (N.Y. App. Div. 1989)); *see also* *Connaughton v. Chipotle Mexican Grill, Inc.*, 23 N.Y.S.3d 216, 219 (N.Y. App. Div. 2016) ("[P]laintiff's claim that he would have received better remuneration had he partnered with a different entity is inherently speculative and would require any factfinder to engage in conjecture.") (citing *Geary*, 257 A.D.2d 482); *accord* *UBS Secs. LLC v. Angioblast Sys., Inc.*, No. 650062/2011, slip op. at \*6 (N.Y. Sup. Ct. Jan. 30, 2012); *see also* 60A LAURA HUNTER DIETZ ET AL., *NEW YORK JURISPRUDENCE: FRAUD AND DECEIT* § 283 (2d ed. 2016) ("A principal reason for this rule is that the loss of an alternative contractual bargain overlooked in favor of the fraudulent one cannot serve as the basis for damages for fraud because such loss is inherently undeterminable and speculative.").

306. 76 A.D.3d 25 (N.Y. App. Div. 2010).

307. *Id.* at 28.

308. *Id.* (quoting *Lama*, 668 N.E.2d 1370); *see also id.* at 29 (addressing the same issue of speculation).

309. *See, e.g.*, *In re WorldCom, Inc. Sec. Litig.*, 336 F. Supp. 2d 310, 318–23 (S.D.N.Y. 2004) (collecting authority across jurisdictions regarding such claims). Such decisions include *Hotaling v. Leach & Co.*, 159 N.E. 870 (N.Y. 1928). *See supra* Section V.D.

ing such a claim is entitled to recover only the difference between the value of the security at the time of the misrepresentation and its value when the misrepresentation is discovered.<sup>310</sup> In contrast, where there is no difference between these values, the plaintiff may allege that he would have profited by selling the security had he known the truth at the time of the misrepresentation, instead of holding the security. The rationale in *Starr* therefore could be either that no such plaintiff is ever allowed to recover profits or that the court cannot endorse undue speculation about what he would have done.<sup>311</sup>

### 3. Forgone Legal Claims

In decisions addressing the question directly, the state courts have continued to hold that a plaintiff may recover the value of a legal claim that he forewent in reliance on fraud. In *Lawrence v. Houston*, for example, the plaintiffs alleged that the defendants fraudulently induced them to wait too long to pursue the injured plaintiff's lawsuit.<sup>312</sup> When sued for fraud, the defendants waived their defense under the statute of limitations.<sup>313</sup> The Third Department nevertheless concluded that the plaintiffs properly stated a claim. The court explained that they "have alleged that the delay in obtaining legal counsel resulted in the failure to properly obtain and preserve evidence which could well result in their inability to prevail at trial or in a diminution of the damages recovered."<sup>314</sup>

The prospect of such a recovery was also at issue in *Gouldsbury v. Dan's Supreme Supermarket, Inc.*<sup>315</sup> The injured plaintiff fell in a

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310. See, e.g., *Matana v. Merkin*, 989 F. Supp. 2d 313, 320–24 (S.D.N.Y. 2013) (predicting that the Court of Appeals would permit holder claims for such losses). But see *Starr*, 76 A.D.3d at 45 (Moskowitz, J., dissenting) ("Under the majority's reasoning, holder claims could never be viable.").

311. See, e.g., *AHW Inv. P'ship, MFS, Inc. v. Citigroup Inc.*,—F. App'x —, 2016 WL 4155020, at \*2 (2d Cir. Aug. 5, 2016) (identifying the second rationale); *Matana*, 989 F. Supp. 2d at 321–22 (identifying both rationales); *ASR Levensverzekering NV v. Swiss Re Fin. Prods. Corp.*, No. 650557/09, 2011 WL 10338595, at \*10–11 (N.Y. Sup. Ct. Oct. 11, 2011) (interpreting *Starr*, 76 A.D.3d 25, to turn on the issue of undue speculation); see also *In re Libor-Based Fin. Instr. Antitrust Litig.*, No. 11 MDL 2262 (NRB), 2016 WL 1558504, at \*3 (S.D.N.Y. Apr. 15, 2016) (interpreting its prior decision in the case and *Hotaling*, 159 N.E. 870, as permitting the holder plaintiff to prove out-of-pocket loss through "a comparison between the cash flows received and what the plaintiff would have earned if he or she had held another investment").

312. 172 A.D.2d 923, 923 (N.Y. App. Div. 1991).

313. *Id.* at 923–24.

314. *Id.* at 925.

315. 154 A.D.2d 509 (N.Y. App. Div. 1989).

supermarket on a ramp that an independent contractor named Hagstrom had built. The plaintiffs alleged that the supermarket fraudulently represented that one of its employees had built the ramp. They alleged that in relying on that misrepresentation, they failed to file a timely negligence claim against Hagstrom, and they sought the value of that claim as damages.<sup>316</sup> The Second Department reasoned that the plaintiffs presented no evidence that but for the misrepresentation, they would have recovered against Hagstrom.<sup>317</sup> The court thus did not reject the plaintiffs' theory of recovery in principle, but in the allegations and evidence.<sup>318</sup>

### *E. Conflicting Precedent in the Federal Courts*

The New York federal courts have extended the line of precedent they staked out in the early 1980s.<sup>319</sup> Several features are notable for purposes here:

First, many federal courts have concluded that “consequential damages” are recoverable for fraud, and without the qualifications the state courts have imposed.<sup>320</sup> The inconsistency in the cases, however, underscores the ambiguity of the controlling precedent: whereas some federal courts interpret such precedent to permit consequential damages,<sup>321</sup> others interpret the same precedent to preclude them.<sup>322</sup>

Second, extending the precedent in which they held that a fraud victim may recover the “costs incurred” in passing up alternative business opportunities, federal courts have held that the plaintiff may recover the *value* of such opportunities, at least where he

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316. *Id.* at 510.

317. *Id.* at 512.

318. *Id.* at 511; *see also, e.g.*, *Hutchins v. Utica Mut. Ins. Co.*, 107 A.D.2d 871, 871–73 (N.Y. App. Div. 1985) (holding that plaintiffs properly alleged fraud against insurer that allegedly fraudulently induced them “to refrain from obtaining legal counsel,” which “effectively precluded a timely action” against the county at issue).

319. *See supra* Section VII.B.

320. For recent cases, *see*, for example, *Nuss v. Sabad*, 976 F. Supp. 2d 231, 252 (N.D.N.Y. 2013); *Universe Antiques, Inc. v. Vareika*, 826 F. Supp. 2d 595, 609–10 (S.D.N.Y. 2011); *Wood v. Maguire Auto. LLC*, No. 5:09-CV-0640 (GTS/GHL), 2011 WL 4478485, at \*9 (S.D.N.Y. Sept. 26, 2011), *aff'd per curiam*, 508 F. App'x 65 (2d Cir. 2013); *E-Glob. Alls., LLC v. Anderson*, No. 10 Civ. 2844 (KMK) (PED), 2011 WL 8879268, at \*6 (S.D.N.Y. May 11, 2011).

321. *See, e.g.*, *Galloo Ile-de-France v. Lancaster Int'l, LLC*, No. 1:14-cv-00629 (MAD/CFH), 2015 WL 3646195, at \*2 (N.D.N.Y. June 10, 2015) (citing *Lama Holding Co. v. Smith Barney Inc.*, 668 N.E.2d 1370 (N.Y. 1996)).

322. *See, e.g.*, *Washington v. Kellwood Co.*, No. 05cv10034 (MHD), 2015 WL 6437456, at \*30 (S.D.N.Y. Oct. 14, 2015) (citing *Lama*, 668 N.E.2d 1370).

gave up “some quantifiable, concrete alternative opportunity.”<sup>323</sup> In *Schonfeld v. Hilliard*, for example, Schonfeld claimed that the Hilliards fraudulently induced him and the nascent cable channel (INN) of which he was president to abandon a twenty-year exclusive license to distribute BBC programming (the “March Supply Agreement”) in favor of alternative licenses with the BBC.<sup>324</sup> The Second Circuit held that a plaintiff’s recoverable “reliance interest” for fraud includes “damages incurred by passing up other business opportunities. Therefore, Schonfeld may seek to recover the market value of the March Supply Agreement which INN abandoned in reliance on the Hilliards’ promises.”<sup>325</sup> The court cited only its own precedent as support, without suggesting that any recovery for the market value of the agreement should exclude any profit inhering in it.<sup>326</sup>

Although these decisions are not grounded in controlling state precedent, they do jibe with *Ritzwoller v. Lurie*.<sup>327</sup> In that case, the Court of Appeals implicitly reasoned that the plaintiff would have sought cognizable damages by alleging that but for the fraud he

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323. *Mehra v. Tetrault*, No. 07-CV-356A, 2008 WL 4276907, at \*3 (W.D.N.Y. Sept. 12, 2008) (collecting precedent) (internal citation omitted); *accord Vereika*, 826 F. Supp. 2d at 609–10; *see also Pasternak v. Dow Kim*, 961 F. Supp. 2d 593, 596–97 (S.D.N.Y. 2013) (holding that under *Lama*, 668 N.E.2d 1370, the plaintiff was not entitled to the discretionary bonuses he might have made at Morgan Stanley if he had not passed over that employment in reliance on the fraud, but appearing to leave open the possibility that he could recover vested and nondiscretionary bonuses); *In re Marketxt Holdings Corp.*, No. 04-12078 (ALG), 2006 WL 2864963, at \*21 (Bankr. S.D.N.Y. Sept. 29, 2006) (holding that under *Lama*, 668 N.E.2d 1370, a plaintiff may recover for “the loss of an alternative contractual bargain” so long as the loss is not “undeterminable and speculative,” and finding such a loss to be adequately plead); *Hershey Foods Corp. v. Collegiate Mktg., Inc.*, No. 95 Civ. 10526 (SAS), 1997 WL 772768, at \*5 (S.D.N.Y. Dec. 15, 1997) (finding that the plaintiff alleged a proper theory of recovery in claiming that he was defrauded into selling cocoa to the defendant at discount prices, where he could have sold it to third parties at full price).

324. 218 F.3d 164, 169–71 (2d Cir. 2000).

325. *Id.* at 183 (citing *Fort Howard Paper Co. v. William D. Witter, Inc.*, 787 F.2d 784, 793 n.6 (2d Cir. 1986)).

326. Other courts have reached a similar conclusion even when they did consider state precedent. *See, e.g., Lam v. Am. Express Co.*, 265 F. Supp. 2d 225, 230–33 (S.D.N.Y. 2003); *Doehla v. Wathne Ltd.*, No. 98 Civ. 6087 (CSH), 2000 WL 987280, at \*8 (S.D.N.Y. July 17, 2000). *But see A.I.A. Holdings, S.A. v. Lehman Bros.*, No. 97 Civ. 4978 (LMM), 2002 WL 1334808, at \*2–3 (S.D.N.Y. June 17, 2002) (holding that “plaintiffs are not entitled to recover lost profits on their fraud claims under New York law,” even when pursuing the value of forgone opportunities).

327. 225 N.Y. 464 (1919).

would have “done better” through the foregone opportunity.<sup>328</sup> The reasoning in these federal cases has also been applied in a congruent line of federal cases concerning the future earnings the plaintiff lost as a result of the fraud.<sup>329</sup>

Third, the Second Circuit has concluded that a plaintiff cannot recover the value of a forgone legal claim. In *Kregos v. Associated Press*, the statute of limitations on plaintiff’s copyright claim against Sports Features expired while he relied on Sports Features’ alleged misrepresentation that the arrangement for baseball statistics that he had created was not copyrightable.<sup>330</sup> Affirming the dismissal of his fraud claim, the court reasoned solely as follows: “In essence, under New York law, Kregos claims damage that is too remote; we are not permitted to speculate what potential award he might have obtained from winning a copyright case against Sports Features.”<sup>331</sup> The court cited *Gouldsbury v. Dan’s Supreme Supermarket, Inc.*<sup>332</sup> as exemplary support.<sup>333</sup> The court in *Gouldsbury*, however, made an evidence-driven decision regarding whether the plaintiff could have prevailed on the forgone lawsuit.<sup>334</sup> The court in *Kregos*, in contrast, seemed to describe a hard-and-fast rule—one at odds with many state decisions, left uncited.<sup>335</sup>

#### F. Disgorgement of Profits for Fraud

As private relief that may exceed restitution, disgorgement awards to the plaintiff all of the profits the defendant made from

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328. *Id.* at 468–69; *see supra* Section V.A.

329. *See, e.g.*, *Stewart v. Jackson & Nash*, 976 F.2d 86, 88 (2d Cir. 1992) (concluding that the plaintiff in a fraud case may recover for harm to career development as part of compensatory damages); *accord* *Kwon v. Yun*, 606 F. Supp. 2d 344, 360–61 (S.D.N.Y. 2009). Adding to the uncertainty, some federal courts disagree with such an interpretation of New York law. *See, e.g.*, *Pasternak v. Dow Kim*, 961 F. Supp. 2d 593, 596–97 (S.D.N.Y. 2013).

330. 3 F.3d 656, 656–57 (2d Cir. 1993).

331. *Id.* at 665.

332. 154 A.D.2d 509 (N.Y. App. Div. 1989).

333. *Kregos*, 3 F.3d at 665.

334. 154 A.D.2d at 510–12; *see supra* Section VII.D.3.

335. The federal courts have also recognized the distinction between regular fraud claims and claims for misrepresentation in warranty. The courts have concluded that a plaintiff cannot recover both benefit-of-the-bargain damages for the fraudulent warranty and out-of-pocket damages for the fraud. *See Ostano Commerzanstalt v. Telewide Sys.*, 880 F.2d 642, 649 (2d Cir. 1989); *accord* *Sofi Classic S.A. de C.V. v. Hurowitz*, 444 F. Supp. 2d 231, 247 (S.D.N.Y. 2006). The American Law Institute has addressed the issue by proposing a contract measure of damages if the fraudulent representation is made so as “to constitute a warranty,” RESTATEMENT (FIRST) OF TORTS § 549 cmt. g (AM. LAW INST. 1938), or in a contract, RESTATEMENT (SECOND) OF TORTS § 549 cmt. g (AM. LAW INST. 1977).

his misconduct.<sup>336</sup> Under New York law, a plaintiff probably cannot bring a separate claim for unjust enrichment on top of her fraud claim to obtain the disgorgement of profits. A claim for unjust enrichment is available only when “the defendant has not breached a contract nor [sic] committed a recognized tort.”<sup>337</sup> The state courts do, however, permit plaintiffs to obtain the disgorgement of profits arising out of fraud in fiduciary or trust relationships.<sup>338</sup>

At the same time, in applying the federal securities laws, federal and state trial courts have reasoned that they may order the disgorgement of ill-gotten gains through their inherent equity powers to make such awards as justice demands.<sup>339</sup> In reaching their holdings, some of the decisions reason that the disgorgement of ill-gotten gains for common law fraud is a well-established remedy.<sup>340</sup> As in its prior iterations, moreover, the *Restatement (Third) of Restitution and Unjust Enrichment* provides that a plaintiff is entitled to choose as her recovery the greater of the amount of her loss or the

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336. *People v. Ernst & Young LLP*, 114 A.D.3d 569, 569 (N.Y. App. Div. 2014). See generally 22A LAURA HUNTER DIETZ ET AL., *NEW YORK JURISPRUDENCE: CONTRACTS* § 528 (2d ed. 2015) (“[O]n a theory of unjust enrichment, the plaintiff must show that the defendant had enriched himself or herself unjustly and cannot, in good conscience, retain the proceeds.”).

337. *Corsello v. Verizon N.Y., Inc.*, 967 N.E.2d 1177, 1185 (N.Y. 2012); accord *The Plumbing Supply, LLC v. ExxonMobil Oil Corp.*, No. 14 CV 3674 (VB), 2016 WL 1249611, at \*10 (S.D.N.Y. Mar. 29, 2016); see, e.g., *Allstate Ins. Co. v. Nazarov*, No. 11 CV 6187 (PKC) (VMS), 2015 WL 5774459, at \*16 (E.D.N.Y. Sept. 30, 2015) (concluding that under *Corsello*, 967 N.E.2d 1177, plaintiff’s fraud claim precluded a claim for unjust enrichment). But see *Allianz Risk Transfer v. Paramount Pictures Corp.*, No. 08 Civ. 10420 (TPG), 2010 WL 1253957, at \*10 (S.D.N.Y. Mar. 31, 2010) (discussing the relationship between claims for unjust enrichment and fraud).

338. See *Diamond v. Oreamuno*, 248 N.E.2d 910, 912 (N.Y. 1969); accord *Excelsior 57th St. Corp. v. Lerner*, 160 A.D.2d 407, 408–09 (N.Y. App. Div. 1990).

339. *SEC v. Fischbach Corp.*, 133 F.3d 170, 175 (2d Cir. 1997); accord *People v. Applied Card Sys. Inc.*, 894 N.E.2d 1, 14 (N.Y. 2008); *Ernst & Young*, 114 A.D.3d at 570; see also *Mitchell v. Robert DeMario Jewelry, Inc.*, 361 U.S. 288, 291–92 (1960) (addressing the seminal U.S. Supreme Court precedent in this area).

340. See, e.g., *SEC v. Cavanagh*, 445 F.3d 105, 118–20 (2d Cir. 2006) (citing precedent from various contexts and concluding that “equity courts traditionally awarded disgorgement of ill-gotten assets”); *United States ex rel. Taylor v. Gabelli*, No. 03 CIV 8762 (PAC), 2005 WL 2978921, at \*5 (S.D.N.Y. Nov. 4, 2005) (describing disgorgement of profits from fraud as “a ‘classic’ restitutionary remedy inherently distinct from compensable damages” awarded at law). Although the law in England on this front may be in flux, see EGGERS, *supra* note 9, §§ 8.73–79, at 227–30, some English courts have treated the remedy as indisputably available, see, e.g., *Lazarus Estates Ltd. v. Beazley* (1956) 1 QB 702 at 712 (“No court in this land will allow a person to keep an advantage which he has obtained by fraud.”).

amount of profit the defendant made through the fraud.<sup>341</sup> The courts in New York do not appear to have addressed such a scenario in any written decision concerning common law fraud.<sup>342</sup>

### VIII. POTENTIAL RECOVERIES—THE PRECEDENT

The discussion to this juncture provides both answers to the question of which recoveries are available for fraud under New York common law<sup>343</sup> and a baseline for assessing such recoveries on a normative basis.<sup>344</sup>

*Out-of-Pocket Costs* (\$1000). The courts agree that Plaintiff is entitled to recover the \$1000. This is the well-established out-of-pocket rule described in *Reno v. Bull*.<sup>345</sup>

*Benefit of the Bargain* (\$2000). Under the precedent before *Reno*, Plaintiff was entitled to recover the \$2000.<sup>346</sup> Since *Reno*, she is not entitled to such a recovery. (If Defendant has made his fraudulent representation so as to constitute a warranty, however, then she has a good argument that she is entitled to recover the \$2000.)

