

MEASURING BUSINESS DAMAGES IN FRAUDULENT INDUCEMENT CASES

By George P. Roach*

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* George Roach practices damages law and provides consulting on litigation damages and valuation in Dallas, Texas. He is a Senior Adviser to the litigation consulting firm of Freeman & Mills, Inc. in Los Angeles. His background includes an M.B.A., J.D. and an A.B. in economics. See www.litigation-consultant.com for further information.

I. SUMMARY

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

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

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

or, if unavoidable, how some of the more obvious risks can be minimized.

II. INTRODUCTION

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

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

Defendants to corporate claims can also be vulnerable to large jury awards. In a case that was later reversed, an agricultural insecticide distributor claimed that a financial partner ruined his business and his plans to manufacture feedstock chemicals by refusing to release about \$200,000 of internally generated funds.³ The jury awarded \$17.5 million of lost profits.⁴ The court of appeals found insufficient evidence to affirm the finding as the plaintiff had no experience in manufacturing chemicals and its distribution business was operating at a large loss.⁵

Plaintiffs face a risk⁶ that jury findings will be reversed as the Texas judiciary continues to fret over the potential that large

1. *Carpenter v. Holmes Builders, Inc.*, No. 11-02-00132-CV, 2004 LEXIS 1649, at *25 (Tex. App.—Eastland Feb. 19, 2004, pet. denied) (not designated for publication).

2. *Id.* at *17 n.6.

3. *Barnes v. Cumberland Int'l Corp.*, No. B14-93-00086-CV, 1994 LEXIS 2011, at *5-6 (Tex. App.—Houston [14th Dist.] Aug. 11, 1994, writ denied) (not designated for publication).

4. *Id.* at *6.

5. *Id.* at *10-11.

6. Statements in this article about the relative frequency of any holding have not been statistically proven and should be viewed as anecdotal or based on impression. There can be no assurance that the article is based on all relevant case opinions or a representative sample of all relevant case opinions. To be fair, however, there can be no

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damage awards in claims for fraudulent inducement will overwhelm other causes of action, and that impressionable juries may accept excessively speculative measurements of plaintiffs' damages. Perhaps these two concerns explain why two thirds of the relevant Texas Supreme Court opinions have reversed or remanded the damage issues: five cases were affirmed,⁷ five were remanded for trial or reconsideration,⁸ and in eight cases the damages were denied completely.⁹

Lawyers are exposed in multiple areas. First, law firms may find themselves defendants to fraudulent inducement claims even in the absence of privity with the plaintiff.¹⁰ Second, plaintiffs' lawyers have to explain to their clients why the jury finding was overridden or remanded, how the jury instructions were defective, or why certain key pieces of evidence were omitted. Not surprisingly, corporate clients can get upset about these damage issues. For example, in one breach of contract case, the corporate plaintiff could not accept the small damage award even though the contract at issue waived consequential and punitive damages.¹¹ That plaintiff then sued his legal team for legal malpractice on the damage issues, but lost at both the trial and appellate level.¹²

assurances that the full population of case opinions on any one issue is necessarily representative of how that issue is treated at the trial level. Perhaps the true import of such case statistics to a litigator can be summarized by paraphrasing a quote sometimes attributed to Joseph Stalin about casualties in war: one reversal is a tragedy; one million reversals is a statistic. See *Joseph Stalin Quotes*, BRAINYQUOTE.COM, <http://www.brainyquote.com/quotes/quotes/j/josephstal137476.html> (last visited Mar. 26, 2011).

7. *Trenholm v. Ratcliff*, 646 S.W.2d 927, 933 (Tex. 1983); *White v. Sw. Bell Tel. Co.*, 651 S.W.2d 260, 263 (Tex. 1983); *Kish v. Van Note*, 692 S.W.2d 463, 466, 468 (Tex. 1985); *Henry S. Miller Co. v. Bynum*, 836 S.W.2d 160, 162-63 (Tex. 1992); and *Tony Gullo Motors I, L.P. v. Chapa*, 212 S.W.3d 299, 303, 314 (Tex. 2006).

