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Finding liability arising out of business dealings in the absence of a contract

Without a written contract, a business litigator must look for other claims; promissory fraud and/or breach of fiduciary duty can be fertile ground to build a case for fraud in many business deals

Whenever a potential client calls about a business dealing gone bad, the first question typically must be whether there was a written contract. Frequently there will be no contract – or at least not one in writing – and lawyers must look for claims that might exist in the absence of a written agreement. The obvious claims that might apply are breach of oral contract and promissory estoppel. There are also traditional claims of fraud where specific facts have been misrepresented. But there are two other claims that may apply that attorneys should consider when performing their analysis – promissory fraud and breach of fiduciary duty. The purpose of this article is to identify some of the techniques worth employing in building your case.

Promissory fraud

This is just a formal way of saying "false promise." A false promise claim is based on Cal. Civil Code section 1710, which lists the four types of statutory deceit. The fourth type relates to a false promise, which is defined as "a promise, made without any intention of performing it." In essence, then, this cause of action is distinguished from a normal breach of contact claim in that the person making the promise, at the time it was made, had no intention of keeping it. In comparison, where someone represents that they intend to do something in the future, and at the time, have a good faith belief that they will in fact do what was promised, if that promise is later not kept, there is no false promise under § 1710. (See e.g., *Church of Merciful Saviour v. Volunteers of America* (1960) 184 Cal.App.2d 851, 859 [no fraud where, at time of statement, defendant intended to perform promise and actually made efforts to carry it out]; *Edmunds v. Valley Circle Estates* (1993) 16 Cal.App.4th 1290, 1301 [no fraud where breach of promise not to sell lots to third parties evolved naturally due to changed circumstances]; *Magpali v. Farmers Group* (1996) 48 Cal.App.4th 471, 480 [promise not to interfere with plaintiff's insurance business was true when made, as evidenced by its being kept for many years, and was not basis for fraud, even though subsequent events made it necessary for defendant to interfere].)

CACI 1902 identifies the eight elements of proving a false promise as follows: (1) that defendant made a promise to plaintiff; (2) that this promise was important to the transaction; (3) that defendant did not intend to perform this promise when made; (4) that defendant intended that plaintiff rely on this promise; (5) that plaintiff reasonably relied on the defendant's promise; (6) that defendant did not perform the promised act; (7) that plaintiff was harmed; and (8) that plaintiff's reliance on defendant's promise was a substantial factor in causing the harm.

In a nutshell, one should note that proving a person's intention is usually a difficult task. Of course, you should first look for any direct evidence of a false promise. Obtaining a defendant's e-mails or text messages sent at the time of a transaction might be a gold mine, for example. Keep in mind the new California electronic discovery statutes that permit you to seek electronic data as a matter of course. (See Cal. Code Civ. Proc., §§ 2031.010 through 2031.060.) Other avenues include interviewing business partners, co-workers, and even friends or spouses (although the spousal privilege may apply if the spouse was not actively part of the business). Former business partners and ex-spouses are even better.

With that said, though, rarely are there smoking-gun pieces of evidence

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showing that someone had no intention of performing. Most of the time, you have to build your case around inference and circumstantial evidence.

An effective technique when building a case of promissory fraud is identifying the defendant's motivation for lying about his or her intention to perform. If you can show that the defendant knew there was no way that performance was possible, or if there were established plans that were contrary to the promises made, this may be a powerful tool in your arsenal.

On a claim for promissory fraud "something more than nonperformance is required to prove the defendant's intent not to perform his promise. [Citations.] ... [I]f plaintiff adduces no further evidence of fraudulent intent than proof of nonperformance of [a] promise, he will never reach a jury." (*Tenzer v. Superscope, Inc.* (1985) 39 Cal.3d 18, 30-31.) Further, the evidence must show that the defendant "did not intend to perform *at the time he or she made the promise* ...." (*Tarmann v. State Farm Mut. Auto. Ins. Co.* (1991) 2 Cal.App.4th 153, 159, italics added.) Examples of proof of a defendant's intent not to perform could include the "defendant's insolvency, his hasty repudiation of the promise, his failure even to attempt performance, or his continued assurances after it was clear he would not perform." (*Tenzer, supra,* 39 Cal.3d at p. 30.) Thus, in *Glendale Fed. Sav. & Loan Assn. v. Marina View Heights Dev. Co.* (1977) 66 Cal.App.3d 101, it was held that there was no promissory fraud where the borrower knew at the time of executing loan agreements that it would be difficult to fulfill the terms within the time specified, but intended to do so unless it had insufficient cash. (*Id.* at pp. 131-132.)