*Natural and Foreseeable Consequences* (\$3000). Under some decisions, Plaintiff might not be entitled to any recovery because she made no expenditures in reliance on the fraud.<sup>347</sup> Under other de-

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341. See RESTATEMENT (THIRD) OF RESTITUTION AND UNJUST ENRICHMENT § 13 cmt. h (AM. LAW INST. 2011); see also RESTATEMENT OF RESTITUTION § 157 cmt. d (AM. LAW INST. 1937); *id.* § 160 cmt. d; see also RESTATEMENT (SECOND) OF CONTRACTS § 376 cmt. a, illus. 5 (AM. LAW INST. 1981) (holding that the plaintiff can recover both the land he was fraudulently induced to sell to the defendant and the profit the defendant made by farming the land).

342. *Cf.* United States v. Puello, Civ. A. No. 92-5040, 2016 WL 660879, at \*4, \*6 (E.D.N.Y. Feb. 18, 2016) (finding that the amount of the plaintiff's out-of-pocket damages and the amount of the defendant's unjust enrichment were the same and that the plaintiff was entitled to only one recovery); *Coactiv Capital Partners, Inc. v. Hudson Converting, Inc.*, No. 1:09-CV-01206 (LEK/RFT), 2011 WL 3876181, at \*1-2 (N.D.N.Y. Aug. 31, 2011) (addressing a scenario in which the plaintiff's damages for fraud and the restitution the defendant should pay for unjust enrichment for the fraud were the same amount).

343. See *supra* Part III.

344. See *infra* Parts IX-X.

345. 124 N.E. 144 (N.Y. 1919). Among the outlier decisions are *Oosterhuis v. Palmer*, 137 F.2d 322 (2d Cir. 1943), *Skrine v. Staiman*, 30 A.D.2d 707 (N.Y. App. Div. 1968), *Saklaris v. Envagelista*, 21 Misc. 2d 781 (N.Y. Sup. Ct. 1956), and *Stillman v. Garmaize Realty Corp.*, 123 N.Y.S.2d 24 (N.Y. Sup. Ct. 1953).

346. *Ettlinger v. Weil*, 184 N.Y. 179 (1906); *Vail v. Reynolds*, 118 N.Y. 297 (1890); *Krumm v. Beach*, 96 N.Y. 398 (1884); *Whitney v. Allaire*, 1 N.Y. 305 (1848); *Wood v. Dudley*, 188 A.D. 136 (N.Y. App. Div. 1919).

347. *Huang v. Sy*, No. 15155/90, slip op. (N.Y. Sup. Ct. Feb. 28, 2008); *Superior Tech. Res., Inc. v. Lawson Software, Inc.*, No. 2003-10104, slip op. (N.Y. Sup.

decisions, she would be entitled to the recovery as long as the facts show that she would have kept her job.<sup>348</sup> Under other decisions, she would not be entitled to the recovery because the contention that she would have made the \$3000 is inherently speculative and indeterminable.<sup>349</sup> Under other decisions, she could not recover the \$3000 to the extent that it is profit.<sup>350</sup> Under still other decisions, she would not be entitled to any recovery because it constitutes what she might have gained but for the fraud.<sup>351</sup>

*Forgone Business Opportunities* (\$4000). Under some decisions, Plaintiff might not be entitled to any recovery because she made no expenditures in reliance on the fraud.<sup>352</sup> Under other state decisions, and many federal decisions, she would be entitled to the recovery as long as the facts support the assertion that she would have made the \$4000.<sup>353</sup> Under other decisions, she would not be entitled to the recovery because the contention that she would have made the \$4000 is inherently speculative and indeterminable.<sup>354</sup> Under the reasoning of other decisions, she would be entitled to only that portion of the \$4000 she was certain to have made.<sup>355</sup>

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Ct. Dec. 7, 2007); *Shalam v. KPMG LLP*, No. 112732/05, slip op. (N.Y. Sup. Ct. Sept. 8, 2006).

348. *Hotaling v. Leach & Co.*, 159 N.E. 870 (N.Y. 1928); *Gould v. Cayuga Cnty. Nat'l Bank*, 99 N.Y. 333 (1885); *Orbit Holding Corp. v. Anthony Hotel Corp.*, 503 N.Y.S.2d 780 (N.Y. App. Div. 1986); *Crain v. Petrie*, 6 Hill 522 (N.Y. Sup. Ct. 1844); *Jeffrey v. Bigelow & Tracy*, 13 Wend. 518 (N.Y. Sup. Ct. 1835).

349. *Starr Found. v. Am. Int'l Grp., Inc.*, 76 A.D.3d 25 (N.Y. App. Div. 2010); *Alpert v. Shea Gould Climenko & Casey*, 160 A.D.2d 67 (N.Y. App. Div. 1990).

350. *Washington v. Kellwood Co.*, No. 05cv10034 (MHD), 2015 WL 6437456 (S.D.N.Y. Oct. 14, 2015); *Clearview Concrete Prods. Corp. v. S. Charles Gherardi, Inc.*, 453 N.Y.S.2d 750 (N.Y. App. Div. 1982); *Imaging Int'l v. Hell Graphic Sys., Inc.*, No. 005062/1992, slip op. (N.Y. Sup. Ct. Oct. 29, 2007).

351. *Cont'l Cas. Co. v. PriceWaterhouseCoopers, LLP*, 933 N.E.2d 738 (N.Y. 2010); *Lama Holding Co. v. Smith Barney Inc.*, 668 N.E.2d 1370 (N.Y. 1996).

352. *Huang*, No. 15155/90; *Lawson*, No. 2003-10104; *Shalam*, No. 112732/05.

353. *Schonfeld v. Hilliard*, 218 F.3d 164 (2d Cir. 2000); *Mehra v. Tetrault*, No. 07-CV-356A, 2008 WL 4276907 (W.D.N.Y. Sept. 12, 2008); *Hershey Foods Corp. v. Collegiate Mktg., Inc.*, No. 95 Civ. 10526 (SAS), 1997 WL 772768 (S.D.N.Y. Dec. 15, 1997); *In re Marketxt Holdings Corp.*, No. 04-12078 (ALG), 2006 WL 2864963 (Bankr. S.D.N.Y. Sept. 29, 2006); *Ritzwoller v. Lurie*, 225 N.Y. 464 (1919); *Mihalakis v. Cabrini Med. Ctr.*, 151 A.D.2d 345 (N.Y. App. Div. 1989).

354. *Connaughton v. Chipotle Mexican Grill, Inc.*, 23 N.Y.S.3d 216 (N.Y. App. Div. 2016); *Starr Found. v. Am. Int'l Grp., Inc.*, 76 A.D.3d 25 (N.Y. App. Div. 2010); *Geary v. Hunton & Williams*, 257 A.D.2d 482 (N.Y. App. Div. 1999); *UBS Secs. LLC v. Angioblast Sys., Inc.*, No. 650062/2011, slip op. (N.Y. Sup. Ct. Jan. 30, 2012); *see also Alpert v. Shea Gould Climenko & Casey*, 160 A.D.2d 67 (N.Y. App. Div. 1990).

355. *See Lama*, 668 N.E.2d 1370; *Hoeffner v. Orrick, Herrington & Sutcliffe LLP*, 878 N.Y.S.2d 717 (N.Y. App. Div. 2009); *Rather v. CBS Corp.*, 68 A.D.3d 49 (N.Y. App. Div. 2009).

Under the literal language of other decisions, she would not be entitled to any portion of the \$4000 that is profit.<sup>356</sup> Under still other decisions, as noted, she would not be entitled to any recovery because it constitutes what she might have gained but for the fraud.<sup>357</sup>

*Forgone Legal Claims* (\$5000). Under some decisions, Plaintiff might not be entitled to any recovery because she made no expenditures in reliance on the fraud.<sup>358</sup> Under other decisions, she would be entitled to a recovery of the value of her lawsuit.<sup>359</sup> Under other decisions, she would not be entitled to such a recovery because the prospect of prevailing on the forgone lawsuit is necessarily too remote.<sup>360</sup> Under the literal language of other decisions, she would not be entitled to any portion of the \$5000 because the entire amount is profit.<sup>361</sup> Under such a rule, she could recover the value of the forgone lawsuit only if she would have sought compensatory damages rather than lost profits.<sup>362</sup> Under still other decisions, as noted, she would not be entitled to any recovery because it constitutes what she might have gained but for the fraud.<sup>363</sup>

*Disgorgement of Profits* (\$6000). Plaintiff probably cannot obtain a disgorgement of profits, because her fraud claim precludes a disgorgement award on a claim for unjust enrichment, and because

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356. *A.I.A. Holdings, S.A. v. Lehman Bros.*, No. 97 Civ. 4978 (LMM), 2002 WL 1334808 (S.D.N.Y. June 17, 2002); *AFA Protective Sys., Inc. v. AT&T*, 442 N.E.2d 1269 (N.Y. 1982); *Foster v. DiPaolo*, 140 N.E. 220 (N.Y. 1923); *Reno v. Bull*, 124 N.E. 144 (N.Y. 1919); *Moezinia v. Damaghi*, 152 A.D.2d 454 (N.Y. App. Div. 1989).

357. *Cont'l Cas. Co. v. PriceWaterhouseCoopers, LLP*, 933 N.E.2d 738 (N.Y. 2010); *Lama*, 668 N.E.2d 1370.

358. *Huang v. Sy*, No. 15155/90, slip op. (N.Y. Sup. Ct. Feb. 28, 2008); *Superior Tech. Res., Inc. v. Lawson Software, Inc.*, No. 2003-10104, slip op. (N.Y. Sup. Ct. Dec. 7, 2007); *Shalam v. KPMG LLP*, No. 112732/05, slip op. (N.Y. Sup. Ct. Sept. 8, 2006).

359. *Brick v. Cohn-Mall-Marx Co.*, 11 N.E.2d 902 (N.Y. 1937); *Ochs v. Woods*, 117 N.E. 305 (N.Y. 1917); *Urtz v. N.Y. Cent. & Hudson River R.R. Co.*, 95 N.E. 711 (N.Y. 1911); *Alpert*, 160 A.D.2d 67; *Gouldsbury v. Dan's Supreme Supermarket, Inc.*, 154 A.D.2d 509 (N.Y. App. Div. 1989); *Griffel v. Belfer*, 12 A.D.2d 609 (N.Y. App. Div. 1960).

360. *Kregos v. Associated Press*, 3 F.3d 656 (2d Cir. 1993); *see also* *Connaughton v. Chipotle Mexican Grill, Inc.*, 23 N.Y.S.3d 216 (N.Y. App. Div. 2016); *Starr Found. v. Am. Int'l Grp., Inc.*, 76 A.D.3d 25 (N.Y. App. Div. 2010); *Geary v. Hunton & Williams*, 257 A.D.2d 482 (N.Y. App. Div. 1999); *UBS Secs. LLC v. Angioblast Sys., Inc.*, No. 650062/2011, slip op. (N.Y. Sup. Ct. Jan. 30, 2012).

361. *AFA*, 442 N.E.2d 1269; *Foster*, 140 N.E. 220; *Reno*, 124 N.E. 144.

362. *See* *Hutchins v. Utica Mut. Ins. Co.*, 107 A.D.2d 871 (N.Y. App. Div. 1985); *Dupuis v. Van Natten*, 61 A.D.2d 293 (N.Y. App. Div. 1978); *Tucci v. DiPaola*, 354 N.Y.S.2d 498 (N.Y. App. Div. 1974).

363. *Cont'l Cas. Co. v. PriceWaterhouseCoopers, LLP*, 933 N.E.2d 738 (N.Y. 2010); *Lama Holding Co. v. Smith Barney Inc.*, 668 N.E.2d 1370 (N.Y. 1996).

the courts have not ordered disgorgement of profits for common law fraud.<sup>364</sup> Accordingly, where she incurred \$5000 in expenses and Defendant made \$6000 profits as a result of the fraud, the New York precedent does not make clear if she would be entitled to recover the higher amount.

*Punishment* (\$7000). The precedent before 1961 did not make clear whether Plaintiff could recover punitive damages. Under *Walker v. Sheldon* and the lower courts' interpretation of that decision, she may recover such damages only for fraud that involved high moral culpability and, perhaps, was aimed at the public.<sup>365</sup>

## IX.

### THE CASE FOR STRONGER COMMON LAW

So—have the courts here made *good* common law? This Part pursues that question through Cardozo's analysis in *The Nature of the Judicial Process*,<sup>366</sup> by considering the linchpins of common law process (called here the "process test") and analyzing policy through the perspective of modern inquiry in the way that Cardozo saw as fundamental (called here the "policy test").

The relationship between the process test and the policy test is central. The interplay concerns the nature and force of *stare decisis*. That doctrine, after all, embodies the social benefits underlying the origins of the common law. In considering whether a line of precedent sets forth sound public policy, the court thus is left to try to quantify and weigh competing bases of social welfare. The difficulty of the task depends on how the precedent fares on the process test.<sup>367</sup> The sound policy of *stare decisis* is grounded in easing the burden on courts to revisit and reconsider fundamental issues with each new case and in permitting people to order their affairs around predictable outcomes in the courts.<sup>368</sup> Such goals are unfulfilled where the courts have left fundamental issues unaddressed,

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364. *The Plumbing Supply, LLC v. ExxonMobil Oil Corp.*, No. 14 CV 3674 (VB), 2016 WL 1249611 (S.D.N.Y. Mar. 29, 2016); *Allstate Ins. Co. v. Nazarov*, No. 11 CV 6187 (PKC) (VMS), 2015 WL 5774459 (E.D.N.Y. Sept. 30, 2015); *Corsello v. Verizon N.Y., Inc.*, 967 N.E.2d 1177 (N.Y. 2012).

365. 179 N.E.2d 497 (N.Y. 1961); *see also infra* Section IX.C.2 (addressing the lower courts' application of *Walker*).

366. CARDOZO, *supra* note 32.

367. *Cf.* Thomas D. Rowe, Jr., *The Legal Theory of Attorney Fee Shifting: A Critical Overview*, 1982 DUKE L. J. 651, 666 (1982) ("It is a commonplace of legal method that the reasons for a policy's adoption should guide its application in difficult cases.").

368. *See, e.g.*, CARDOZO, *supra* note 32, at 34, 149; *see also* *Burnet v. Coronado Oil & Gas Co.*, 285 U.S. 393, 406 (1932) (Brandeis, J., dissenting) (characterizing

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where the rules of decision are unclear and inconsistent, where they fail to cohere with each other, and where they differ in the state and federal courts.<sup>369</sup> In considering public policy, a court faced with such precedent is therefore positioned to afford relatively greater weight to the conclusions drawn from the policy test, facilitating the analysis.

#### A. *Accurate Interpretation of Relevant Precedent?*

With the pressure of simultaneously interpreting and making precedent, courts build on and benefit from the decision-making in prior cases; they cannot do so unless they first identify and understand the relevant decisions.<sup>370</sup> A corollary is that a court should have clear reasons for changing a rule of decision.<sup>371</sup> The operating assumption, in Cardozo's words, must be "that the precedent is known as it really is."<sup>372</sup> In critical respects in the New York courts, gaps appear between the rule applied and the precedent cited.

First, in addressing the actual damages available for fraud, the Court of Appeals has cited decisions for propositions that they do not appear to set forth and has overlooked notable decisions on

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*stare decisis* as "usually the wise policy" on the grounds that in most matters settled law is more important than rightly settled law).

369. *Cf. CARDOZO, supra* note 32, at 151 ("There should be greater readiness to abandon an untenable position when the rule to be discarded may not reasonably be supposed to have determined the conduct of the litigants.")

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370. *See, e.g., id.* at 19 (explaining with respect to the judge that the "first thing he does is to compare the case before him with the precedents"); *id.* at 20 ("[P]recedents have so covered the ground that they fix the point of departure from which the labor of the judge begins. Almost invariably, his first step is to examine and compare them. If they are plain and to the point, there may be need of nothing more."); *id.* at 21 ("It is when . . . there is no decisive precedent, that the serious business of the judge begins."); *id.* at 21–22 ("Every precedent . . . 'has a directive force for future cases of the same or similar nature.'") (internal citation omitted); *id.* at 28 (explaining that the judge "must first extract from the precedents the underlying principle, the *ratio decidendi*").

The force of these precepts in the United States legal system in general, outweighing even the considerable burdens of full dockets that judges cite as justification, would explain why many lawyers find the relatively recent prevalence of unpublished, uncitable opinions to be perplexing and shortsighted—even unsavory. *See, e.g.,* Adam Liptak, *Courts Write Decisions That Elude Long View*, N.Y. TIMES, Feb. 3, 2015, at A10; *see also* Chad M. Oldfather, *Writing, Cognition, and the Nature of the Judicial Function*, 96 GEO. L. J. 1283, 1285–97 (2008) (analyzing and citing the many journal articles addressing the issue).

371. *See, e.g., CARDOZO, supra* note 32, at 10 ("If a precedent is applicable, when do I refuse to follow it?")

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372. *Id.* at 30.

point.<sup>373</sup> Similarly, on the subject of punitive damages, the decision in *Walker v. Sheldon* seems inconsistent with the precedent on which it relies.<sup>374</sup> The court reasoned that permitting such damages only for more than ordinary fraud was “in line with what appears to be the weight of authority.”<sup>375</sup> The court did not acknowledge several of the cases that contemplated punitive damages for fraud.<sup>376</sup>

Similarly tenuous is the court’s reasoning that it had sanctioned punitive damages “in a fraud and deceit case where the defendant’s conduct evinced a high degree of moral turpitude and demonstrated such wanton dishonesty as to imply a criminal indifference to civil obligations.”<sup>377</sup> In one of the cited decisions, the court reasoned that it would be appropriate to award punitive damages against a conductor if he had ejected a train passenger knowing that the passenger’s fare had been paid.<sup>378</sup> Such conduct is not more immoral than most fraud. The conductor would not have secured any personal economic profit, and the plaintiff had only to buy a ticket for the next train.

The court in *Walker* cites other decisions holding that conduct amounting to ordinary fraud is sufficient to justify punitive damages.<sup>379</sup> In *Craig v. Spitzer Motors, Inc.*, for example, the plaintiff alleged that the defendant mulcted him into purchasing an automobile on the misrepresentation that the car had been driven only fifty-one miles as a demonstration model, when in fact it had been used to pull a house trailer and had been repossessed.<sup>380</sup> This is ordinary fraud. In *Whitehead v. Allen*, in turn, the plaintiff alleged that the defendants cozened him through an oral contract by falsifying the weight records pursuant to which the defendants had paid him for his hay.<sup>381</sup> This too is ordinary fraud.

Second, lower state courts have derived rules of decision from opinions that do not appear to set forth those rules, and have overlooked central decisions.<sup>382</sup> In *Alpert v. Shea Gould Climenko & Casey*,<sup>383</sup> for example, the court interpreted *Cayuga Harvester, Inc. v.*

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373. See *supra* Parts V–VII.

374. 179 N.E.2d 497, 498–99 (N.Y. 1961).

375. *Id.* at 499.

376. See *supra* Section VI.C.2.

377. *Walker*, 179 N.E.2d at 498–99.

378. *Hamilton v. Third Ave. R.R. Co.*, 53 N.Y. 25, 28–31 (1873).

379. 179 N.E.2d at 498–99.

380. 160 N.E.2d 537, 537–38 (Ohio Ct. App. 1959).

381. 313 P.2d 335 (N.M. 1957).

382. See *supra* Section VII.D.

383. 160 A.D.2d 67 (N.Y. App. Div. 1990).