8. *Arthur Andersen & Co. v. Perry Equip. Corp.*, 945 S.W.2d 812, 817 (Tex. 1997); *Formosa Plastics Corp. v. Presidio Eng'rs & Contractors, Inc.*, 960 S.W.2d 41, 51 (Tex. 1998); *Waite Hill Servs. v. World Class Metal Works*, 959 S.W.2d 182, 184 (Tex. 1998); *Fortune Prod. Co. v. Conoco, Inc.*, 52 S.W.3d 671, 682 (Tex. 2000); and *Aquaplex, Inc. v. Rancho La Valencia, Inc.*, 297 S.W.3d 768, 775-76 (Tex. 2009).

9. *Woods v. Littleton*, 554 S.W.2d 662, 664 (Tex. 1977); *Leyendecker & Assocs., Inc. v. Wechter*, 683 S.W.2d 369, 373-74 (Tex. 1984); *W.O. Bankston Nissan, Inc. v. Walters*, 754 S.W.2d 127, 128 (Tex. 1988); *Fed. Land Bank Ass'n v. Sloane*, 825 S.W.2d 439, 442-43 (Tex. 1991); *D.S.A., Inc. v. Hillsboro Indep. Sch. Dist.*, 973 S.W.2d 662, 664 (Tex. 1998); *R.E. Haase v. Glazner*, 62 S.W.3d 795, 800 (Tex. 2001); *Baylor Univ. v. Sonnichsen*, 221 S.W.3d 632, 637 (Tex. 2007); *Stuart v. Bayless*, 964 S.W.2d 920, 921-22 (Tex. 1998).

10. *McCamish, Martin, Brown & Loeffler v. F.E. Appling Interests*, 991 S.W.2d 787, 791 (Tex. 1999).

11. *Cont'l Holdings, Ltd. v. Leahy*, 132 S.W.3d 471, 472 (Tex. App.—Eastland 2003, no pet.).

12. *Id.*

The Texas judiciary faces hazards of its own, both real and perceived. First, trial judges and appellate panels face the prospect of reversal.¹³ Second, for more than 100 years, the Texas Supreme Court rejected expectancy damages for claims of fraudulent inducement even though two thirds of the other states accepted such damages before 1900.¹⁴ The Court's concern about speculative damage awards continues even now, after the expectancy approach to measuring damages has been approved for such common law claims.

The Texas judiciary has reason to be concerned that juries can be easily swayed in cases of fraudulent inducement. For example, in one case, even though the plaintiff testified that he had no direct evidence of damages,¹⁵ plaintiff's counsel persisted and was quoted in the opinion for the following ambivalent argument:

Well, we're always a little stumped here. In a personal injury case where someone is seriously injured, there's no equation that allows you to measure out so many dollars and cents against so many ounces or minutes or hours of pain and suffering or permanent injury. And, in this case that's something that you are going to have to determine.¹⁶

The jury still found damages of \$42,000, which the court of appeals held were unsubstantiated.¹⁷

Twenty years after the Texas Supreme Court first affirmed expectancy damages for common law claims, the Court

13. See *supra* notes 8-10.

14. See generally *George v. Hesse*, 93 S.W. 107 (1906) (rejecting expectancy damages for claims of fraudulent inducement).

15. *Hicks Oil & Butane Co. v. Garza*, No. 04-05-00836-CV, 2006 LEXIS 6997, at *4 (Tex. App.—San Antonio Aug. 9, 2006, no pet.) (mem. op.) (“However, when asked if he had anything in writing or any documents to support how much money he thought he had lost, Garza replied, ‘Well it’s quite substantial, but I don’t have anything to prove it.’”).

16. *Id.* at *5. For another example of equivocal arguments made by counsel on the measure of damages, see the closing argument in *Miles Homes Div., Insilco Corp. v. Smith*, 790 S.W.2d 382, 395-96 (Tex. App.—Beaumont 1990, writ denied) (Brookshire, J., dissenting). For an example of a jurist’s confusion, see *Manon v. Tejas Toyota, Inc.*, 162 S.W.3d 743, 756-57 (Tex. App.—Houston [14th Dist.] 2005, no pet.) (“The trial judge also appears to have been uncertain as to which theory of liability was applicable. While considering this issue, the trial judge stated, ‘Oh, DTPA, same as fraud. I’m still contemplating whether or not I can go under DTPA, although I’m leaning more toward DTPA and less toward fraud. Okay? But I haven’t totally made up my mind yet. I’ll flip a coin. Okay? All right.’ Therefore, we agree with Tejas that the damage award is not a model of specificity.”) (emphasis omitted).