In light of the above, it may be helpful to establish a timeline that shows the defendant must have been lying about his or her intention to perform. Show what other activities were scheduled and other commitments that existed that were inconsistent with performance. Generally attack the defendants' credibility at trial so that at a minimum, the jury can infer that they were lying when they made the promises to perform to your client.

On the other hand, be prepared for the defense to try to show actions were taken consistent with a willingness and intent to perform. For example, they may show that the defendant was putting money into the project, making related commitments, or there was a clear financial benefit to the defendant for performing (or a clear detriment to them if they did not).

Breach of fiduciary duty

In certain situations, the relationship between the parties will dictate the type of disclosure obligations and affirmative duties they have towards each other. Where that relationship imposes fiduciary duties, the tools available to the Plaintiff's lawyer are significant and powerful. For example, a fiduciary relationship is "any relation existing between parties to a transaction wherein one of the parties is in duty bound to act with the utmost good faith for the benefit of the other party. Such a relation ordinarily arises where a confidence is reposed by one person in the integrity of another, and in such a relation the party in whom the confidence is reposed, if he voluntarily accepts or assumes to accept the confidence, can take no advantage from his acts relating to the interest of the other party without the latter's knowledge or consent ...." (*Wolf v. Superior Court* (2003) 107 Cal.App.4th 25, 29.)

"Every agent owes his principal the duty of undivided loyalty. During the course of his agency, he may not undertake or participate in activities adverse to the interests of his principal. In the absence of an agreement to the contrary, an agent is free to engage in competition with his principal after termination of his employment but he may plan and develop his competitive enterprise during the course of his agency only where the particular activity engaged in is not against the best interests of his principal." (*Sequoia Vacuum Systems v. Stransky* (1964) 229 Cal.App.2d 281, 287.)

Thus, very high standards are imposed on a fiduciary. Therefore, if you can fit your client's situation into one of the boxes that define a fiduciary relationship, you will significantly strengthen your case.

Jury instructions

The relevant jury instructions for breach of fiduciary duty are found at CACI 4100-4107. If you have any case that seems remotely likely to involve a fiduciary relationship, at a minimum, take a few minutes and read through the CACI instructions. In addition, authorities cited by the CACI instructions provide for excellent special jury instructions, which should be requested. These include:

- Restatement Second of Agency, section 387, which states: "Unless otherwise agreed, an agent is subject to a duty to his principal to act solely for the benefit of the principal in all matters connected with his agency."
- Restatement Second of Agency, section 391, which states: "Unless otherwise agreed, an agent is subject to a duty to his principal not to act on behalf of an adverse party in a transaction connected with his agency without the principal's knowledge."
- Restatement Second of Agency, section 393, which states: "Unless otherwise agreed, an agent is subject to a duty not to compete with the principal concerning the subject matter of his agency."
- Restatement Second of Agency, section 394, which states: "Unless otherwise agreed, an agent is subject to a duty not to act or to agree to act during the period of his agency for persons whose interests conflict with those of the principal in matters in which the agent is employed."
- Restatement Second of Agency, section 396, which extends the duty even after the agency's termination "unless otherwise agreed."

What relationships trigger fiduciary duties?

In light of the high standard imposed on a defendant with fiduciary obligations, knowing when fiduciary duties attach is essential. "Before a person can be charged with a fiduciary obligation, he must either knowingly undertake to act on behalf and for the

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benefit of another, or must enter into a relationship which imposes that undertaking as a matter of law." (*Committee On Children's Television, Inc., v. General Foods Corporation* (1983) 35 Cal.3d 197, 221 citing Scott, *The Fiduciary Principle* (1949) 37 Cal.L.Rev. 539, 540; Rest.2d Trusts (1959) § 2.) Therefore, practitioners should determine whether someone volunteered to act as a fiduciary, regardless of the relationship involved, or should seek to identify a relationship that creates such obligations by law. For an excellent survey of the relationships found to either be fiduciary or not, practitioners should read *Oakland Raiders v. National Football League* (2005) 131 Cal.App.4th 621. In that case, the Raiders contended that the NFL had fiduciary duties towards the team (and all teams, for that matter) and had violated such duties. After an extensive review of the types of relationships that triggered fiduciary duties, the court of appeal found against the Raiders, upholding the summary judgment in favor of the NFL.