*Allis-Chalmers Corp.*<sup>384</sup> as consistent with the rule of restoring the plaintiff to the position occupied before commission of the fraud, but *Cayuga* applies a broader rule. The court in *Alpert* also cited *Kensington Publishing Corp. v. Kable News Co.*<sup>385</sup> as precluding recovery of the benefit of an alternative agreement overlooked in favor of the fraudulent one, but in *Kensington* the court held only that a plaintiff cannot recover profits she would have made from the defendant if he had been telling the truth. In *Starr Foundation v. American International Group, Inc.*,<sup>386</sup> the court interpreted *Dress Shirt Sales, Inc. v. Hotel Martinique Assocs.*<sup>387</sup> to hold that the value of any lost opportunity is necessarily undeterminable and speculative, but a close reading of the holding in *Dress Shirt* does not support that interpretation. The court in *Geary v. Hunton & Williams*<sup>388</sup> similarly applied such a rule in the absence of precedent supporting it. In three cases in the middle of the century, the courts inexplicably applied the measure of damages for fraud that the Court of Appeals had disavowed decades before.<sup>389</sup>

Third, in most of the decisions in the line of federal cases concerning recovery of forgone business opportunities, the courts have failed to cite any state decisions.<sup>390</sup> The task of a federal court in interpreting state common law is to predict how the state's highest court would rule.<sup>391</sup> Yet more than twenty years later, the Second Circuit cited the very damages rule that existed *before* the Court of Appeals' controlling decision in *Reno v. Bull*,<sup>392</sup> failing even to cite that decision.<sup>393</sup> The federal courts later proceeded as if there were no binding state precedent.<sup>394</sup> As one federal court has observed with bemusement, reflecting an untoward result given the absence of federal general common law today, the "Second Circuit takes a rather flexible approach to the out-of-pocket rule."<sup>395</sup>

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384. 465 N.Y.S.2d 606 (N.Y. App. Div. 1983).

385. 474 N.Y.S.2d 524 (N.Y. App. Div. 1984).

386. 76 A.D.3d 25 (N.Y. App. Div. 2010).

387. 190 N.E.2d 10 (N.Y. 1963).

388. 257 A.D.2d 482 (N.Y. App. Div. 1999).

389. *See supra* Section VII.D.

390. *See supra* Section VII.B.

391. *See, e.g.*, *Phansalkar v. Andersen Weinroth & Co.*, 344 F.3d 184, 199 (2d Cir. 2003).

392. 124 N.E. 144 (N.Y. 1919).

393. *See supra* Section VII.B.

394. *See supra* Sections VII.B, VII.D.

395. *Virola v. XO Commc'ns, Inc.*, No. 05-CV-5056 (JG)(RER), 2008 WL 1766601, at \*15 (E.D.N.Y. Apr. 15, 2008).

### B. *Clear Rules of Decision?*

An unclear rule of decision does not constructively interpret or build upon precedent and fails to provide any firm reasoning for courts in subsequent cases.<sup>396</sup> Meeting those goals is one of the foundations of common law.<sup>397</sup> The New York courts have repeatedly set forth rules of decision in an effort to be clear, but the rules are opaque in their application.<sup>398</sup> The courts might find it useful to take a more panoramic view of the representations and results that concern claims for fraud.

With respect to the economic impact that a representation may cause a recipient who reasonably relies on it, there are six main worlds that could result:

1. The representation is true, and as a result:
  - a. the recipient enjoys a net benefit.
  - b. the recipient suffers a net loss by incurring costs.
  - c. the recipient suffers a net loss by losing something of value.
2. The representation is not true, and as a result:
  - a. the recipient enjoys a net benefit.
  - b. the recipient suffers a net loss by incurring costs.
  - c. the recipient suffers a net loss by losing something of value.

Claims for fraud exist only in world 2. The recipient could have a claim for fraud under New York law only in worlds 2.b and 2.c (as world 2.a could give rise to a claim only under the benefit-of-the-bargain rule). In addition, the recipient could suffer net losses from a combination of worlds 2.b and 2.c. Against this outline, however, several latent ambiguities lie in the courts' various rules of decision.

The first main source of murkiness lies in the relationship between worlds 1.a and 2.c—an overlap that courts and commentators do not appear to have addressed. The decision in *Cayuga*

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396. See, e.g., CARDOZO, *supra* note 32, at 21 (“He must then fashion law for the litigants before him. In fashioning it for them, he will be fashioning it for others.”); *id.* at 23 (“The principles themselves are continually retested; for if the rules derived from a principle do not work well, the principle itself must ultimately be re-examined.”) (internal citation omitted); *id.* at 28 (“In this perpetual flux, the problem which confronts the judge is in reality a twofold one: he must first extract from the precedents the underlying principle, the *ratio decidendi*; he must then determine the path or direction along which the principle is to move and develop, if it is not to wither and die.”).

397. See *supra* Section IX.A.

398. See *supra* Parts V–VII.

*Harvester, Inc. v. Allis-Chalmers Corp.* is a good example.<sup>399</sup> The farm sought to recover the value of the corn that was lost because the combine represented to be in good working order did not work.<sup>400</sup> The farm thus found itself in world 2.c, but seeking a recovery tantamount to world 1.a. That is, if the representation had been true, as a result the farm would have enjoyed the value of the corn by harvesting it.

The farm thus literally sought the “profits which would have been realized in the absence of fraud,” a recovery that *Lama Holding Co. v. Smith Barney Inc.* prohibits.<sup>401</sup> That description of the recovery would be accurate, however, only because the benefits the farm would have enjoyed if the representation had not been made happened to be the same as the benefits the farm would have enjoyed if the representation had been true. In *principle*, in other words, the farm was not seeking to enforce the bargain of the representation; it was seeking to be compensated for the net loss that the representation caused.

The same is true of *Ochs v. Woods*.<sup>402</sup> The defendant defrauded the plaintiff into accepting the agreement of a third party to pay the plaintiff the commissions that the defendant owed him.<sup>403</sup> If the representation had been true, the plaintiff would have received the commissions. By accepting the agreement with the third party, the plaintiff lost the value of his “legal right” to the commissions.<sup>404</sup> The benefits the plaintiff would have enjoyed if the representation had not been made were the same as the benefits he would have enjoyed if the representation had been true. The court in *Cayuga* observed that “fraud damages are to give the plaintiff what he lost because he made the bargain, not what he would have gained had it been performed.”<sup>405</sup> The more precise rule would be that fraud damages are not to give the plaintiff what she would have gained *only* had the bargain been performed.

The second main source of murkiness thus lies in how the recipient would have fared if the defendant had made no representation at all. In this additional respect, which the authority again does not address, the literal articulation of one of the rules of decision does not draw the requisite distinctions. In seeking to demonstrate

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399. 465 N.Y.S.2d 606 (N.Y. App. Div. 1983).

400. *See supra* Part VII.

401. 668 N.E.2d 1370, 1374 (N.Y. 1996).

402. 117 N.E. 305 (N.Y. 1917).

403. *Id.* at 307.

404. *Id.*

405. 465 N.Y.S.2d at 618–19 (citing *Reno v. Bull*, 124 N.E. 144 (N.Y. 1919)).

the benefits they would have enjoyed but for the representation, plaintiffs *are* seeking compensation “for what they might have gained.”<sup>406</sup> But they *have* to make such a showing to prove the net loss that the representation caused—to show the usual benefits that the representation prevented the plaintiffs from enjoying.

A further point bears mentioning. The “might have” phrasing originated in *Smith v. Bolles*.<sup>407</sup> As the past of “may,” “might” can convey either “probability” or “possibility” in the past, and is *sometimes* used to convey “less probability or possibility than *may*.”<sup>408</sup> If courts have intended to use “might have” in contrast to “may have,” to convey that “might have gained” means “probably would not have gained,” then the rule would be clearer and more sensible. In the main, no plaintiff could prevail on the argument that the representation prevented her from realizing benefits she was unlikely to have enjoyed.<sup>409</sup> To be clear, however, there is no suggestion in these decisions that the courts used “might have gained” in lieu of “may have gained” to denote unlikelihood as such.

The third main source of murkiness lies in the courts’ stated goal of restoring the plaintiff to the position she occupied before commission of the fraud. Taken literally, this language raises similar conceptual difficulties as the rule that a fraud victim is not entitled to what she might have gained. The restoration rule should mean that the plaintiff is entitled to the benefits she would have enjoyed but for the representation. Merely returning the plaintiff to the position she occupied before the representation, without taking account of the benefits she would have realized thereafter, does not fairly or fully compensate her for the loss of things of value as a result of the fraud.

The fourth main source of murkiness lies in the issue of lost profits. Many decisions use language suggesting a rule that the plaintiff may not recover any profits. The language in these decisions does not distinguish between the profits she would have enjoyed *only* if the representation had been true and the profits she would have otherwise made, but failed to make, because of the rep-

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406. *Lama*, 668 N.E.2d at 1373.

407. 132 U.S. 125, 129 (1889); *see supra* Section V.B.

408. *Might*, MERRIAM-WEBSTER DICTIONARY ONLINE (2015), <http://www.merriam-webster.com/dictionary/might> (last visited Aug. 16, 2016).

409. The possible exception is where a plaintiff has foregone a legal claim in reliance on a misrepresentation, and a court concludes that she is entitled to recover the expected value of that claim. She could then recover damages even though she was unlikely to have prevailed on the claims in her foregone lawsuit. *See infra* note 513 & accompanying text.

resentation. Those are two different concepts—even if the *amounts* of the damages in the two scenarios sometimes are the same.

This area of murkiness also implicates worlds 2.b and 2.c. Several state courts appear to interpret “consequential damages” to permit recoveries only in world 2.b, and many state courts appear implicitly to reason that world 2.c is not one in which the plaintiff has suffered any cognizable “loss” at all.<sup>410</sup> The more nuanced rules of decision recognize that although world 2.b presents a straightforward and often easier-to-calculate loss, world 2.c is also one in which a plaintiff is entitled to a recovery, under the right facts.

The final main source of murkiness lies in how the *defendant* fared from the fraud. He may have profited from having committed the fraud, and in an amount that exceeds the actual damages he must pay. The courts in New York do not appear to have addressed whether a plaintiff pursuing a claim for fraud is entitled to choose the remedy of disgorgement of profits when that amount exceeds her loss. The issue remains for the courts to resolve on policy.<sup>411</sup>

### C. Coherent Rules of Decision?

This question concerns coherence in the sense of integration, consistency, and logical ordering.<sup>412</sup> Where the aspect of common law at issue did not develop solely out of custom, but also “large and fundamental concepts,” then “we shall give a larger scope to logic and symmetry.”<sup>413</sup> The question thus includes whether courts apply consistent rules of decision, where appropriate, in the adjudication of different causes of action and among the elements of a single cause of action.<sup>414</sup> If the courts fail to do so, and there is no good

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410. See *infra* Sections VII.A, VII.C, VII.D.1–2.

411. See *infra* Section IX.E.4.

412. See, e.g., S. F. C. MILSOM, *A NATURAL HISTORY OF THE COMMON LAW* xv (2003) (explaining that the earliest English historians of the common law “could think of law, as we do, as an intellectually coherent system of substantive rules that courts would bring to bear on the particular facts of each case”).

413. CARDOZO, *supra* note 32, at 65; see, e.g., *id.* at 10 (referring to “logical consistency, the symmetry of the legal structure”); *id.* at 14–16 (explaining that “order and certainty and coherence” retain value, if not conclusive value); *id.* at 32 (“Logical consistency does not cease to be a good because it is not the supreme good.”); *id.* at 50 (referring to “the constant striving of the mind for a larger and more inclusive unity, in which differences will be reconciled, and abnormalities will vanish”).

414. The question of coherence has been a frequent subject of commentary; the details of such analyses are beyond the scope of this Article, except to underscore the relevance of Cardozo’s allusions. For a convenient summary of such issues, see Julie Dickson, *INTERPRETATION AND COHERENCE IN LEGAL REASONING*, *STANFORD ENCYCLOPEDIA OF PHILOSOPHY* (2010), <http://plato.stanford.edu/en->

reason, then the decisions are incoherent.<sup>415</sup> Some inconsistency in judicial decisionmaking is inevitable, in particular with respect to the application of the same rules of decision to comparable facts in different cases.<sup>416</sup> In the area of fraud damages under New York common law, however, incoherence appears in the very formulation and interpretation of the rules. In concept, increasing coherence among rules may lead to “decisions that appear morally arbitrary.”<sup>417</sup> Such concerns are muted here, however, given the moral foundations for fraud and the independent moral considerations for the available recoveries.<sup>418</sup>

### 1. Consequential Damages

In their tolerance for speculation as to consequential damages, the courts apply a stricter rule in fraud cases than in cases concerning other common law claims. Many courts have held as a matter of law that a fraud victim is not entitled to consequential damages in the form of lost profits because they are inherently speculative.<sup>419</sup> These courts have not applied the well-established standards for assessing such damages as a result of breach of contract, and have given no indication that they have considered doing so.

The nature of these types of claims does not support the discrepancy. Consequential damages typically are speculative.<sup>420</sup> The question from case to case must be whether they are *too* speculative to estimate. The framework for assessing consequential damages for breach of contract readily applies to assessing such damages for fraud.<sup>421</sup> “[C]ausation itself is the same problem in negligence, in

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tries/legal-reas-interpret/. For a discussion of the view that courts achieve coherence by interpreting settled law and applying new rules of decision to be consistent, see *id.* § 3.1.

415. See, e.g., CARDOZO, *supra* note 32, at 33 (“I am not to mar the symmetry of the legal structure by the introduction of inconsistencies and irrelevancies and artificial exceptions unless for some sufficient reason, which will commonly be some consideration of history or custom or policy or justice.”).

416. Addressing “the inferiority of expert judgment,” for example, Nobel-prize-winning psychologist Daniel Kahneman offers the sobering assessment that “humans are incorrigibly inconsistent in making summary judgments of complex information. When asked to evaluate the same information twice, they frequently give different answers. The extent of the inconsistency is often a matter of real concern.” DANIEL KAHNEMAN, *THINKING, FAST AND SLOW* 224–25 (2011).

417. Kenneth J. Kress, *Legal Reasoning and Coherence Theories: Dworkin’s Rights Thesis, Retroactivity, and the Linear Order of Decisions*, 72 CAL. L. REV. 369, 371 (1984).

418. See *supra* Section IX.E.

419. See *supra* Sections VII.A–B.

420. See 24 WILLISTON ON CONTRACTS § 64:10 (4th ed. 2010).

421. See *infra* Sections VI.D.1, VII.D.1.

reckless misconduct, and in intentional wrongs.”<sup>422</sup> As the U.S. Supreme Court has explained:

Although the principles of legal causation sometimes receive labels in contract analysis different from the “proximate causation” label most frequently employed in tort analysis, these principles nevertheless exist to restrict liability in contract as well. Indeed, the requirement of foreseeability may be more stringent in the context of contract liability than tort liability.<sup>423</sup>

New York courts have often taken the *opposite* perspective.<sup>424</sup>

This area of incoherence also involves a subtler inconsistency within the cause of action for fraud itself. Some courts decline to engage in the speculation required to determine lost profits. Other courts (and sometimes the same courts) do assess whether the fraud has caused the plaintiff to suffer consequential damages in the form of out-of-pocket expenditures.<sup>425</sup> Each assessment involves the same basic inquiry of what would have happened if the defendant had not made the representation.

## 2. Punitive Damages

Although the law is uncertain in its particulars, the courts have clearly set out different standards for awarding punitive damages on fraud claims as opposed to other torts. “Whether or not a public harm is necessary to award punitive damages pursuant to fraud causes of action is where many New York courts diverge.”<sup>426</sup> Most courts continue to interpret *Walker v. Sheldon*<sup>427</sup> as requiring fraud

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422. Ralph S. Bauer, *The Degree of Moral Fault as Affecting Defendant's Liability*, 81 U. PA. L. REV. 586, 588 (1933).

423. *Exxon Co. v. Sofec, Inc.*, 517 U.S. 830, 839–40 (1996) (citations omitted) (collecting authority). The Court's statement echoes the doctrine described in the contracts treatise cited in *Jeffrey v. Bigelow & Tracy*, 13 Wend. 518 (N.Y. Sup. Ct. 1835)). See *supra* Section II.B.1. Albeit decades ago, at least one New York court has noted the incongruity in permitting a plaintiff to recover lost profits for negligence but not fraud. See *Ming Hin Chin v. Fletcher*, 21 Misc. 2d 421, 433 (N.Y. Sup. Ct. 1959) (“[W]here properly pleaded, damages for loss of profits have been awarded in actions for negligence. The intentional tort of deceit would seem to present an *a fortiori* case for allowing such a recovery.”); cf. Bauer, *supra* note 422, at 588 (“[T]he so-called rules of causation . . . are administered in such a manner as to be most severe upon the intentional wrongdoer and more severe upon the reckless wrongdoer than upon the negligent wrongdoer.”).

424. See *supra* Sections VI.C.1, VII.D.1–3.

425. See *supra* Sections VI.C.1, VII.D.1.

426. *Leventhal & Dickerson*, *supra* note 200, at 995.

427. 179 N.E.2d 497 (N.Y. 1961).

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aimed at the public,<sup>428</sup> leaving a minority that do not.<sup>429</sup> In addition, “New York courts seem to adopt different standards for punitive damages in fraud, breach of contract, and breach of fiduciary duty cases.”<sup>430</sup> Some courts allow an award of punitive damages “if a bad faith breach of contract reaches a high level of moral turpitude,” without requiring public harm.<sup>431</sup> Other courts hold that there is no requirement of public harm in cases involving breach of a fiduciary duty.<sup>432</sup> With respect to torts other than fraud, moreover, the threshold question of whether the defendant’s misconduct warrants punitive damages is for the jury.<sup>433</sup>

Affording the court the determination of whether fraud warrants punitive damages is bound to create incoherence. Such discrepancies are more corrosive of the rule of law than inevitable differences in how juries—in their varied motivations—resolve similar cases. A few years ago, the Court of Appeals affirmed a decision that reflects such tension.<sup>434</sup> According to the complaint, a wife told her husband that he was the father of her child, when she knew the child was conceived in adultery. She maintained the fraud for four years. They got divorced when he learned the truth. He alleged fraud. The First Department held as a matter of law that the former wife’s alleged conduct did not constitute a “high degree of moral turpitude.”<sup>435</sup> The court sought to reconcile its holding with the Court of Appeals’ holding in 1896 in *Kujek v. Goldman*.<sup>436</sup> That decision allowed punitive damages where the defendant fraudulently induced the plaintiff to marry a woman by failing to mention that she was pregnant with the defendant’s child.<sup>437</sup> The court in *Howard S.* concluded: “The facts of *Kujek* are inapposite in that it involves a third person and its holding reflects the moral standards of an earlier era.”<sup>438</sup>

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428. Leventhal & Dickerson, *supra* note 200, at 996; *see, e.g.*, Koch v. Greenberg, 626 F. App’x 335, 340 (2d Cir. 2015).

429. Leventhal & Dickerson, *supra* note 200, at 995.

430. *Id.* at 993–94.

431. *Id.* at 999.

432. *Id.* at 1000–01.