17. *Hicks Oil & Butane Co.*, 2006 Tex. App. LEXIS 6997, at *5.

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acknowledged its concern that fraudulent inducement can overwhelm breach of contract as a cause of action:

We recognize the need to keep tort law from overwhelming contract law, so that private agreements are not subject to readjustment by judges and juries. But we long ago abandoned the position that procuring a contract by fraud was simply another contract dispute.¹⁸

The judiciary's concerns about a vulnerable or volatile jury process is the result of at least two compounding factors: (1) that claims for fraudulent inducement offer strong financial remedies in the possible combination of expectancy and punitive damages,¹⁹ and (2) the common wisdom that juries may be more motivated to employ these strong remedies in cases where the defendant is proven to have been deceitful, i.e. that juries punish liars.

There is no complete explanation of why this litigation is error prone. The Texas judiciary may be reacting to fears of impressionable juries or dominant remedies but there is insufficient evidence to prove this supposition or even to establish that jury findings in fraudulent inducement are more disproportionate than in other causes of action. Similarly, the Texas judiciary's aversion to "speculative" damage findings is not limited to claims of fraudulent inducement.²⁰ Aside from inferring fears and speculating about speculativeness, a more tangible explanation lies with the view that the standard of practice for both lawyers and jurists since 1980 has needed improvement. Jury findings may have been overruled at a disproportionate rate because some lawyers and judges have demonstrated confusion on how to comply with the established

18. Tony Gullo Motors I, L.P. v. Chapa, 212 S.W.3d 299, 306 (Tex. 2006); *see also* PPG Indus. v. JMB/Houston Ctrs. Partners Ltd. P'ship, 146 S.W.3d 79, 89 (Tex. 2004) ("DTPA claims generally are also punitive rather than remedial. In this respect, it is important to remember that the DTPA overlaps many common-law causes of action, including breach of contract, warranty, fraud, misrepresentation, and negligence. Frequently, the DTPA is pled not because it is the only remedy, but because it is the most favorable remedy. In this case, for example, JMB pled one set of factual allegations that was then incorporated wholesale into claims for breach of contract, warranty, and the DTPA. The contract and warranty claims offered a remedy, but only the DTPA offered treble damages.") (emphasis omitted).

19. *See* Robert K. Wise, Andrew J. Szygenda, & Thomas F. Lillard, *Of Lies and Disclaimers-Contracting Around Fraud Under Texas Law*, 41 ST. MARY'S L.J. 119, 120 (2009).

20. *See, e.g.,* State v. Cent. Expressway Sign Assocs., 302 S.W.3d 866, 871 (Tex. 2009) (noting the speculative nature of lost profits); Pleasant Glade Assembly of God v. Schubert, 264 S.W.3d 1, 6 (Tex. 2008) (finding lost earning capacity too speculative).

requirements for instructing juries as well as proving or distinguishing damage claims for fraudulent inducement.²¹

The minefield of hazards does have an established map or guide, although the map is easier to discern for asset transactions than service contracts. There has not been much change in the requirements for proving damages from fraudulent inducement except for the addition of expectancy damages, which have been applied extensively for breach of contract.²² The basic elements required for proving direct and special damages for contract claims in asset transactions have been fairly constant for at least 85 years.²³ For example, measuring expectancy damages especially in the form of lost profits has been commonplace in Texas courts since the late nineteenth century.²⁴

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

III. SUMMARY CHARACTERISTICS OF FRAUDULENT INDUCEMENT

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

- (1) that a material representation was made;
- (2) the representation was false;
- (3) when the representation was made, the speaker knew it was false or made it recklessly without any knowledge of the truth and as a positive assertion;
- (4) the speaker made the representation with the intent that the other party should act upon it;
- (5) the party acted in reliance on the representation; and
- (6) the party thereby suffered injury.²⁵