During its analysis, the court listed those relationships already identified as imposing fiduciary obligations:
(1) principal and agent (*Recorded Picture Company [Productions] Ltd. v. Nelson Entertainment, Inc.* (1997) 53 Cal.App.4th 350, 369-370), including real estate broker/agent and client (*Smith v. Zak* (1971) 20 Cal.App.3d 785, 792-793, and stockbroker and customer (*Black v. Shearson, Hammill & Co.* (1968) 266 Cal.App.2d 362, 367);
(2) attorney and client (*Rader v. Thrasher* (1962) 57 Cal.2d 244, 250);
(3) partners (*Koyer v. Willmon* (1907) 150 Cal. 785, 787-788; Corp.Code, § 16404);
(4) joint venturers (*Sime v. Malouf* (1949) 95 Cal.App.2d 82, 98);
(5) corporate officers and directors, on the one hand, and the corporation and its shareholders, on the other hand (*Bancroft-Whitney Co. v. Glen* (1966) 64 Cal.2d 327, 345);
(6) husband and wife, with respect to the couple's community property (*Vai v. Bank of America* (1961) 56 Cal.2d 329, 337; see also Fam.Code, § 1100, subd. (e));
(7) controlling shareholders and minority shareholders (*Jones v. H.F. Ahmanson & Co.* (1969) 1 Cal.3d 93, 108-112);
(8) trustee and trust beneficiary (*Estate of Vokal* (1953) 121 Cal.App.2d 252, 257);
(9) guardian and ward (*Estate of Kay* (1947) 30 Cal.2d 215, 226; Prob.Code, § 2101);
(10) pension fund trustee and pensioner beneficiary (*Lix v. Edwards* (1978) 82 Cal.App.3d 573, 578),
(11) executor and decedent's estate (*Estate of Boggs* (1942) 19 Cal.2d 324, 333); and
(12) trustee and trust beneficiaries. (*Penny v. Wilson* (2004) 123 Cal.App.4th 596, 603 Prob.Code, §§ 16004, 16081, subd. (a).)

On the other hand, relationships where courts rejected the notion of there being fiduciary obligations include:
(1) an attorney and his co-counsel under the theory that the former's malpractice in handling of a mutual client's case caused damage to co-counsel in the loss of fees (*Beck v. Wecht* (2002) 28 Cal.4th 289, 292-298);
(2) one shareholder and another by virtue of the fact that they were former partners in an entity that was later incorporated (*Persson v. Smart Inventions, Inc.* (2005) 125 Cal.App.4th 1141, 1158-1159);
(3) an unmarried cohabitant and his cohabitant concerning the operation of the former's business (*Maglica v. Maglica* (1998) 66 Cal.App.4th 442, 448);
(4) a movie distributor and movie producers under a distribution contract *Recorded Picture, supra,* (53 Cal.App.4th at pp. 369-370);
(5) a homeowner's association and the buyer of an individual unit (with respect to disclosure of known construction defects) (*Kovich v. Paseo Del Mar Homeowners' Assn.* (1996) 41 Cal.App.4th 863, 869-870);
(6) a trade union and a union member (apart from the union's duty of fair representation) (*Hussey v. Operating Engineers Local Union No. 3* (1995) 35 Cal.App.4th 1213, 1221);
(7) a bank and its borrowers (*Kim v. Sumitomo Bank* (1993) 17 Cal.App.4th 974, 979-981);
(8) a corporation and its bondholders (*Pittelman v. Pearce* (1992) 6 Cal.App.4th 1436, 1444-1445);
(9) a clearing broker and an investment broker's customer (*Mars v. Wedbush Morgan Securities, Inc.* (1991) 231 Cal.App.3d 1608, 1614-1615),
(10) an insurer and its insured (*Love v. Fire Ins. Exchange* (1990) 221 Cal.App.3d 1136, 1148-1149); and
(11) a manufacturer and an authorized dealer (*Rickel v. Schwinn Bicycle Co.* (1983) 144 Cal.App.3d 648, 653-655).

Punitive damages

It is also important to remember that when a fiduciary relationship exists, a claim for breach of that fiduciary duty may include a request for punitive damages. (*Hobbs v. Bateman Eichler, Hill Richards, Incorporated,* (1985) 164 Cal.App.3d 174 [Upholding award of punitive damages on breach of fiduciary duty claim].) Therefore, when conducting discovery, be sure to explore facts related to the factors enumerated in CACI 3949, which apply in the punitive phase II portion of a bifurcated trial. This includes "whether plaintiff was financially weak or vulnerable and the defendant knew plaintiff was financially weak or vulnerable and took advantage of him/her" and "whether the defendant's conduct involved a pattern or practice."

Conclusion

Do not be afraid to be creative. In the absence of a written contract, claims for promissory fraud and breach of fiduciary duty can provide imposing and powerful weapons for you and your client.

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