433. *See* Nardelli v. Stamberg, 377 N.E.2d 975, 977 (N.Y. 1978); Baity v. Gen. Elec. Co., 86 A.D.3d 948, 950 (N.Y. App. Div. 2011); Swersky v. Dreyer & Traub, 643 N.Y.S.2d 33, 37 (N.Y. App. Div. 1996) (collecting authority).

434. *See* Howard S. v. Lilian S., 876 N.Y.S.2d 351 (N.Y. App. Div. 2009), *aff’d*, 14 N.Y.3d 431 (2010).

435. *Id.* at 355.

436. *Id.* (addressing *Kujek v. Goldman*, 150 N.Y. 176 (1896)).

437. *Kujek*, 150 N.Y. at 179.

438. *Id.*

The fraud at issue in *Howard S.* is not all that rare, the wife's dishonesty can easily be interpreted as intended to benefit the child as well as herself, and morals do change.<sup>439</sup> Still, the implicit premises of the holding—that it is not particularly immoral, but rather a kind of chicanery, for a wife to hide from her husband for years the paternity of a child she conceived in adultery; that society has less interest in deterring such misconduct today than it did a century ago—are questionable. At a minimum, such reasoning illustrates the inconsistency in the decisions in this area that already exists and that will continue to emerge. Indeed, the Court of Appeals in *Walker v. Sheldon* cited *Kujek* as *exemplifying* fraud involving a “high degree of moral turpitude.”<sup>440</sup> As examples arising out of the recent financial crisis, one state judge concluded that a company's fraud in misrepresenting its practices in originating what the court regarded as shady mortgages involved high moral culpability, whereas another state judge concluded that a company's fraud in misrepresenting its practices in bundling such mortgages for sale as securities did not.<sup>441</sup>

### 3. The Wrongdoer Rule

In their willingness to afford the plaintiff leeway in estimating damages, the courts again apply a stricter standard in fraud cases than in contract cases. With one or two older exceptions, the courts in fraud cases have not applied the doctrine of refusing to permit the defendant to escape liability because the amount of damages he has caused is uncertain.<sup>442</sup> The nature of the two types of claims, again, does not justify such a discrepancy. To the contrary, although the wrongdoer rule in New York originated in contract

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439. In *Kujek*, for example, the court reasoned that the defendant “induced the plaintiff to enter into a marriage contract whereby he assumed certain obligations and became entitled to certain rights,” including “the right to his wife's services, companionship and society.” *Id.* The court concluded that as a result of the fraud, the plaintiff “was not only compelled to expend money to support a woman whom he would not otherwise have married, but was also deprived of her services while she was in child-bed.” *Id.*

440. 179 N.E.2d 497, 499 (N.Y. 1961) (citing *Kujek*, 150 N.Y. 176).

441. *Compare* *Ambac Assurance Corp. v. First Franklin Fin. Corp.*, 40 Misc. 3d 1214(A), 2013 N.Y. slip op. 51180(U), at \*15–16 (N.Y. Sup. Ct. July 28, 2013) (high moral culpability), *with* *Stichting Pensioenfonds ABP v. Credit Suisse Grp. AG*, 38 Misc. 3d 1214(A), 2012 N.Y. slip. op. 52433(U), at \*14 (N.Y. Sup. Ct. Nov. 30, 2012) (not high moral culpability).

442. *See supra* Section VI.C.3.

cases, it is a common law doctrine that courts have emphasized should apply even more forcefully in tort actions.<sup>443</sup>

#### 4. The Question of the Majority Rule

The law of fraud damages in New York is an admixture of majority and minority rules. The enforcement of minority rules for fraud in the state courts is particularly inconsonant where, in formulating the law of fraud damages, the Court of Appeals looked to the *Restatement of Torts* or otherwise sought to follow what the court regarded as the relevant general rule.<sup>444</sup> The prevalence of any minority rules should at least reflect careful reasoning and deliberate choice. If it is true, as Judge Posner says, that “there is a kind of competitive process at work” in the making of common law, then the majority rule reflects the winning consensus.<sup>445</sup>

The many state decisions precluding the recovery of consequential damages and lost profits, and the value of forgone business opportunities, differ from the majority rule. Under the *Restatement (Second) of Torts* and in other out-of-pocket jurisdictions, a plaintiff may recover consequential damages, including the value of opportunities that the plaintiff passed over in reliance on the fraud.<sup>446</sup> In

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443. The U.S. Supreme Court, for example, has noted the “clear distinction between the measure of proof necessary to establish the fact that petitioner had sustained some damage and the measure of proof necessary to enable the jury to fix the amount.” *Story Parchment Co. v. Paterson Parchment Paper Co.*, 282 U.S. 555, 562 (1931). “Where the tort itself is of such a nature as to preclude the ascertainment of the amount of damages with certainty,” then the defendant should “bear the risk of the uncertainty.” *Id.* at 565 (quoting *Gilbert v. Kennedy*, 22 Mich. 117, 131 (1871)). The Court analyzed several cases, including actions “sounding in tort,” as the foundational precedent in this area. *Id.* at 562–66; *see also infra* Section IX.E.6 (analyzing the reasoning in *Story Parchment*, and the precedent cited therein, regarding the wrongdoer rule); Bauer, *supra* note 422, at 592 (“The rule laying emphasis upon the necessity of certainty of proof is applied chiefly to cases of negligence and of apparently non-wilful breach of contract. The rule laying emphasis upon the necessity of only reasonable certainty of proof is applied chiefly to cases of wilful or reckless torts and of wilful breach of contract.”) (emphasis omitted).

444. *See supra* Sections V.D, IX.A.

445. Posner, *Role of the Judge*, *supra* note 2, at 1054–55; *see also* Caleb Nelson, *The Persistence of General Law*, 106 COLUM. L. REV. 503, 505–25 (2006) (concluding that notwithstanding *Erie*, federal courts continue to apply general law in a variety of contexts) [hereinafter “Nelson, *General Law*”].

446. *See* RESTATEMENT (SECOND) OF TORTS, *supra* note 335, § 549(1)(b) (specifying that among the damages to which a plaintiff is entitled is the “pecuniary loss suffered otherwise as a consequence of the recipient’s reliance upon the misrepresentation”); 37 LAURA HUNTER DIETZ ET AL., *NEW YORK JURISPRUDENCE: FRAUD AND DECEIT* § 378 (2d ed. 2016) (“The out-of-pocket rule permits recovery of conse-

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the minority in applying the out-of-pocket rule, the New York courts are also in the minority in declining to award disgorgement of profits for fraud or permit punitive damages for “ordinary” fraud.<sup>447</sup> These are not matters for which the Court of Appeals, or any other state court, has looked to the majority or relevant Restatement rule and offered any reason for declining to follow it.

##### 5. State and Federal Court Agreement

The state and federal decisions in this area are dissonant. The importance of coherence among such decisions is reflected in the rationales for allowing federal courts to certify questions of state law to the state’s highest court. Among the reasons are that (a) state courts have assurance “that state law will be applied uniformly and in accordance with the interpretations given by each state’s highest court”; (b) federal courts “are able to avoid the awkward, tenuous, and difficult chore of attempting to determine how a state high court would rule on a matter of state law”; and (c) federal courts avoid the awkwardness of resolving an issue “only to be ‘corrected’ subsequently by state high courts.”<sup>448</sup> The goals are “facilitating the orderly development and fair application of the law and preventing the need for speculation.”<sup>449</sup> Such considerations, of course, prompted the U.S. Supreme Court to overrule *Swift v. Tyson*.<sup>450</sup>

Any significant discrepancies between the state and federal decisions applying a state’s common law reflect either of two main scenarios. The first is that the court systems are not paying attention to each other’s decisions. That result increases the likelihood of different outcomes on similar facts and creates incentives for litigants to choose one system over another for reasons divorced from the rationale for having federal courts resolve state common law claims.

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quential or special damages that are proximately caused by the misrepresentation, including damages incurred by passing up other business opportunities.”) (citing, among other cases, *Schonfeld v. Hilliard*, 218 F.3d 164 (2d Cir. 2000), as “applying New York law”); DAN B. DOBBS, *HANDBOOK ON THE LAW OF REMEDIES* 697–98 (2d ed. 1993) (consequential damages are recoverable for fraud in “appropriate cases” in “most jurisdictions”); *see, e.g., Trytko v. Hubbell, Inc.*, 28 F.3d 715, 722–24 (7th Cir. 1994) (explaining the propriety of recovering consequential damages and the value of foregone opportunities as out-of-pocket damages for fraud).

447. *See infra* Sections IX.E.4–5.

448. Jonathan Remy Nash, *Examining the Power of Federal Courts to Certify Questions of State Law*, 88 *CORNELL L. REV.* 1672, 1673–74 (2003).

449. *Tunick v. Safir*, 731 N.E.2d 597, 599 (N.Y. 2000).

450. 41 U.S. 1 (1842). The Court in *Erie Railroad v. Tompkins*, 304 U.S. 64 (1938), cited the lack of “uniformity” and the “well of uncertainties” that disparate federal general common law had caused, and the “mischievous results” of forum-shopping that had resulted. *Id.* at 73–74.

The second unfavorable scenario is dissensus. Under either result, the state's common law system is suffering. The jurisdictions' respective formulations of the law should coalesce.

The decisions in New York evidence both scenarios. As to the first, each court system has issued numerous decisions analyzing the damages for fraud without citing precedent from the other. Such omissions would be less problematic if the rules of decision applied in the two systems were consistent, but they are not.<sup>451</sup> The omissions are also incongruous in that the Court of Appeals cited the rule in the federal courts in its seminal decisions in this area.<sup>452</sup> The federal courts no longer formulate common law as they did under *Swift v. Tyson*.<sup>453</sup> It is disconcerting, however, that the state courts would find thoughtful federal decisions to be unilluminating—particularly where many of these decisions are consistent with the majority rule.<sup>454</sup> As to the second scenario, one stark example is the line of decisions in the federal courts concerning the costs and value of lost alternative opportunities. Such decisions arose out of the dubious interpretation of a Court of Appeals decision and the invocation of a measure of damages in contract law that the state courts have not applied for fraud damages.<sup>455</sup>

#### D. *Similar Cases Resolved the Same Way?*

If courts reach different decisions on the same material facts, then at least two bad results follow. The first is that the decisions either do not turn on any common rule of decision or else apply different rules to the same facts.<sup>456</sup> The second is that by all appearances, to the public and to the participants in it, the system lacks

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451. *See supra* Sections VII.B, D, E.

452. *See supra* Part V.

453. 41 U.S. 1.

454. *See supra* Sections VII.B, E.

455. *See supra* Section VII.B.

456. *See, e.g.,* CARDOZO, *supra* note 32, at 33 (“It will not do to decide the same question one way between one set of litigants and the opposite way between another. ‘If a group of cases involves the same point, the parties expect the same decision. It would be a gross injustice to decide alternative cases on opposite principles.’”) (citation omitted); *id.* at 112 (“One of the most fundamental social interests is that law shall be uniform and impartial.”).

integrity.<sup>457</sup> A common law system that has lost the faith of the public it serves is obviously less than optimal.<sup>458</sup>

The New York courts have reached different results in cases involving, in Cardozo's words, "the same point." The courts cannot agree on whether the plaintiff may recover "consequential damages" and, if so, what types of losses the phrase encompasses.<sup>459</sup> They also reach opposite conclusions in cases concerning the plaintiff's decision to forgo business opportunities in reliance on the fraud.<sup>460</sup> The decisions also differ on whether a plaintiff may recover damages based on the value of forgone legal claims.<sup>461</sup>

The decisions in *Jeffrey v. Bigelow & Tracy*,<sup>462</sup> *Foster v. DiPaolo*,<sup>463</sup> and *Cayuga Harvester, Inc. v. Allis-Chalmers Corp.*<sup>464</sup> exemplify such ambiguity. In *Foster*, the apple cider the plaintiff purchased was not the good-quality cider the defendant represented it to be. The Court of Appeals held as a matter of law that the plaintiff was not entitled to any recovery for his inability to sell the cider to third parties.<sup>465</sup> Consider, however, if before the fraud the plaintiff could have bought good-quality cider from any number of other people and then sold the cider to third parties. The plaintiff thus would have secured a benefit but for the misrepresentation, just as the sheep owner in *Jeffrey* would have realized the value of his original sheep, and just as the farm in *Cayuga* would have realized the value of its corn, but for the misrepresentations. In each case, the fraud caused the plaintiff to lose something of value.<sup>466</sup>

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457. See, e.g., *id.* at 34 ("Everyone feels the force of this sentiment when two cases are the same. Adherence to precedent must then be the rule rather than the exception if litigants are to have faith in the even-handed administration of justice in the courts."); *id.* at 35–36 ("Only experts perhaps may be able to gauge the quality of his work and appraise its significance. But their judgment, the judgment of the lawyer class, will spread to others, and tinge the common consciousness and the common faith. . . . [T]he affairs of men are to be governed with the serene and impartial uniformity which is the essence of the idea of law.")

458. See, e.g., *supra* note 31 & accompanying text (noting that New York has come to be viewed negatively in the arena of financial services and that its legal system lags behind London's in terms of predictability and fairness).

459. See *supra* Sections VI.C.1, VII.D.1, VII.E.

460. See *supra* Sections VI.B, VII.D.2, VII.E.

461. See *supra* Sections VI.A, VII.D.3, VII.E.

462. 13 Wend. 518 (N.Y. Sup. Ct. 1835).

463. 140 N.E. 220 (N.Y. 1923).

464. 465 N.Y.S.2d 606 (N.Y. App. Div. 1983).

465. *Foster*, 140 N.E. at 220.

466. The analysis would therefore be different if the defendant in *Foster*, 140 N.E. 220, misrepresented that he was selling *extraordinary*-quality cider, which in fact was unavailable elsewhere. The plaintiff then could not show that, but for the misrepresentation, he would have completed his contracts in the normal course

*E. The Best Policy?*

The out-of-pocket rule arises from English common law, it has been in place in New York for almost a hundred years, the Court of Appeals has repeatedly reaffirmed it, and it is the rule in other states.<sup>467</sup> The measure is thus durable, but it has shortcomings. The analysis below addresses them, mindful that “the out-of-pocket formula is likely to lead to smaller verdicts” than the benefit-of-the-bargain measure.<sup>468</sup> Absent reshaping, the courts’ stingy application of the formula have compounded to leave a body of law that is mild where it should be forceful. The discussion that follows principally seeks to identify the best policy in the context of rules and reasoning that the New York courts have set out. Even thus focused, however, the analysis is beset with questions of first principles; some would say there are only qualified answers.<sup>469</sup> The analysis here seeks to limit such qualifications.

Cardozo asks what best serves social welfare and “the sense of justice.”<sup>470</sup> Although there is a plain social interest in the coherent

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with third parties, because he would not have been able to buy extraordinary-quality cider from anyone else. In seeking the value of these third-party contracts, he would be seeking a benefit he could have obtained *only* if the representation had been true—an unrecoverable benefit of the bargain. See *supra* Section IX.B.

467. The out-of-pocket test also has sensible academic support. See, e.g., Jill Wieber Lens, *Honest Confusion: The Purpose of Compensatory Damages in Tort and Fraudulent Misrepresentation*, 59 KAN. L. REV. 231, 232 (2011) (concluding that the appropriate measure of damages for fraud is the out-of-pocket test because benefit-of-the-bargain damages “cannot be compensatory in tort, and none of the practical or theoretical justifications for awarding benefit-of-the-bargain-based compensatory damages for breach of contract apply to tort law”).

468. McCormick, *Damages in Actions*, *supra* note 132, at 1055.

469. See, e.g., Oldfather, *supra* note 268, at 1323 (explaining that “a court contemplating the extension of a tort doctrine must attempt to assess the likely consequences of a legal change for the affected parties, prioritize those in conjunction with an assessment of the various policy goals of tort law, and check all of that against its conception of justice,” and concluding that “[i]n these contexts any assessment of decisional quality may have to be qualified”). For his part, describing the methods of judicial decisionmaking and acknowledging the challenge in determining what weight to ascribe to each method, Cardozo pauses early in his second of four lectures and notes: “We have gone far enough to appreciate the complexity of the problem.” CARDOZO, *supra* note 32, at 64.

470. *Id.* at 150 (“I think that when a rule, after it has been duly tested by experience, has been found to be inconsistent with the sense of justice or with the social welfare, there should be less hesitation in frank avowal and full abandonment.”); see also *id.* at 67 (“I mean that when they are called upon to say how far existing rules are to be extended or restricted, they must let the welfare of society fix the path, its direction and its distance.”). An example is the case of the legatee who murdered his testator to secure the benefits of the will. Cardozo explains that the legatee was not permitted to enjoy the benefits, and thus profit from his wrong-

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application of clear rules of decision, “[t]he social interest served by symmetry or certainty must then be balanced against the social interest served by equity and fairness or other elements of social welfare.”<sup>471</sup> The resulting balance is “what is commonly spoken of as public policy, the good of the collective body.”<sup>472</sup>

Such goals and policy must include “ethical considerations.”<sup>473</sup> The initial question here is whether the law should follow from the morality of the day, from more abstract formulations, or from both. In several parts of the lectures, Cardozo links the law and “customary morality.”<sup>474</sup> In other parts, however, he suggests that the law must do more than incorporate the judge’s empirical assessment of current moral standards.<sup>475</sup> Indeed, given the implications of such an approach, it would be surprising if Cardozo believed that the law should stand on moral relativism.<sup>476</sup> In alluding to the customary morality of “*right-minded* men and women,” Cardozo allows for the law to incorporate *conceptions* of morality. Cardozo’s framework, as discussed further below, thus leaves room for the law to take account of both approaches.

The threshold question from the conceptual perspective is whether moral considerations are based on deontological or conse-

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doing, because “the principle that was thought to be most fundamental, to represent the larger and deeper social interests, put its competitors to flight.” *Id.* at 40–42. “[T]he social interest served by refusing to permit the criminal to profit by his crime is greater than that served by the preservation and enforcement of legal rights of ownership.” *Id.* at 43.

471. *Id.* at 113. This observation is a more nuanced view than the narrow notion that predictability in its application is the “chief reason for an adoption of a general rule of law.” Note, *supra* note 29, at 1025.

472. CARDOZO, *supra* note 32, at 72.

473. *Id.* at 66 (citation omitted).

474. See, e.g., *id.* at 106 (“His duty to declare the law in accordance with reason and justice is seen to be a phase of his duty to declare it in accordance with custom. It is the customary morality of right-minded men and women which he is to enforce by his decree.”).

475. See, e.g., *id.* at 108 (addressing how the judge is not “powerless to raise the level of prevailing conduct”).

476. “[C]onventionalist legal moralism would mean that there are no principled limits to what may be legislated by a majority.” Moore, *supra* note 34, at 1545; see also Heidi Margaret Hurd, *Relativistic Jurisprudence: Skepticism Founded on Confusion*, 61 S. Cal. L. Rev. 1417, 1466 (1988) (“By maintaining that moral truth is coextensive with the temper of a community at any given time, relativists are thus committed to the possibility that what they consider evil will become moral, and vice-versa.”).