21. See *supra* notes 8-10.

22. See *infra* Part III.

23. See *Booth v. Coward*, 265 S.W. 1026, 1027 (Tex. Comm'n App. 1924, judgment adopted).

24. See, e.g., *Jones v. George*, 61 Tex. 345, 354 (1884).

25. In re *FirstMerit Bank, N.A.*, 52 S.W.3d 749, 758 (Tex. 2001).

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Furthermore, the subject contract must satisfy the Statute of Frauds for the plaintiff to be entitled to expectancy damages.²⁶

Fraudulent inducement can be pled in Texas under statute or common law.²⁷ Claims under Texas Business and Commerce Code, Section 27.01 (“Section 27.01”) are limited to transactions in real estate or common stock transactions and apply to defendants who made false misrepresentations or a third party who was aware of the falsity of a representation made by another party.²⁸ Claims under this section are required to prove causation as under common law claims except that plaintiff is not required to prove that the defendant knew of the falsity of her representation at the time unless the plaintiff pleads for punitive damages.²⁹ From 1919 to 1983, the statute provided for expectancy damages; in 1983 the statute was amended to provide for the award of legal fees but expectancy damages were deleted.³⁰ Generally, claims are allowed a four year limitations period.³¹

Commonly referred to as the Deceptive Trade Practices Act (“DTPA”), Texas Business and Commerce Code Section 17.41, et. seq. was enacted as a consumer protection act.³² Currently, claims under the DTPA are limited to transactions of \$500,000 or less.³³ The statute provides for a plaintiff to claim actual damages, punitive damages, mental anguish³⁴ and legal fees although non-economic damages are now limited to a maximum

26. *Haase v. Glazner*, 62 S.W.3d 795, 799 (Tex. 2001). *But see Pierre v. Tilley*, No. 2-06-308-CV, 2007 LEXIS 5719, at *11 (Tex. App.—Fort Worth July 19, 2007, pet. denied) (mem. op.) (holding that the Statute of Frauds did not apply to the contract at issue).

27. Statutory standing is provided under TEX. BUS. & COM. CODE ANN. §§ 17.41-45 (Vernon 2011) and TEX. BUS. & COM. CODE ANN. § 27.01 (Vernon 2011).

28. TEX. BUS. & COM. CODE ANN. § 27.01.

29. *Id.* § 27.01(c).

30. Act of 1983, 68th Leg., p. 5208, ch. 949, §§ 1, 2 (codified as Tex. Bus. & Code. Ann. § 27.01).

31. TEX. CIV. PRAC. & REM. CODE ANN. § 16.004(a)(4) (Vernon 2011).

32. *See Woods v. Littleton*, 554 S.W.2d 662, 663 n.1 (Tex. 1977) (referencing the DTPA and noting “[t]he Consumer Protection Act, originally enacted on May 21, 1973, was amended effective September 1, 1975 and effective May 23, 1977”).

33. TEX. BUS. & COM. CODE ANN. § 17.49(g) (“Nothing in this sub-chapter shall apply to a cause of action arising from a transaction, a project, or a set of transactions relating to the same project, involving total consideration by the consumer of more than \$500,000, other than a cause of action involving a consumer’s residence.”).

34. *Arthur Andersen & Co. v. Perry Equip. Corp.*, 945 S.W.2d 812, 816 n.3 (Tex. 1997) (“In 1995, the Legislature amended § 17.50(b)(1) to permit recovery of ‘economic damages’ and, if the defendant acted knowingly, ‘damages for mental anguish,’ instead of ‘actual damages.’ (citing Act of May 17, 1995, 74th Leg., R.S., ch. 414, 1995 Tex. Gen. Laws 2992.”).

of three times actual damages.³⁵ Direct and special damages are required to meet the producing cause standard of causation.³⁶ Claims for damages are allowed a two year limitations period while claims for restitution are allowed a four year limitations.³⁷

It has been held that the statutes do not limit the measure of actual damages; statutory provisions are considered cumulative or in addition to those damages normally allowed for claims under the common law.³⁸

Claims for constructive fraud can also be pled as fraudulent inducement.³⁹ Proof of a prior confidential or fiduciary relationship is required although no proof is required of intent to defraud.⁴⁰ A court might be more likely to exercise its equitable discretion in favor of a constructive trust for constructive fraud relating to fiduciary claims.⁴¹ Under some circumstances, a breach of fiduciary duty accompanied by the remedy of a constructive trust has allowed plaintiffs to avoid Statute of Frauds issues.⁴²