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quentialist theories.<sup>477</sup> The answer can depend on the nature of the cause of action. In a convincing assessment of most tort law, for example, Professor Michael S. Moore regards us “all to be consequentialists.”<sup>478</sup> He concludes that the interesting divide really is between “welfare-oriented consequentialisms (utilitarianism) and justice-oriented consequentialisms (like retributivism, corrective justice theories, etc.).”<sup>479</sup>

The moral considerations concerning fraud, however, must reflect that the claim lies at the intersection of tort law and criminal law as a “civil crime.”<sup>480</sup> Whereas tort law generally concerns consequential wrongs, “criminal law appears to be about deontological wrongs.”<sup>481</sup> Fraud implicates both (a) the consequentialist concerns of wasted resources and corrective and retributive justice and (b) the deontological concerns with taking advantage of people for personal ends.<sup>482</sup> The recovery of compensatory damages, for example, concerns corrective justice.<sup>483</sup> Requiring fraudsters to disgorge profits and pay punitive damages in appropriate circumstances, in contrast, concerns both retributive justice and deontological principles.<sup>484</sup> These perspectives reflect the premise, implicit in the early New York precedent at least, that “fraudulent representors are more culpable than non-fraudulent ones.”<sup>485</sup>

Under the modern inquiry whose application Cardozo regarded as integral, the assessment of social welfare must also consider the economic analysis of the incentives and disincentives that the law should provide.<sup>486</sup> A policy backdrop for the following dis-

477. Moore, *supra* note 34, at 1551; *see also* Heidi M. Hurd, *The Deontology of Negligence*, 76 B.U. L. REV. 249, 251 (1996) [hereinafter “Hurd, *Deontology*”] (addressing the moral considerations underlying negligence). R

478. Moore, *supra* note 34, at 1552. R

479. *Id.*

480. *See* Hurd, *Deontology*, *supra* note 477, at 271. R

481. *Id.*; *see also id.* at 249, 253 (explaining that negligence typically is described in consequentialist terms).

482. *See supra* Part II; *see also* Hurd, *Deontology*, *supra* note 477, at 250. R

483. *See* Moore, *supra* note 34, at 1556–57. R

484. *See id.*; Owen, *Moral Foundations*, *supra* note 52, at 719. R

485. Qi Zhou, *Economic Analysis of the Legal Standard for Deceit in English Tort Law*, 28 EUR. J.L. & ECON. 83, 88 (2009).

486. For a summary of discrete schools of thought in the vast literature of law and economics, *see* Nicholas Mercuro, *The Jurisprudential Niche Occupied by Law and Economics*, 2 J. JURIS. 61 (2009). This Article focuses on rationales of the sort set forth in Professor Qi Zhou’s *Economic Analysis of the Legal Standard for Deceit in English Tort Law*, *supra* note 485, which in turn relies in significant part on the foundational work of William Landes & Richard Posner, *An Economic Theory of Intentional Torts*, 1 INT’L REV. L. & ECON. 127 (1981). R

cussion therefore is that “the imposition of severe private legal sanctions on a fraudulent representor can be justified as strengthening legal deterrence.”<sup>487</sup> Intentional wrongdoers are more likely to impose harm than unintentional tortfeasors; they create social waste by investing in the wrongdoing instead of productive conduct; and they usually take steps to hide their fraud.<sup>488</sup> They thus increase the cost of, and make even less likely, private legal enforcement, which is already imperfect in the face of “high litigation costs and judicial errors.”<sup>489</sup> Where rules of decision make the prospect of higher pri-

487. Zhou, *supra* note 485, at 88. A growing area of scholarship asks whether people act on rational preferences in the way that law and economics presupposes. See, e.g., Jeffrey L. Harrison, *The Influence of Law and Economics Scholarship on Contract Law: Impressions Twenty-Five Years Later*, 68 N.Y.U. ANN. SURV. AM. L. 1, 8–16 (2012) (focusing on behavioral economics and “happiness and utility”); Robin Bradley Kar, *The Deep Structure of Law and Morality*, 84 TEX. L. REV. 877 (2006) [hereinafter “Kar, *Deep Structure*”] (citing such scholarship and proposing an alternative, obligations-related description of how people behave in “social contract” situations); see also Robin Bradley Kar, *Hart’s Response to Exclusive Legal Positivism*, 95 GEO. L.J. 393, 432–34, 446–47 (2007) [hereinafter “Kar, *Hart’s Response*”] (describing the scholarship of empirical studies “that better characterize our human decision-making processes”). See generally KAHNEMAN, *supra* note 416, at 269–374 (debunking the proposition that economic agents are rational).

Understanding explanations for human behavior has “important consequences” for “how we should approach normative proposals in law.” Kar, *Deep Structure*, *supra*, at 879. Professor Kar accepts, however, that prospective legal sanction does affect people’s decision-making, in particular for deliberate conduct. See *id.* at 920–23. This conclusion is consistent with Professor Kar’s explanation that one of the very elements of commonly felt obligation is that the individual’s breach of a standard of action “gives some other person or group standing to complain or warrants what would otherwise be resented, namely, certain forms of punishment or coercion for noncompliance.” *Id.* at 881 & n.23. A logical conclusion from this explanation is that bolstering the sanctions and punishment for fraudulent conduct would affect people’s decision-making. Cf. *infra* Section IX.E.5 (addressing how the law should operate against the prospect that punitive damages may not deter misconduct). The prospect of such behavioral consequences does not generally pose any complicated or counterintuitive utilitarian calculations for the individual. The relevant standard of action (in essence, I shall not tell big lies to people for personal economic gain at their expense) would be a “simple” and “moral” one that, if followed, would “conduce to the common good.” Kar, *Deep Structure*, *supra*, at 927. One exception might be the fraudster with a good-hearted, consequentialist motive, as “[n]o one is purely a deontologist. It is simply too implausible to maintain that moral imperatives govern all decisions.” Hurd, *Deontology*, *supra* note 477, at 253; see also *infra* note 571 & accompanying text.

488. Zhou, *supra* note 485, at 88; accord Klass, *supra* note 12, at 451.

489. Zhou, *supra* note 485, at 88. In particular, the “probability of private legal enforcement is lower in the case of fraudulent misrepresentation.” *Id.* (citing Landes & Posner, *supra* note 486); cf. FED. TRADE COMM’N, A STAFF REPORT ON THE FEDERAL TRADE COMMISSION’S FRAUD FORUM 7–10 (Dec. 2009), <https://www.ftc.gov/sites/default/files/documents/reports/staff-report-federal-trade-commission>

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vate recovery for the fraud more likely, there is an increased probability of legal enforcement; the potential plaintiff will then be more likely to pursue the action, enhancing deterrence.<sup>490</sup>

In ascribing to the common law judge the power and obligation to make public policy, Cardozo's analysis also raises the question of what limits constrain the judge, even apart from the default setting of *stare decisis*. The propriety of such boundaries is fundamental.<sup>491</sup> The debate over whether common law is "found" or "made" asks whether the judge relies on "external" sources (such as real-world customs and social practices), "internal" sources (such as precedent, including from other jurisdictions), or neither.<sup>492</sup> "If the common law has either external or internal sources that courts have a duty to respect, common law rules can be thought of as existing in at least semi-determinate form before current judges crystallize them in particular cases."<sup>493</sup>

Cardozo's approach fits that description. He reasons, as shown, that customary morality is relevant. In addition, he concludes that common law is "made" in a potent but circumscribed way. The common law judge takes a "ready-made" set of "juridical conceptions and formulas," but also

is legislating within the limits of his competence. . . . He legislates only between gaps. He fills the open spaces in the law . . . . [W]ithin the confines of these open spaces and those of precedent and tradition, choice moves with a freedom which stamps its action as creative. The law which is the resulting product is not found, but made.<sup>494</sup>

Consistent with that approach, and with Judge Posner's conception of common law as following from options on offer, compelling pol-

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[%E2%80%99s-fraud-forum-commission%E2%80%99s-division-marketing-practices/091229/fraudstaffreport.pdf](#) (explaining that victims of consumer fraud are unlikely to report the fraud to any government agency).

490. Zhou, *supra* note 485, at 88; *see also* Walker v. Sheldon, 179 N.E.2d 497, 499 (N.Y. 1961) (addressing such a rationale for punitive damages).

491. *See, e.g.*, Caleb Nelson, *The Legitimacy of (Some) Federal Common Law*, 101 VA. L. REV. 1, 19–20, 41–42, 63–64 (2015) (reasoning that the emphasis on the different roles that federal and state courts play in relation to common law might encourage state judges to conclude "that they can legitimately establish whatever rules they like," and concluding that "the fact that state courts may have the practical ability to say whatever they want does not mean that a conscientious state judge should do so").

492. *See id.* at 2–19 (analyzing core perspectives within the debate).

493. *Id.* at 19–20.

494. CARDOZO, *supra* note 32, at 47–48, 113–15; *accord* Gregory v. Ashcroft, 501 U.S. 452, 482 (1991) (White J., concurring in part, dissenting in part, and concurring in the judgment).

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icy changes incorporate customary conceptions of morality and rules of decision that are applied across jurisdictions and typically are part of what has been called “general law,” or “the consensus of decisions by courts in other American jurisdictions.”<sup>495</sup>

Accordingly, a further policy cornerstone that follows from Cardozo’s framework, and the resulting relevance of general law, is that the New York courts should consider the pertinent Restatements, developed to “enhance economic growth and maximize social welfare.”<sup>496</sup> The *Restatement (Second) of Torts* identifies the purposes of tort damages as “(a) to give compensation, indemnity or restitution for harms; (b) to determine rights; (c) to punish wrongdoers and deter wrongful conduct; and (d) to vindicate parties and deter retaliation or violent and unlawful self-help.”<sup>497</sup>

### 1. Consequential Damages

A rule that precludes a plaintiff from recovering the profits that he would have realized in the absence of fraud is not the best policy. The same is true of a rule, taken literally, that precludes a plaintiff from recovering what he might have gained, but for the fraud, or that would merely restore him to the position occupied before commission of the fraud. This area is ripe for rethinking as one in which the Court of Appeals has described its rules of decision as reflecting sound “policy.”<sup>498</sup>

Contrary to some confusion in the state courts, a recovery of consequential damages is not a benefit of the bargain in conflict

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495. Nelson, *Federal Common Law*, *supra* note 491, at 14; *see also* Nelson, *General Law*, *supra* note 445, at 505–25 (concluding that federal courts continue to apply general law in a variety of contexts).

496. Mercuro, *supra* note 486, at 65. Cardozo of course was a strong proponent of the Restatements. In December 1923, referring to the American Law Institute, he said the following at Yale Law School:

When, finally, it goes out under the name and with the sanction of the Institute, after all this testing and retesting, it will be something less than a code and something more than a treatise. It will be invested with unique authority, not to command, but to persuade. It will embody a composite thought and speak a composite voice. Universities and bench and bar will have had a part in its creation. I have great faith in the power of such a restatement to unify our law.

CARDOZO, *GROWTH OF THE LAW*, *supra* note 7, at 9.

497. RESTATEMENT (SECOND) OF TORTS, *supra* note 335, § 901. The damages awarded should carry out one or more of these purposes. *See id.* cmt. a; *see also id.* cmt. b. (noting that purpose (b) “results from the inability of the common law to settle controversies before some wrongful act has been done”).

498. *Dress Shirt Sales, Inc. v. Hotel Martinique Assocs.*, 190 N.E.2d 10, 12–13 (N.Y. 1963).

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with *Reno v. Bull*.<sup>499</sup> Instead, the plaintiff may recover the benefits of a subsequent bargain, such as lost sales, that he would have enjoyed but for the defendant's representation. These are the same types of damages that a plaintiff may pursue for breach of contract. Social welfare is served less well if "one guilty of willful fraud may suffer less than one who merely breaches his contract."<sup>500</sup>

As for the degree of certainty the plaintiff must meet, the most sensible rule would permit him to recover if the representation caused him to incur an expenditure he would not have incurred, or prevented him from enjoying a benefit he would have realized, in the normal course.<sup>501</sup> The "normal course" describes a result that was quite likely, even if not certain, to have occurred.<sup>502</sup> The plaintiff is best positioned to demonstrate such a likelihood where the result is one, or is similar to one, that had occurred before. The application of the rule is fact intensive.

The rule should also permit the plaintiff to recover if his loss was foreseeable to the defendant. The standard of foreseeability for assessing consequential damages from breach of contract easily applies to fraud.<sup>503</sup> In both contexts, moreover, the standard furthers the goal of reducing the likelihood of the underlying misconduct.<sup>504</sup> Making such an assessment only for contract law would result in the very type of "arbitrary rule" that the Court of Appeals in *Hotaling v. Leach & Co.* ruled out.<sup>505</sup> The principles for assessing

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499. 124 N.E. 144 (N.Y. 1919).

500. *Damages in Fraud Actions*, *supra* note 132, at 290; *see also* DOBBS, *HANDBOOK* (1973), *supra* note 17, at 602 (discussing the availability of consequential damages for fraud and concluding that "it would seem that so long as the plaintiff's recovery is based on an intentional fraud and nothing else, the tort policy of allowing a broad range of damages, provided they are provided with adequate certainty, should be followed").

501. *See supra* Parts II, V; *infra* Part X.

502. *But see infra* note 513 (addressing the theoretical bases on which the factfinder could fix a recovery of consequential damages by estimating the likelihood that the plaintiff would have enjoyed a given benefit, but for the representation).

503. The Restatement rule is that a plaintiff may recover consequential damages for fraud regardless of which measure of actual damages applies. *See* RESTATEMENT (SECOND) OF TORTS, *supra* note 335, § 549(1)(b).

504. *See, e.g.*, Cunningham, *supra* note 34, at 1425–30 (explaining that for Cardozo, as for Judge Posner, the analysis of foreseeability in both contract and tort law turns on the "prior policy" choice of "whether imposing liability will reduce the likelihood that injuries of the kind at stake will occur in the future").

505. 159 N.E. 870, 873 (N.Y. 1928).

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consequential damages, in turn, are “long-established and precise rules of law.”<sup>506</sup>

The predominant question under contract law, for example, is “the reasonable contemplation of the parties,” considering what they know about the “nature, purpose and particular circumstances of the contract.”<sup>507</sup> Although a contract may not exist in the case of a fraudulent transaction, the evidence of the nature, purpose, and particular circumstances of the transaction may nevertheless satisfy the requirement that consequential damages be capable of proof with reasonable certainty.<sup>508</sup> In many instances, in fact, the circumstances under which the fraud took place will resemble (if not constitute) contract negotiations.

Plaintiffs face a real burden in proving lost profits for fraud; that is no reason to apply a rule presupposing that they could *never* do so. The law should be more nimble. In *Hoeffner v. Orrick, Herington & Sutcliffe LLP*, in fact, the precedent the First Department cited for fraud damages were breach-of-contract cases.<sup>509</sup> Although the issue of lost profits does involve speculation, that fact does not preclude their recovery as a matter of law. The propriety of such damages turns on the evidence.<sup>510</sup>

## 2. Forgone Business Opportunities

A rule precluding a fraud victim from ever recovering the value of forgone business opportunities is not the best policy. This is true in part for the reasons set forth above regarding the prospect of recovering lost profits.<sup>511</sup> Implicit in some of the state decisions is that the plaintiff faces too high a hurdle in proving that he would have secured an alternative opportunity. One can easily construct

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506. *Kenford Co. v. Cty. of Erie*, 493 N.E.2d 234, 235 (N.Y. 1986) (addressing contract law).

507. *Kenford Co. v. Cty. of Erie*, 537 N.E.2d 176, 179 (N.Y. 1989); *see, e.g.*, *Bykowsky v. Eskenazi*, 58 A.D.3d 405, 405 (N.Y. App. Div. 2009); *see also* *Schonfeld v. Hilliard*, 218 F.3d 164, 168–75 (2d Cir. 2000) (summarizing the law of lost profits for breach of contract).

508. *Kenford*, 493 N.E.2d at 235–36.

509. 878 N.Y.S.2d 717, 718 (N.Y. App. Div. 2009) (citing *Lama Holding Co. v. Smith Barney, Inc.*, 668 N.E.2d 1370 (N.Y. 1996); *Kenford*, 493 N.E.2d 234)).

510. *See, e.g.*, *Kenford*, 493 N.E.2d at 179–80 (undertaking a detailed consideration of “the evidence in the record” in assessing claim for lost profits); *Val Tech Holdings, Inc. v. Wilson Manifolds, Inc.*, 119 A.D.3d 1327, 1329 (N.Y. App. Div. 2014) (whether “it could be determined that lost profits were within the contemplation of the parties” raises a triable issue of fact); *see also* *Christians of Cal., Inc. v. Clive Christian N.Y., LLP*, No. 13-cv-275 (KBF), 2014 WL 3407108, at \*3 (S.D.N.Y. July 7, 2014) (finding genuine issues of material fact on claim for lost profits).

511. *See supra* Section IX.E.1.

scenarios, however, in which a plaintiff could convince a reasonable jury that the third-party arrangement would have borne fruit. The facts might be, for example, that contract negotiations with the third party were far along at the time of the fraudulent representation; the third party was prepared to enter into the contract; the plaintiff had executed many such contracts in the recent past; and there were clear benefits he would have received under the terms of the contract. In that circumstance, the jury could reasonably conclude that the plaintiff would have received the benefits in the normal course.

Courts thus go a step too far in intoning that it is inherently speculative and indeterminable for a plaintiff to allege that he forwent an alternative opportunity in reliance on the representation. Whether he would have succeeded in the opportunity, and what benefit he would have enjoyed, are fact-intensive questions. As with lost profits for breach of contract, it is accurate to say that they are inherently speculative, but it does not follow that they are *unrecoverable*. The question should be whether the prospective fruition and value of the forgone opportunity are *unreasonably* speculative.

### 3. Forgone Legal Claims

A rule that precludes a plaintiff from ever recovering damages based on the value of a lawsuit that he forwent in reliance on the fraud is not the best policy. Where the plaintiff proves that he did so in reliance on the misrepresentation, then it is clear that the fraud caused him to lose something of value. The issue is determining that value. That does present a challenge for the factfinder, but hardly an insuperable one. The court in *Urtz v. New York Central & Hudson Railroad Co.* detailed long ago how the jury should go about analyzing the issue.<sup>512</sup> Where the plaintiff can show that he would have probably recovered a given sum (or range of sums) on the underlying claim, he has made the same type of showing that warrants the recovery of lost profits.<sup>513</sup> Where the forgone claim was

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512. 95 N.E. 711, 711–12 (N.Y. 1911); *see supra* Part IV.

513. *See supra* Section IX.C.1. The courts have room for logical creativity here, such as by using basic expected values. If the jury decided that the plaintiff had a sixty percent chance of recovering \$5000 on her forgone legal claim, for example, then the fraud caused her to lose a lawsuit whose expected value was \$3000. The dissent in *Urtz* suggested such an analysis. *See* 95 N.E. at 714 (Vann, J., dissenting) (“A reasonable chance to recover a sum of money has a pecuniary value depending upon the strength of the probability and the plaintiff lost that chance on account of the fraud practiced upon her by the defendant through its dishonest agent.”). With respect to consequential damages in general, the same logic would permit the factfinder to quantify the likelihood that the plaintiff would have

against the fraudster herself, moreover, allowing such damages affords the right weight to the principle that no defendant should be permitted to profit from her fraud, which has “its roots deeply fastened in universal sentiments of justice.”<sup>514</sup>

The balance of considerations here is analogous to the rationales for the law that applies in New York in certain circumstances when evidence has been fraudulently concealed in litigation. Endorsing the law in New Jersey, the First Department has held that under New York law, a distinct claim for fraud exists against such misconduct.<sup>515</sup> In the cited New Jersey decisions, acknowledging that the plaintiff must speculate as to whether he would have prevailed on his lawsuit if the concealed evidence had been produced, the courts nevertheless permit such claims where he would otherwise have no “meaningful remedy” for his damages.<sup>516</sup>

Allowing the plaintiff to prove up his underlying claim with whatever evidence and information about the undisclosed evidence is available (sometimes the evidence itself has been subsequently disclosed) is the way to “even the playing field” and “to make whole, *as nearly as possible*, the litigant whose cause of action has been impaired by the absence of crucial evidence.”<sup>517</sup> In such cases, as should be true of a legal claim forgone for fraud, the imperative is to give the plaintiff a “meaningful remedy”;<sup>518</sup> the “fundamentals of

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earned profits, but for the fraud, and fix an expected-value recovery. *Cf.* JOSEPH M. PERILLO, *CONTRACTS* § 14.10 (6th ed. 2009) (“Value of a Chance or Opportunity”); MCCORMICK, *DAMAGES*, *supra* note 17, at 117–23 (“The Value of a Chance”). Judges and juries might come to find such an approach to be more compelling as the concept of expected values finds greater traction in society.

514. CARDOZO, *supra* note 32, at 41; *see also supra* note 470; *infra* Section IX.E.4 (addressing the principle); RESTATEMENT (THIRD) OF RESTITUTION, *supra* note 341, § 51 cmt. h (citing with approval the proposition that “ordinarily, a person guilty of fraud is not to be allowed profits or benefits derived therefrom in whatever form”) (citation omitted).

515. *See* *IDT Corp. v. Morgan Stanley Dean Witter & Co.*, 63 A.D.3d 583, 587 (N.Y. App. Div. 2009) (“We note that the New Jersey courts, which do not recognize a separate tort action for intentional spoliation, recognize a claim of fraudulent concealment based on the intentional spoliation of evidence. There is no sound reason for New York courts to conclude otherwise.”) (citation omitted and emphasis added). Some courts interpret the decision to permit such a claim only when a fiduciary or third party concealed the evidence. *See, e.g.*, *Landis v. Remington Arms Co.*, No. 8:11-CV-1377, 2012 WL 6098269, at \*5 (N.D.N.Y. Dec. 7, 2012) (fiduciary); *Mohammed v. Delta Airlines, Inc.*, No. 08-CV-1405 (FB) (JMA), 2011 WL 5554269, at \*2 (E.D.N.Y. Nov. 15, 2011) (third party).

516. *Rosenblit v. Zimmerman*, 766 A.2d 749, 758 (N.J. 2001).

517. *Robertet Flavors, Inc. v. Tri-Form Constr., Inc.*, 1 A.3d 658, 671 (N.J. 2010) (emphasis added) (citation omitted).

518. *Rosenblit*, 766 A.2d at 758.

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the underlying litigation” will require exposition;<sup>519</sup> and the remedy “depends on the jury’s assessment of the underlying action.”<sup>520</sup>

#### 4. Disgorgement of Profits

The best policy is to permit a plaintiff to recover the disgorgement of fraudulently obtained profits.<sup>521</sup> New York state courts have reasoned that the prospect of disgorgement removes incentives for trustees and fiduciaries to abuse their positions.<sup>522</sup> The Court of Appeals has supposed that the sole function of a claim for an ordinary tort, in contrast, is “merely to compensate the plaintiff for wrongs committed by the defendant.”<sup>523</sup> The goals of tort law, however, go further.<sup>524</sup> If the court’s observation was ever true of fraud, the modern commentary focused on precluding the fraudster from benefitting from his wrongdoing, and of removing incentives for fraud, compel a reevaluation of the supposition.<sup>525</sup>

In harmony with the recent *Restatement (Third) of Restitution and Unjust Enrichment*, the courts should permit a plaintiff to choose as his recovery the greater of the amount of his loss or the amount of

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519. *Id.*

520. R.L. v. Voytac, 954 A.2d 527, 536 (N.J. App. Div. 2008).

521. Criminal prosecution is the other way for the law to prevent the defendant from securing more than the damages she pays in tort, but that prospect is a matter of prosecutorial discretion and does not bear on whether the tort law *itself* is achieving its goals. These goals overlap with the criminal law and include the disincentives for fraud discussed above—for discouraging “undesirable conduct.” LEO KATZ, *ILL-GOTTEN GAINS: EVASION, BLACKMAIL, FRAUD, AND KINDRED PUZZLES OF THE LAW* 152 (1996); *see also infra* note 544 & accompanying text. R

522. *See* *Diamond v. Oreamuno*, 248 N.E.2d 910, 912 (N.Y. 1969); *Dutton v. Willner*, 52 N.Y. 312, 319 (1873).

523. *Diamond*, 248 N.E.2d at 912.

524. *See* RESTATEMENT (SECOND) OF TORTS, *supra* note 335, § 901 (enumerating four purposes for which tort actions are maintainable). R

525. Cardozo’s jurisprudence suggests he would agree that the goals of tort law should account for the fraudster’s benefit. During his tenure as a New York Supreme Court justice, he addressed the law that applies where a defendant has induced a testator to devise to him property to be used for a particular purpose, concluding that “equity will compel him to apply the property in accordance with the promise by force of which he procured it.” *Golland v. Golland*, 147 N.Y.S. 263, 267–68 (N.Y. Sup. Ct. 1914). Cardozo explained that the principle applies “not merely because there has been a breach of contract, but because the promise has been used as an instrument to induce the promisee to part with his property, so that the retention of it by the promisor in violation of the promise would result in an unjust enrichment and would constitute a fraud.” *Id.* at 268 (emphasis added). Cardozo thus regarded fraud as naturally resulting in the unjust enrichment of the defendant and the courts as empowered to prevent such an outcome.

profit the defendant made through the fraud.<sup>526</sup> The First Department recently cited that Restatement with approval.<sup>527</sup> The policy behind such a result is as well established as it is logical. The principle that no person should be permitted to profit from his fraud is entitled to great weight.<sup>528</sup> The plaintiff could enjoy a “windfall” when the principle is applied, but to honor the principle, some likelihood of such a result is necessary.<sup>529</sup> The incentives should be for people to redress rather than commit fraud.

526. See *supra* Section VII.F; see also EGGERS, *supra* note 9, § 8.79, at 230 (addressing the uncertain English law in this area and surmising that “there must be some cases, which may well be the more unusual case, where a restitutionary remedy is justified to deprive a fraudster of an ill-spirited profit, where the claimant’s loss is relatively slight”). As with actual damages, the plaintiff has the burden of establishing the amount of the unjust enrichment. See RESTATEMENT (THIRD) OF RESTITUTION, *supra* note 341, § 13 cmt. e.

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527. See *People v. Ernst & Young LLP*, 114 A.D.3d 569, 570 (N.Y. App. Div. 2014) (explaining that “the ‘wrongdoer who is deprived of an illicit gain is ideally left in the position he would have occupied had there been no misconduct’”) (quoting RESTATEMENT (THIRD) OF RESTITUTION, *supra* note 341, § 51 cmt. k). This Restatement may eventually lead to a “restitution revival,” Caprice L. Roberts, *The Restitution Revival and the Ghosts of Equity*, 68 WASH. & LEE L. REV. 1027, 1027 (2011), but at least with respect to common law fraud, it has not yet occurred in the New York courts.

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528. See *supra* Section IX.E.3. The principle also raises the question of the precise rationale for the decision in *Corsello v. Verizon New York, Inc.*, 967 N.E.2d 1177, 1185 (N.Y. 2012) (precluding the pursuit of a claim for unjust enrichment where another tort claim applies to the facts). See *supra* Section VII.F. If disgorgement of profits is unavailable for fraud, then at least with respect to the damages sought, a claim for unjust enrichment is not one that “simply duplicates, or replaces, a conventional contract or tort claim.” *Corsello*, 967 N.E.2d at 1185; see, e.g., *State Farm. Mut. Auto Ins. Co. v. Grafman*, No. 04-CV-2609, 2013 WL 1911301, at \*4 n.3 (E.D.N.Y. Jan. 3, 2013) (refusing to consider claims for unjust enrichment because “the damages sought on the unjust enrichment claims are duplicative of those sought on the common law fraud claims”).

529. Contrary to what appears to be the conventional wisdom, see, e.g., Ashika David, *The Problem of State Split-Recovery Statutes: Why Punitive Damages Should Be Taxed as Windfalls*, 68 TAX. LAW. 715, 717 (2015); Kimberly A. Pace, *Recalibrating the Scales of Justice Through National Punitive Damage Reform*, 46 AM. U. L. REV. 1573, 1594 n.93 (1997), there may be no economic windfall to the plaintiff whose attorneys’ fees and costs are unreimbursed, see Owen, *Moral Foundations*, *supra* note 52, at 711–13. This country’s general policy against their recovery should not cloud the sensible argument that attorneys’ fees are an economic burden the defendant’s misconduct has caused. See, e.g., Rowe, *supra* note 367, at 657–59, 668 (concluding that the strongest of the various rationales for fee shifting is that “refusing to award fees denies a wronged party full compensation for his injury”).

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As time may have obscured, the American Law Institute commissioned a number of prominent legal scholars in 1986 to reexamine then contemporary tort law, and their 1991 conclusions included that “[r]easonable attorneys’ fees and other litigation costs should be part of the plaintiff’s damages.” Stephen D. Sugarman, A

As for social welfare, although the Second Circuit has concluded that disgorgement “has the effect of deterring subsequent fraud,”<sup>530</sup> the remedy does not replace punitive damages to that end. Disgorgement imposes a harsher result on the defendant than “simple restitution,” but it is not punitive as such.<sup>531</sup> “If the cheat can anticipate that the worst that can happen is that he shall be called upon to pay back his profit upon the trade, he may be encouraged to defraud.”<sup>532</sup> At the most, disgorgement “removes an incentive for such behavior by refusing to allow the maker of a fraudulent misrepresentation to emerge from the transaction in a more favorable financial position.”<sup>533</sup> Accordingly, the two types of recovery should coexist.<sup>534</sup>

### 5. Punitive Damages

A rule requiring a plaintiff seeking punitive damages to prove to the court that the defendant committed a fraud on the public or acted with some degree of moral culpability beyond that inherent in typical fraud is not the best policy. This subject is also an area ready for reevaluation, where as with actual damages, the Court of Appeals has reasoned that punitive damages are available on grounds of “policy” specific to tort law.<sup>535</sup>

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*Restatement of Torts*, 44 STAN. L. REV. 1163, 1188 (1991) (citing II ALI REPORTERS’ STUDY ON ENTERPRISE RESPONSIBILITY FOR PERSONAL INJURY 315 (1991)). (The ALI’s Executive Council decided not to have the ALI’s members take a formal position on the policy issues addressed in the study.) Unless the plaintiff recovers such fees and costs, the defendant’s disgorgement of profits might not exceed the total economic loss that her fraud effectively imposed on him. *See infra* Section IX.E.4.

530. *SEC v. Cavanagh*, 445 F.3d 105, 117 (2d Cir. 2006).

531. Stephanie R. Hoffer, *Misrepresentation: The Restatement’s Second Mistake*, 2014 U. ILL. L. REV. 115, 152 (2014); *see also Ernst & Young*, 114 A.D.3d at 570 (concluding that since disgorgement leaves the wrongdoer in the position occupied before the fraud, “[n]or would ordering disgorgement be tantamount to an impermissible penalty”).

532. McCormick, *Damages in Actions*, *supra* note 132, at 1055.

533. Hoffer, *supra* note 531, at 152.

534. *See* RESTATEMENT (THIRD) OF RESTITUTION, *supra* note 341, § 51 cmt. k.

535. *Home Ins. Co. v. Am. Home Prods. Corp.*, 550 N.E.2d 930, 934 (N.Y. 1990). Cardozo’s view was likewise that the proper role of tort law, distinct from “public justice,” should include the imposition of punishment. *See Loucks v. Standard Oil Co. of N.Y.*, 120 N.E. 198, 202 (N.Y. 1918) (Cardozo, J.) (“We have no public policy that prohibits exemplary damages or civil penalties. We give them for many wrongs. To exclude all penal actions would be to wipe out the distinction between the penalties of public justice and the remedies of private law.”); *see also* Joseph Eric Oliva, *CPLR 8701: New York Legislature Adopts a Statute Allocating Twenty Percent of Punitive Damage Awards to the State General Fund*, 67 ST. JOHN’S L. REV. 159,

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*The moral foundations of the tort justify punitive damages for fraud.* The moral considerations underpinning fraud claims should guide the recoverable damages.<sup>536</sup> The elemental considerations supporting fraud are centered on the consequences of being dishonest and taking advantage of people for personal, material gain. The bases for impugning such conduct are closer to “certain and timeless” than changeable and relative.<sup>537</sup> The imposition of punitive damages follows from the moral bases that correspond to those underlying the claim of fraud itself.<sup>538</sup> Punitive damages are justified on deontological grounds in that they punish the fraudster retributively in proportion to his misconduct in seeking to secure profit for himself at the victim’s expense.<sup>539</sup> In particular where fraudsters often succeed in hiding their fraud and fraud victims often decline to pursue their claims, punitive damages for fraud are justified on consequentialist grounds in that they are calculated to deter future wrongdoing, to condemn wrongdoers publicly, and to induce plaintiffs to sue wrongdoers—thereby creating “a net benefit for society in general.”<sup>540</sup>

*The goals of tort damages justify punitive damages for fraud.* Furthering two worthy goals of tort damages, punitive damages certify the plaintiff’s right not to suffer lies that profit the defendant at the plaintiff’s expense and proclaim the importance of that right by publicly condemning the defendant.<sup>541</sup> Punitive damages thus vindicate the plaintiff’s “tort right,” the right not to be subject to a tort.<sup>542</sup> Punitive damages punish the fraudster if they require her to

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165 & n.33 (1993) (collecting New York authority addressing the public-policy bases for punitive damages).

536. See EGGERS, *supra* note 9, §§ 1.43–.44, at 16; see also Owen, *Moral Foundations*, *supra* note 52, at 722 (“Integrity in the legal system requires that punitive damages be allowed only in cases where there is adequate moral justification for their assessment, and that they be denied in cases where such justification is absent.”); accord *id.* at 726.

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537. EGGERS, *supra* note 9, § 1.75, at 31; see also *supra* Part II; see, e.g., Renault UK Ltd. v. Fleetpro Tech. Servs. Ltd. [2007] EWHC 2541 (QB), para. 128 (“It does not seem to me that, in relation to matters of dishonesty and its consequences, it is appropriate for the court to adopt any less exacting standards today than those applied . . . nearly 100 years ago.”).

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538. See *supra* Sections II.A, IX.E.

539. See Leventhal & Dickerson, *supra* note 200, at 962–64; Owen, *Moral Foundations*, *supra* note 52, at 707–09.

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540. Owen, *Moral Foundations*, *supra* note 52, at 713–14.

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541. See Owen, *Overview*, *supra* note 200, at 374; Leventhal & Dickerson, *supra* note 200, at 964–68.

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542. Mark A. Geistfeld, *Punitive Damages, Retribution, and Due Process*, 81 S. CAL. L. REV. 263, 293 (2008).

pay an amount that exceeds the value of the benefits she secured through the fraud, imposing disincentives on others who would commit fraud.<sup>543</sup> Society has a strong interest in deterring fraud and in publicly condemning it.<sup>544</sup>

Whether punitive damages in fact deter wrongdoing is an open question.<sup>545</sup> The Court of Appeals appears to have concluded that they do, in particular for fraud.<sup>546</sup> Similarly, a representative law-and-economics perspective is that “one should by no means underestimate the deterrence function of exemplary damages.”<sup>547</sup> Other commentators are more dubious.<sup>548</sup> Even if they do have a deterrent effect, it may be “impossible to know with confidence whether on balance punitive damages will generate too much or too little deterrence of good or bad behavior.”<sup>549</sup> Clearly, however, punitive damages hold the *prospect* of deterrence.

The principal practical question thus reduces to whether any concern for *over*-detering fraud counsels against the availability of punitive damages.<sup>550</sup> The definition of the misconduct for which such damages are available should provide “breathing space that allows persons to make good faith mistakes.”<sup>551</sup> The elements of

543. Owen, *Moral Foundations*, *supra* note 52, at 713–14.

544. As with disgorgement of profits, *see supra* note 521, criminal prosecution of the defendant is the other way for the law to deter and condemn the misconduct, but does not bear on whether the tort law itself is achieving such goals. *See KATZ*, *supra* note 521, at 152; *see also supra* note 535 (addressing Cardozo’s views that the proper role of tort law includes the imposition of punishment where appropriate). Similar reasoning holds true with respect to any objection that the plaintiff may enjoy a windfall recovery. *See, e.g., Walker v. Sheldon*, 179 N.E.2d 497, 501 (N.Y. 1961) (Van Voorhis, J., dissenting) (opining that an “injustice” occurs when the plaintiff obtains a recovery that exceeds his compensatory damages). In addition to mischaracterizing the nature of the plaintiff’s attorneys’ fees and costs, *see supra* note 529, such a case-specific objection “overlooks the important fact that it is the very existence of a prospective windfall that helps to motivate reluctant victims to press their claims and enforce the rules of law.” Owen, *Overview*, *supra* note 200, at 380. Punitive damages thus have a “vital procedural function,” in providing a mechanism that serves to facilitate the realization of the goals of both punitive damages specifically, *id.*, and compensatory awards.

545. *See generally* A. Mitchell Polinsky & Steven Shavell, *Punitive Damages: An Economic Analysis*, 111 HARV. L. REV. 869 (1998) (considering, among other issues, the rational responses to the prospect of punitive damages).

546. *See Walker*, 179 N.E.2d at 498–99.

547. Zhou, *supra* note 485, at 93.

548. *See, e.g., Owen, Overview*, *supra* note 200, at 397 n.122; *see also Owen, Moral Foundations*, *supra* note 52, at 714.

549. Owen, *Overview*, *supra* note 200, at 398.

550. “It will be recalled that (optimal) deterrence is the principal utilitarian objective of punitive damages.” Owen, *Moral Foundations*, *supra* note 52, at 724.

551. *Id.* at 730.

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fraud, however, do not generally present such close-call questions of good faith as whether the defendant breached a duty of care in the course of conducting business or engaging in some other productive undertaking.<sup>552</sup> The net social benefits that could result from *near* fraud—such as intentionally making *nearly* material misstatements or misstatements that the speaker believes *probably* are untrue and that the listener *might* rely upon—seem marginal. The law is not designed to deter “puffery,” in contrast, because the representations are clearly just opinions, or else obviously exaggerated.<sup>553</sup> Without such accommodation in the law, for example, people would have to live without professional wrestling.

*The prospect of punitive damages for fraud is particularly warranted in New York.* The benefit-of-the-bargain measure of damages for fraud serves to punish the defendant and deter similar misconduct; the out-of-pocket measure does not.<sup>554</sup> Granting punitive damages therefore “is another device that may be employed by out-of-pocket jurisdictions to increase the amount of damages recoverable.”<sup>555</sup> Compared to the benefit-of-the-bargain rule, the rule of damages in New York puts more of a burden on the potential victim to take precautions and creates more incentive for committing fraud.<sup>556</sup> The greater prospect of punitive damages changes the calculus for each side, creating more disincentives and less of a burden.

*Common law fraud is a fair basis for punitive damages.* The foundations of both fraud and punitive damages underline that in this context in particular, the legal legitimacy of rules of decision turn

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552. See, e.g., *Developments in the Law—Jury Determination of Punitive Damages*, 110 HARV. L. REV. 1408, 1514–15 (1997) (concluding that the harms resulting from excessive or unprincipled awards of punitive damages include “deterrence of socially desirable activities” and the “removal of useful products from the market”).

553. See, e.g., INST. FOR INFO. LAW & POLICY, N.Y. LAW SCH., PUFFERY IN ADVERTISING (Anthony diFrancesca ed., Apr. 22, 2009), [http://www.nyls.edu/documents/institute\\_for\\_information\\_law\\_and\\_policy/past\\_events7/difrancesca\\_puffery\\_in\\_advertising.pdf](http://www.nyls.edu/documents/institute_for_information_law_and_policy/past_events7/difrancesca_puffery_in_advertising.pdf) (summarizing the Second Circuit law in this area).

554. *Lens*, *supra* note 467, at 273–74; see, e.g., *Toho Bussan Kaisha, Ltd. v. Am. President Lines, Ltd.*, 265 F.2d 418, 421–22 (2d Cir. 1959) (the New York decisions “make it plain that the recovery allowable for fraud is not punitive in nature”).

555. Note, *Measure of Damages for Fraud and Deceit*, 47 VA. L. REV. 1209, 1223 (1961). A modification of the standards for punitive damages for fraud is a less intrusive and more predictable way of modifying the law to account for smaller recoveries than Professor McCormick’s proposal, which was to give the courts the option of applying either the out-of-pocket or benefit-of-the-bargain rule, “as the circumstances of the case may demand.” McCormick, *Damages in Actions*, *supra* note 132, at 1056.

556. See, e.g., *Measure of Damages*, *supra* note 555, at 1211–12; see also Zhou, *supra* note 485, at 99.

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on their moral legitimacy.<sup>557</sup> Courts and commentators commonly observe that fraud evinces a degree of moral turpitude sufficient to warrant the punishment and condemnation that punitive damages impose.<sup>558</sup> Several state statutes, and English precedent, embody the same principle.<sup>559</sup>

Such authority resonates with the more satisfying normative guidelines for punitive damages that scholars have endorsed. A frequent and authoritative commentator in this area, Professor David

557. See Owen, *Moral Foundations*, *supra* note 52, at 706 (opining that “legal legitimacy is largely dependent upon moral legitimacy”). The depth of issues that arise here even further implicates the relationship between law and morality. See generally Kar, *Hart’s Response*, *supra* note 487 (assessing the foundational analyses regarding that relationship). In terms of inclusive legal positivism, as one example, the decision in *Walker v. Sheldon*, 179 N.E.2d 497 (N.Y. 1961), creates an “inclusive rule of recognition” whereby a judge determines the law (whether the fraudster may be liable for punitive damages) on the basis of “moral insight.” Kar, *Hart’s Response*, *supra* note 487, at 419–21. The result of such judicial decision-making may be that a rule precluding a plaintiff from recovering punitive damages for “ordinary” fraud is not a valid legal rule at all, where the distinction lacks “substantive (moral) merit.” *Id.* at 393–400. R

558. See, e.g., LAW OF REMEDIES, *supra* note 8, at 567 (observing with respect to punitive damages: “It is usually not clear from the cases how additional requirements add any better grounds for liability than can be found in the fraud itself, with its deliberate lie and intended or foreseeable harm.”); DOBBS, HANDBOOK (1973), *supra* note 17, at 607 (considering contrary precedent and musing that “one might expect all intentional lies to be treated as morally culpable and hence sufficient foundation for punitive damages”); OLIVER WENDELL HOLMES, JR., THE COMMON LAW 132 (1881) (“Deceit is a notion drawn from the moral world, and in its popular sense distinctly imports wickedness . . . . There is no doubt the typical case, and it is a case of intentional moral wrong.”); see also *Schlaifer Nance & Co. v. Estate of Warhol*, 927 F. Supp. 650, 664 (S.D.N.Y. 1996) (applying *Walker*, 179 N.E.2d 497, but acknowledging that “[i]n some respect, all fraud contains an element of ‘gross, wanton, or willful’ conduct”); Lens, *supra* note 467, at 275 n.231 (collecting cases reaching similar conclusions regarding the nature of fraud); Klass, *supra* note 12, at 451 (“Deception is often also a wrong that warrants public condemnation, punishment, and compensation.”); Ostas, *supra* note 10, at 571 (concluding that “fraud carries strong moral disapprobation”), 580–82 (creating a “hierarchy of law” on moral grounds and concluding that the various forms of fraud “generate a strong sense of moral disapproval”). R

559. Several states declare by statute that punitive damages are available where the defendant committed “fraud,” by making an intentional misrepresentation with the intent to cause injury. See Lens, *supra* note 467, at 275 n.232 (collecting authority); see, e.g., *Peek v. Derry* (1887) 37 Ch 541 at 586 (“It is true that there are different degrees of moral delinquency, but I know of no fraud which will support an action of deceit to which some moral delinquency does not belong.”). For a summary of the English cases making the point that fraud is inherently immoral, see EGGERS, *supra* note 9, § 1.26, at 10–11. “Indeed, it has been said that an action in deceit is the ‘paradigm case’ for an award of exemplary damages.” *Id.* § 8.44, at 213 (quoting *Musca v. Astle Corp.* (1988) 80 ALR 251, 268 (Austl.)). R

G. Owen has concluded that “[p]robably the best of all the conventional liability standards is ‘conscious or reckless disregard of the rights of others,’ for it captures all misconduct that should be punished and, theoretically, no more.”<sup>560</sup> The very elements of common law fraud in New York ensure that such a standard is met.

This authority undercuts the premise in *Walker* that ordinary fraud never warrants punitive damages.<sup>561</sup> Since *Walker*, in fact, the Court of Appeals has summarized the law of punitive damages for torts in a way that captures how ordinary fraud *is* a fair basis for such awards. “Punitive damages are awarded in tort actions ‘[w]here the defendant’s wrongdoing has been intentional and deliberate, and has the character of outrage frequently associated with crime.’”<sup>562</sup> The court has explained that there must be “‘circumstances of aggravation or outrage,’” such as “‘a fraudulent or evil motive on the part of the defendant, or such a conscious and deliberate disregard of the interests of others that the conduct may be called wilful or wanton.’”<sup>563</sup>

The Court of Appeals in *Walker* further missed the mark in seeking but failing to follow the general rule.<sup>564</sup> The consensus remains that punitive damages are available for what the court seemed to regard as ordinary fraud.<sup>565</sup> Punitive damages are available for torts like fraud because of the criminal aspect—because the defendant intentionally or recklessly committed wrongdoing.<sup>566</sup>

Perhaps *Walker* turned on unstated premises, such that ordinary fraud is commonplace. Such a reality of human interaction, however, would counsel in favor of applying tort law to *deter* such

560. Owen, *Moral Foundations*, *supra* note 52, at 728 (citation omitted).

561. 179 N.E.2d at 498–99.

562. *Prozeralik v. Capital Cities Commc’ns, Inc.*, 626 N.E.2d 34, 41–42 (N.Y. 1993) (quoting WILLIAM LLOYD PROSSER ET AL., PROSSER AND KEETON ON TORTS § 2, at 9 (5th ed. 1984)).

563. *Id.* at 42 (quoting PROSSER ET AL., *supra* note 562, § 2, at 9).

564. 179 N.E.2d at 498–99; *see also supra* Section IX.A.

565. *See, e.g.*, RESTATEMENT (SECOND) OF TORTS, *supra* note 335, § 908 cmt. b (punitive damages are awarded to punish acts “done with an evil motive or because they are done with reckless indifference to the rights of others”); THOMAS J. COLLIN, PUNITIVE DAMAGES AND BUSINESS TORTS: A PRACTITIONER’S HANDBOOK 45–46 (1998) (discussing when punitive damages may be available in cases of fraud).

566. *See* Heidi M. Hurd, *Justification and Excuse, Wrongdoing and Culpability*, 74 NOTRE DAME L. REV. 1551, 1560 (1999); *see also* KATZ, *supra* note 521, at 203, 275 n.27 (concluding that in comparison to criminal law, the “tort law does seem like a far more utilitarian enterprise, principally designed to minimize the amount of harm done,” but that “when the gap between penal desert and tort damages becomes too large, we often become queasy and seek to ‘criminalize’ the tort law by introducing punitive damages”).

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misconduct, even arising out of recklessness.<sup>567</sup> The law should aim to “influence people’s decisions” in the right direction.<sup>568</sup> Another unstated premise might have been that private fraud is not a serious social problem. On consequentialist grounds alone, however, preventing a multitude of private frauds is as morally compelling as preventing a few public or egregious ones. Analogous to the “broken windows” theory in criminology, such prevention may amount to a greater benefit to social welfare.<sup>569</sup>

In sum, under our “best moral theory,” on Professor Heidi M. Hurd’s cogent four-category hierarchy of culpable/nonculpable and wrong/justified actions, fraud presumptively qualifies as culpable wrong action.<sup>570</sup> This is not to say that all fraud warrants the same level of punishment or condemnation or that the jury *must* impose punitive damages.<sup>571</sup> Petty fraud in the criminal law has its

567. As an overarching policy of tort law, “we want to strengthen potential tortfeasors’ incentives to take care.” Eric A. Posner, *Fault in Contract Law*, 107 MICH. L. REV. 1431, 1444 (2009).

568. Anthony D’Amato, *A New (and Better) Interpretation of Holmes’s Prediction Theory of Law* 7 (Northwestern University School of Law Faculty Working Papers 2008), available at <http://scholarlycommons.law.northwestern.edu/facultyworkingpapers/163>. In plain terms: “The law does pretty well if it can induce its citizens to keep their moral obligations, to observe the social minimum of living together.” Moore, *supra* note 34, at 1550.

569. George Kelling & James Q. Wilson, *Broken Windows*, ATLANTIC MONTHLY (Mar. 1982), <http://www.theatlantic.com/magazine/archive/1982/03/broken-windows/304465/>. The analogy is that if the law leaves smaller frauds “untended,” *id.*, then larger frauds are more likely to follow. See, e.g., Mary Jo White, Chair, Sec. & Exch. Comm’n, Remarks at the Securities Enforcement Forum (Oct. 9, 2013), [http://www.sec.gov/News/Speech/Detail/Speech/1370539872100#\\_ftn1](http://www.sec.gov/News/Speech/Detail/Speech/1370539872100#_ftn1) (explaining the SEC’s adoption of broken-windows theory, on the premises that “minor violations that are overlooked or ignored can feed bigger ones, and, perhaps more importantly, can foster a culture where laws are increasingly treated as toothless guidelines”); cf. MATHIEU LEFEBVRE ET AL., TAX EVASION, WELFARE FRAUD, AND “THE BROKEN WINDOWS” EFFECT: AN EXPERIMENT IN BELGIUM, FRANCE AND THE NETHERLANDS (Mar. 2011), <http://ftp.iza.org/dp5609.pdf> (concluding from a series of experiments conducted in Belgium, France, and the Netherlands that, among other results, where subjects are given examples of other individuals’ low compliance with the tax laws, they are more likely to engage in tax evasion themselves). But see Alexis Goldstein, *Why Is a Wall Street Regulator Embracing “Broken Windows” Theory?*, BULL MARKET (Nov. 20, 2014), <https://medium.com/bull-market/why-is-a-wall-street-regulator-embracing-broken-windows-theory-85f7ba5370f0#.s04fkpkrq> (criticizing the SEC’s broken-windows strategy on several grounds, including that “since its emergence, the theory has never been empirically verified”).

570. Hurd, *supra* note 566, at 1560.

571. British scholar Peter MacDonald Eggers concludes that English common law has developed to the point where moral conduct may nevertheless qualify as fraud. He focuses on possibilities such as the fraudster’s good-hearted motive. See EGGERS, *supra* note 9, §§ 1.79–.80, at 32–33, § 1.86, at 35, §§ 2.13–.14, at 41,

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analog in tort law. As the tort typically is defined (as in New York), however, the defendant must have possessed the intent to profit himself at the plaintiff's expense and have induced the plaintiff reasonably to rely on a misrepresentation. To say "as a matter of law" that such misconduct warrants no punishment or condemnation, signifying that society has no interest in deterring such planning, evinces an unconvincing conception of the role of such law.

*The determination and amount of punitive damages are for the jury.* Whether the defendant's conduct is sufficiently immoral to warrant punitive damages, and in what amounts, are questions better suited for juries than judges.<sup>572</sup> The imposition of punitive damages "publicly reaffirms society's commitment to maintaining its moral and legal standards."<sup>573</sup> The Court of Appeals has repeatedly observed that punitive damages "may be considered expressive of the community attitude" toward the defendant.<sup>574</sup>

The notion that a given judge shares the moral views of the community is questionable.<sup>575</sup> The chances are better that a jury's collective view will more closely reflect the community's perspective.<sup>576</sup> The decision in *Howard S. v Lillian S.*, concerning the wife's decision to hide the paternity of the child she conceived in adul-

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§§ 2.31–.35, at 46–48, §§ 2.41–.46, at 50–53, § 2.77, at 64, § 5.57, at 140. His analysis turns on the proposition that under English law, the defendant's motive is "irrelevant to the cause of action itself." *Id.* § 5.32, at 130. He regards that fact as morally dubious. *Id.* § 5.33, at 131. Whatever his broader intent, however, the defendant has caused harm for which the tort law makes compensation a goal. Eggers's concerns carry more force as regards the prospect of punishing or seeking to deter any good-hearted fraud. Juries in New York, as addressed below, should take account of such motives in considering the imposition of punitive damages.

572. "Whether to award punitive damages and the determination of the amount are within the sound discretion of the trier of fact." RESTATEMENT (SECOND) OF TORTS, *supra* note 335, § 908 cmt. d. See generally Theodore Eisenberg & Michael Heise, *Judge-Jury Difference in Punitive Damage Awards: Who Listens to the Supreme Court*, 8 J. EMPIRICAL LEGAL STUD. 325, 326–27 (2011) (summarizing the competing perspectives on whether the judge or jury should award punitive damages); Lisa M. Sharkey, Comment, *Judge or Jury: Who Should Assess Punitive Damages?*, 64 U. CIN. L. REV. 1089, 1127–36 (1996) (same).

573. Owen, Overview, *supra* note 200, at 375.

574. *Thoreson v. Penthouse Int'l*, 606 N.E.2d 1369, 1371 (N.Y. 1992); *accord* *Home Ins. Co. v. Am. Home Prods.*, 550 N.E.2d 930, 934 (N.Y. 1990); *Toomey v. Farley*, 138 N.E.2d 221, 228 (N.Y. 1956).

575. EGGERS, *supra* note 9, § 2.8, at 38–39; cf. Alan H. Scheiner, *Judicial Assessment of Punitive Damages, the Seventh Amendment, and the Politics of Jury Power*, 91 COLUM. L. REV. 142, 173 (1991) (concluding that judges are no better than juries at making moral judgments).

576. Scheiner, *supra* note 575, at 171–73, 188–89.

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tery, may be an example.<sup>577</sup> In one federal decision, as another example, the court cited several instances of fraud that courts had decided as a matter of law did not warrant punitive damages.<sup>578</sup> Reasonable people could disagree and conclude in each instance that the defendant engaged in behavior that society has a strong interest in deterring.

Just as fundamentally, arrogating to the jury the analysis of punitive damages recognizes the importance of “empirical desert” to a tort as closely tied to morality, and to the criminal law, as common law fraud.<sup>579</sup> Calling to mind Cardozo’s allusions to customary morality, such desert concerns “the shared intuitions of justice of the community” that the law is to govern.<sup>580</sup> The rationale for giving such intuitions particular weight in fixing liability in the law (as opposed to many formulations of moral philosophy) is “utility of desert.”<sup>581</sup> This is the notion that “strong arguments suggest greater utility in a distribution based on shared intuitions of justice than in a distribution based upon optimizing deterrence.”<sup>582</sup>

The core ideas of empirical desert are that “deviating from a community’s intuitions of justice inspires resistance and subversion among participants”; that punishment is effective only if it serves “to stigmatize” wrongdoers; that “the system’s ability to stigmatize depends upon it having moral credibility with the community,” in that “the law must have earned a reputation for accurately assessing what violations do and do not deserve moral condemnation”; and that “[I]iability and punishment rules that deviate from a community’s shared intuitions of justice undercut this reputation.”<sup>583</sup> If the rules of decision have been modified to increase the likelihood of higher recoveries for compensatory damages, then deferring to the jury’s shared intuitions of justice in awarding any punitive damages rounds out the law of recoveries for fraud as turning on a balance of analytic and customary conceptions of morality.

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577. 876 N.Y.S.2d 351 (N.Y. App. Div. 2009), *aff’d*, 928 N.E.2d 399 (N.Y. 2010); *see supra* Section IX.C.2.

578. *See Schlaifer*, 927 F. Supp. at 664–65.

579. Paul H. Robinson, *The Role of Moral Philosophers in the Competition Between Deontological and Empirical Desert*, in *WHY PUNISH? HOW MUCH? A READER OF PUNISHMENT* 283 (Michael Tonry ed. 2011).

580. *Id.* at 284. Addressing social welfare, Cardozo also alluded generally to “adherence to the standards of right conduct, which find expression in the *mores* of the community.” *CARDOZO*, *supra* note 32, at 72.

581. Robinson, *supra* note 579, at 286.

582. *Id.*

583. *Id.* at 286–87.

Similarly, affording such discretion to the jury would deflect the criticism that as judge-made law, the common law tends to operate in an “undemocratic” way.<sup>584</sup> That prospect is ingrained, given what judges do. Keeping juries relevant, however, is a worthwhile balance against the judicial role in a democratic society.<sup>585</sup> Deferring to the jury’s judgment on punitive damages would also cohere with the way juries determine whether a defendant has made a fraudulent statement at all—by considering the “social norms that govern the meaning and veracity of speech acts,” not by employing any particular legal rules or interpretive guidelines of the sort that govern issues such as contract interpretation.<sup>586</sup>

*Sensible principles exist for fixing the amount of punitive damages.* The *amount* of punitive damages should also be justifiable on moral grounds.<sup>587</sup> The courts can reify this idea as evidentiary footholds for the jury, improving on the arid considerations typically recited.<sup>588</sup> Reflecting the jury’s additional fact-finding following its resolution of liability, and the court’s assessment of whether certain evidence is unduly prejudicial, the jury might consider:

- The plaintiff’s reasonable litigation costs and attorneys’ fees. This measure imposes just deserts on the defendant and takes better account of the plaintiff’s losses,<sup>589</sup> and “it is

584. Steilen, *supra* note 6, at 437; *see also* Maxeiner, *supra* note 4, at 201 (“No one ever voted for common law.”); Robert J. Ridge, *Beyond Judging: Considering the Critical Role of Non-Judicial Actors to a Functioning Legal System*, 25 J. JURIS. 9, 11, 21 (2015) (proposing that “the most essential elements” of the U.S. justice system are “democracy-promoting components” such as juries, and that “an ordinary citizen’s respect for legal processes and her fidelity to law is, at least in the American judicial process, a function of the operation of the process through juries and other mechanisms of citizen participation”).

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585. *See* Steilen, *supra* note 6, at 438.

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586. Klass, *supra* note 12, at 453–60; *see also* Scheiner, *supra* note 575, at 187–89 (concluding that jurors establish norms and reflect community values in determining liability, and would do the same in determining punitive damages).

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587. Owen, *Moral Foundations*, *supra* note 52, at 731.

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588. “In assessing punitive damages, the trier of fact can properly consider the character of the defendant’s act, the nature and extent of the harm to plaintiff that the defendant has caused or intended to cause and the wealth of the defendant.” RESTATEMENT (SECOND) OF TORTS, *supra* note 335, § 908(2). As one frequent commentator on punitive damages notes, “a more vague basis for measurement could hardly be devised.” Owen, *Moral Foundations*, *supra* note 52, at 731. The New York Pattern Jury Instructions flesh out certain considerations for assessing the defendant’s motives and the character of his wrongdoing, but with the exception of the amount of the plaintiff’s loss, they are similarly short on concrete guideposts. *See* N.Y. PATTERN JURY INSTRUCTIONS – CIVIL § 2:278 (2014).

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589. Owen, *Moral Foundations*, *supra* note 52, at 711–13; *see also supra* notes 529 & 544. For two years in the early 1990s, New York law provided that twenty

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through the attorney’s efforts that the general public has benefitted by the jury’s action.”<sup>590</sup>

- The economic benefits the defendant intended to secure,<sup>591</sup> and did secure,<sup>592</sup> through the fraud. These measures would be deterrent and would turn on particularly palpable evidence of the defendant’s motive.
- The bargain the plaintiff reasonably expected. Where the amount of that bargain exceeds the compensatory damages or disgorged profits, basing punitive damages on this measure would punish the defendant<sup>593</sup> and would stand to deter similar misconduct in a concrete way that prospective fraudsters could foresee.
- The chance the defendant thought he would get caught. This metric vindicates the tort right (the right not to be subject to a tort) of both the plaintiff and the many others who could be harmed if people are undeterred from pursuing the same misconduct.<sup>594</sup>

percent of any recovery of punitive damages would go to a state general fund. *See* Oliva, *supra* note 535, at 159–66. The law further provided that the jury should consider such costs and fees in deciding on the amount of punitive damages. *See* N.Y. C.P.L.R. 8703 (McKINNEY 1992) (deemed repealed in 1994). Attorneys’ fees have been considered a proper element of punitive damages in many states. *See* J.L. Litwin, *Attorneys’ Fees or Other Expenses of Litigation as Element in Measuring Exemplary or Punitive Damages*, Annotation, 30 A.L.R.3d 1443 (1970). Underscoring that such fees are only one factor, however, “the amount of an adversary’s legal fee often will not provide the full or optimal measure of deterrence and punishment.” Rowe, *supra* note 367, at 661.

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590. Justice Janie L. Shores, *A Suggestion for Limited Tort Reform: Allocation of Punitive Damage Awards to Eliminate Windfalls*, 44 ALA. L. REV. 61, 92 (1992).

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591. Geistfeld, *supra* note 542, at 271-72 (explaining with respect to the plaintiff’s tort right that “disgorgement of the wrongful gains the defendant expected to derive by violating the right” is “an outcome consistent with the deterrence rationale for a punitive award”).

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592. *See supra* Section IX.E.4; *see, e.g.*, EGGERS, *supra* note 9, § 8.44, at 213 (concluding that exemplary damages may be particularly warranted where the defendant intended to make a profit for himself that exceeds compensatory damages).

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593. Lens, *supra* note 467, at 232, 271–77; Geistfeld, *supra* note 542, at 271.

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594. Geistfeld, *supra* note 542, at 293–95. The evidence in some cases might not permit the juries to make the assessment, but the concept (simplified from Professor Geistfeld’s analysis) is that giving weight to the plaintiff’s tort right and the tort rights of others requires the defendant to pay a multiple of the damage his misconduct caused the plaintiff. In terms of the nitty-gritty math, if the defendant thought there was a one-in-ten chance of getting caught, then an award of ten times the plaintiff’s actual damages is what “vindication of an individual tort right requires the defendant to incur.” *Id.* at 294. The amount is “equivalent to ten fully compensatory awards to ten similarly situated victims.” *Id.* at 295. In that way,

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- Whether and in what amount criminal sanctions have already been imposed. This bears on the jury's assessment of whether further punishment or deterrence is warranted.<sup>595</sup>
- Whether the defendant committed a similar fraud in the past and, if it was discovered and he was found liable for it, whether he paid any punitive damages.<sup>596</sup>

The courts may also consider these guidelines in assessing the reasonableness of the award, in addition to using the constitutional limits on the ratio of punitive damages to actual damages to control any excessive awards.<sup>597</sup> In many cases, in fact, the guidelines would serve to frame the evidence so as to minimize the chance of a disproportionately high award. The long view, however, suggests that most jury-awarded punitive damages are reasonable in size.<sup>598</sup>

These considerations would increase the likelihood of awards moored to the moral considerations compelling punitive damages and facilitate the jury's difficult task of calculating an appropriate amount. This approach would thus also address the Second Circuit's disconcerting conclusions that awards of punitive damages *inevitably* are "arbitrary," turning on "intangibles" that jurors must attempt to quantify with "no objective standards to guide them."<sup>599</sup> The law here need not operate so loosely.

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"[v]indication of the individual tort right can straightforwardly account for harms to nonparties." *Id.*

595. See MCCORMICK, DAMAGES, *supra* note 17, at 292–93.

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596. Jeremy C. Baron, Comment, *The "Monstrous Heresy" of Punitive Damages: A Comparison to the Death Penalty and Suggestions for Reform*, 159 U. PA. L. REV. 853, 859, 884–85 (2011). This guideline would account for the frequency with which fraud goes unredressed, *see supra* Sections II.A, IX.E, and for deterrence. By way of comparison, New York statutory law permits the state's attorney general to enjoin and direct "restitution" from any person who has engaged "in repeated fraudulent or illegal acts" or who has otherwise demonstrated "persistent fraud or illegality in the carrying on, conducting or transaction of business." N.Y. Exec. Law § 63(12). The courts interpret the statute to permit the attorney general to order disgorgement of the person's profits. *See, e.g.*, *People v. Trump Entrepreneur Initiative LLC*, 26 N.Y.S.3d 66, 70–72 (N.Y. App. Div. 2016).

597. *See, e.g.*, Geistfeld, *supra* note 542, at 284–96.

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598. "[I]t is now generally understood that the bulk of punitive damages awards have been reasonably sober, modest in size, and relatively stable over time." Eisenberg & Heise, *supra* note 572, at 325.

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599. *Payne v. Jones*, 711 F.3d 85, 93–94 (2d Cir. 2012); *see, e.g.*, *BMW of N. Am., Inc. v. Gore*, 517 U.S. 559, 605–06 (1996) (Scalia, J., dissenting) (lamenting the lack of any firm guidelines for awarding punitive damages).

## 6. The Wrongdoer Rule

Any rule that fails to afford the plaintiff some leniency in proving the damages the fraud has caused is not the best policy. The wrongdoer rule does not free the plaintiff from showing that she has suffered damages; it speaks only to the precision in the amount. With respect to social welfare, the rule is another way to increase the deterrence of fraud.<sup>600</sup> With respect to coherence, the modern courts in New York have regularly applied the wrongdoer rule in cases of breach of contract.<sup>601</sup> As with lost profits, it should follow *a fortiori* that the wrongdoer rule apply in cases of fraud.

The authority the U.S. Supreme Court has cited explains how the wrongdoer rule applies forcefully in claims sounding in tort. The premise is that “the constant tendency of the courts is to find some way in which damages can be awarded where a wrong has been done.”<sup>602</sup> Under contract law, for which the New York courts nevertheless apply the wrongdoer rule, the parties (a) have consented to their respective rights; (b) are in a position to estimate their own damages in the contract itself; (c) have thus assumed the risk of uncertainty in calculating damages for breach; and (d) have agreed to terms that provide a means for assessing the range of prospective damages in the contemplation of the parties.<sup>603</sup>

None of these considerations bears on a typical tort action. Applied to fraud, the principles would be that (a) the injured party has not consented to the defendant’s actions; (b) the wrongdoer has not given any consideration for his fraudulent representation; (c) without the requisite knowledge, the injured party had no impetus to protect herself by contract against any uncertainty in damages she might suffer; and of course (d) she has not consented that the wrongdoer might harm her rights.<sup>604</sup> At bottom, to relieve wrongdoers of liability for uncertainty in damages calculations would be incompatible with “every principle of justice” and would tend to encourage torts.<sup>605</sup>

With respect to justice, moreover, the reasons the courts cited for such leniency in the nineteenth century were compelling

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600. *See supra* Sections IX.E.4–5.

601. *See supra* Section VI.D.3.

602. *Story Parchment Co. v. Paterson Parchment Paper Co.*, 282 U.S. 555, 563–66 (1931) (quoting *Straus v. Victor Talking Mach. Co.*, 297 F. 791, 802 (2d Cir. 1924) (examining *Allison v. Chandler*, 11 Mich. 542, 1863 WL 1202, at \*5–7 (1863))).

603. *Allison*, 1863 WL at \*5–6.

604. *See id.* at \*6.

605. *Id.*

ones—that it was the defendant’s deliberate wrongdoing that put the plaintiff to the task in the first place, and that the courts should not apply a standard so exacting that it permits the wrongdoer to escape liability altogether.<sup>606</sup> The U.S. Supreme Court has set forth such rationales in even sharper terms, explaining that “it would be a perversion of fundamental principles of justice to deny all relief to the injured person, and thereby relieve the wrongdoer from making any amend for his acts”;<sup>607</sup> that “‘justice and sound public policy alike’” require the defendant to “bear the risk of the uncertainty”;<sup>608</sup> and that such doctrine turns on the “most elementary conceptions of justice and public policy.”<sup>609</sup> A fraudster has committed a moral wrong of some weight; where reasonably possible, the tort law should not allow him to get away with it.<sup>610</sup>

## X. BACK WHERE WE STARTED

Considering the origins of American common law and this analysis of New York jurisprudence, one might ask what damages are recoverable for fraud under English common law today. “A fundamental idea that underlies, often quite explicitly, much of the work of doctrinal scholars is that the common law is some kind of single unified system, such that solutions reached in one legal system should be largely the same as those in others.”<sup>611</sup> The idea “is not treated merely as a reflection of common historical origin, but as a fact of normative significance such that divergences between common law jurisdictions are thought to be a cause for concern.”<sup>612</sup>

The residual relevance of contemporary English common law in America today, however, is thin. “[D]ivergences between English law and American law are not considered a cause for alarm in the way that divergences between English and Australian or Canadian courts are.”<sup>613</sup> The fact is that “American cases rarely cite foreign materials. Courts occasionally cite a British classic or two, a famous old case, or a nod to Blackstone; but current British law almost

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606. *See supra* Section VI.D.3.

607. *Story Parchment*, 282 U.S. at 563.

608. *Id.* at 565 (quoting *Gilbert v. Kennedy*, 22 Mich. 117, 131 (1871)).

609. *Bigelow v. RKO Pictures, Inc.*, 327 U.S. 251, 265 (1946).

610. *See supra* Section VI.D.3.

611. Dan Priel, *The Law and Politics of Unjust Enrichment* 23 (COMP. RES. IN L. & POL. ECON. Research Paper No. 15, Mar. 15, 2013), [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=2234202](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2234202).

612. *Id.*

613. *Id.*

never gets any mention.”<sup>614</sup> The observation holds true in the Court of Appeals.<sup>615</sup> So the court may be disinclined to consider English precedent in this area, but that law does color two central aspects of the New York law of damages for fraud.<sup>616</sup>

First, although a loss is unrecoverable for breach of contract if the defendant could not have foreseen it, that rule does *not* apply in cases of fraud: “The defendant is bound to make reparation for all of the actual damages directly flowing from the fraudulent inducement . . . . All such damages can be recovered; and it does not lie in the mouth of the fraudulent person to say that they could not reasonably have been foreseen.”<sup>617</sup> That rule remains the law.<sup>618</sup> It is the one described in the treatise that the court in *Jeffrey v. Bigelow & Tracy* cited in 1835 in explaining that the plaintiff was entitled to recover for his diseased sheep,<sup>619</sup> and that the court in *Sharon v. Mosher* endorsed decades later.<sup>620</sup>

Second, contrary to New York law in many (if not most) decisions, fraud victims may recover lost profits on forgone business opportunities.<sup>621</sup> The propriety of lost profits on such an “alternative

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614. FRIEDMAN, *supra* note 220, at 575.

615. “Ever since Benjamin Cardozo left Albany for the U.S. Supreme Court, the New York Court of Appeals has generally cited few British cases. In addition, there has been absolutely no interest in contemporary British opinions.” Manz, *supra* note 281, at 1279 (citation omitted). In 1999 and 2000, for example, the court’s opinions contained “a combined total of only three citations to British opinions, all from the eighteenth or nineteenth century.” *Id.* at 1280.

616. On that point, Cardozo’s jurisprudence again is illuminating. On the Court of Appeals, he addressed the rule that a “tort committed in one state creates a right of action that may be sued upon in another unless public policy forbids.” *Loucks v. Standard Oil Co. of N.Y.*, 120 N.E. 198, 200 (N.Y. 1918). Considering the appropriate scope of the rule, he began by observing that such a rule does not apply in every jurisdiction where common law prevails and that the rule in England is different, but satisfied himself that the “wisdom of the departure” between English law and New York law was sound. *Id.*; *see also* *Sinclair v. Purdy*, 139 N.E. 255, 258 (N.Y. 1923) (Cardozo, J.) (considering the rule in contracts that “a description that might otherwise be indefinite becomes definite and adequate when applied to the only subject-matter that can reasonably fit it” and noting that “[m]any cases, both in England and in our own country, enforce the same distinction”).

617. *Doyle v. Olby* (1969) 2 QB 158 at 167.

618. *See, e.g.*, EGGERS, *supra* note 9, § 8.10, at 195 (summarizing English law).

619. 13 Wend. 518, 523–24 (N.Y. Sup. Ct. 1835).

620. 17 Barb. 518, 522 (N.Y. Gen. Term 1854); *see also supra* Section II.B.1 (addressing *Jeffrey*, 13 Wend. 518, and *Sharon*).

621. *See, e.g.*, *East v. Maurer* (1991) 1 WLR 461 (the foundational precedent in this area). The decision “shows that an award based on the hypothetical profitable business in which the plaintiff would have engaged but for deceit is permissi-

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course of action” also remains the law.<sup>622</sup> Similarly, contrary to several vague rules of decision in New York, English common law permits the plaintiff to recover damages where he has been “induced by the defendant’s fraud to give up a valuable right.”<sup>623</sup>

Such law is designed for deterrence.<sup>624</sup> “[T]he courts have developed the law of deceit with the object of deterring other or future frauds. The remedies for fraud are often penal. The courts have not shied away from emphasizing the deterrent nature of the remedies for deceit.”<sup>625</sup> These characteristics of the English common law of fraud so differ from the corresponding features of New York law that one must ask which is better—as this Article has done.<sup>626</sup> Once again invoking the rule in England may be in order.

### CONCLUSION

Although the task might seem elusive, even idealistic, we can use well-founded criteria to evaluate whether an area of jurisprudence amounts to good common law. Benjamin Cardozo’s classic description of the judicial process, interweaving modern inquiry to maintain robust policy, provides the framework. From that perspective, the New York common law of fraud damages leaves significant room for rigor. The current common law in England, developed in parallel since the New York courts last looked to English precedent for guidance, reflects sounder and more forceful policy. One could similarly evaluate any given area of American common law and thus invigorate such law in line with Cardozo’s legacy.

A cove premise of the common law, however, is the certainty and predictability in its application. A final fundamental question thus arises. Where a given body of jurisprudence does not amount to good common law, what is the net balance of social costs and

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ble: it is a classic consequential loss.” *Smith New Court Ltd. v. Srimgeour Vickers (Asset Mgmt.) Ltd.* (1996) 3 WLR 1051.

622. *See, e.g.,* EGGERS, *supra* note 9, §§ 8.16–.21, at 197–201.

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623. *Id.* § 8.21, at 201.

624. *See supra* Section IX.E; *see, e.g.,* Qi Zhou, *A Deterrence Perspective on Damages for Fraudulent Misrepresentation*, 19 J. INTERDISC. ECON. 83, 91–92 (2007) (explaining the deterrence effect of these aspects of modern English common law).

625. EGGERS, *supra* note 9, § 1.35, at 13–14.

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626. Underscoring the challenges the courts face in striking the right balance in this area, Eggers concludes that too often English courts have expressed moral indignation at “any attempt at deception,” making the tort of deceit too penal on moral grounds with respect to “non-fraudulent cases of misrepresentation.” *Id.* §§ 1.74–.78, at 30–32. The elements of fraud under New York common law, and the guidelines suggested above for juries to assess punitive damages, strongly mitigate against such concerns.

benefits in changing the law? Where changes might apply retroactively, Cardozo concludes that whether to invite the result should be determined “not by metaphysical conceptions of the nature of judge-made law . . . but by considerations of convenience, of utility, and of the deepest sentiments of justice.”<sup>627</sup>

The question of competing costs and benefits is more trenchant with respect to certain claims than others. Under contract law, for example, the parties have ordered their transactions on the rules of decision at the time of contracting. In altering the law, the courts would be affecting the enforcement of agreements to the detriment of many parties in a way that would be unfair where they were not acting immorally in entering into the contracts. The prediction of net benefits in reworking the law would have to incorporate a long-term outlook, looking past the arguably unjust consequences for the negatively affected parties who contracted under the old law.

The courts would not present such concerns, however, in expanding the recoveries for common law fraud. Where fraudulent behavior is immoral and a waste of resources, there are no significant social costs in modifying the law to operate more to the detriment of fraudsters. The reasons the precedent in a given area may not amount to good common law, moreover, may include that the courts have left fundamental issues unaddressed, that the rules of decision are unclear and inconsistent, and that they fail to cohere with each other and with rules of decision in other areas.<sup>628</sup> In critical respects, the law of fraud damages in New York suffers from such flaws. Accordingly, fraudsters would not suffer injustice by confronting greater financial liability than they did when they committed the fraud.

If their premises hold true, changes in the law would both increase the likelihood that victims of fraud bring suit and reduce the frequency of fraud. Any increased burden on the courts would therefore be marginal. Accordingly, even in the near term—and mounting in the long run—net benefits would follow from advancing the law in the ways that this Article proposes. Time and study would tell. We may never finish exploring Cardozo’s changeable land of mystery, but it falls on us to try.

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627. CARDOZO, *supra* note 32, at 148–49.

628. *See supra* Part IX.