While it is beyond the scope of the article to fully address the issue of contributory negligence, it is important to note that contributory negligence provisions under Tex. Civ. Prac. & Rem. Code Ann. § 33.002 have been found to apply to some⁴³ or all torts,⁴⁴ including common law and statutory fraud, even though it continues to be held that negligence is not a defense to fraud.⁴⁵

35. See *Tony Gullo Motors I, L.P. v. Chapa*, 212 S.W.3d 299, 304 (Tex. 2006) (“For breach of contract, Chapa could recover economic damages and attorney’s fees, but not mental anguish or exemplary damages. For fraud, she could recover economic damages, mental anguish, and exemplary damages, but not attorney’s fees. For a DTPA violation, she could recover economic damages, mental anguish, and attorney’s fees, but not additional damages beyond . . . (three times her economic damages).”).

36. *Arthur Andersen*, 945 S.W.2d at 816 (“Of course, foreseeability is not an element of producing cause under the DTPA.”).

37. *Thomas v. State*, 226 S.W.3d 697, 707 (Tex. App.—Corpus Christi 2007, pet. dismissed).

38. *Wright v. Carpenter*, 579 S.W.2d 575, 577 n.1 (Tex. Civ. App.—Corpus Christi 1979, writ refused n.r.e.).

39. See *Chien v. Chen*, 759 S.W.2d 484, 495-96 (Tex. App.—Austin 1988, no writ).

40. *Id.* at 494-95.

41. *Eglin v. Schober*, 759 S.W.2d 950, 955 (Tex. App.—Beaumont 1988, writ denied).

42. *Id.* at 955-56 (“An oral promise to buy for another creates a constructive trust which can bypass the Statute of Frauds.”); *Matthews v. AmWest Sav. Ass’n*, 825 S.W.2d 552, 554 (Tex. App.—Beaumont 1992, writ denied).

43. *Davis v. Estridge*, 85 S.W.3d 308, 312 (Tex. App.—Tyler 2001, pet. denied) (“In addition, the proportionate responsibility statute does not specifically include the Fraud in Real Estate and Stock Transactions statute within its application, as it does the DTPA.”).

44. *Villarreal v. Wells Fargo Brokerage Servs., LLC*, 315 S.W.3d 109, 124-25 n.7 (Tex. App.—Houston [1st Dist.] 2010, no pet.); *Harris v. Archer*, 134 S.W.3d 411 (Tex. App.—Amarillo 2004, pet. denied) (proportional responsibility statute no longer excludes

A. *Damage Preliminaries*

Actual damages are defined as those damages recoverable at common law⁴⁶ and include direct and special damages.⁴⁷ *Perry Equipment* offers the following comparison between direct and special damages:

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

[Special] damages, on the other hand, result naturally, but not necessarily, from the defendant's wrongful acts. Under the common law, consequential damages need not be the usual result of the wrong, but must be foreseeable and must be directly traceable to the wrongful act and result from it.⁴⁸

Special damages include incidental, consequential and reliance damages.⁴⁹ The three categories can be duplicative and their applicability can be limited by the plaintiff's approach to direct damages.⁵⁰

Under the market method,⁵¹ direct damages can be measured according to the Out-of-Pocket Approach (a restitutionary measure, "OOP") or the Benefit-of-the-Bargain Approach (an expectancy measure, "BOB"). The OOP measure compensates for the actual injury sustained, "measured by the

intentional torts). For an example of sufficient evidence of contributory negligence, see *Isaacs v. Bishop*, 249 S.W.3d 100, 110 (Tex. App.—Texarkana 2008, pet. denied) ("Some evidence and a jury finding established that Bishop was at least partly responsible for the fraud perpetrated on him. Evidence suggested that, before Bishop signed the promissory note prepared by Schleier — who Bishop knew had a history as Isaacs' lawyer — Bishop did have, but failed to make use of, an opportunity to read the note.")

45. *McCrary v. Taylor*, 579 S.W.2d 347, 349 (Tex. Civ. App.—Eastland 1979, writ ref'd n.r.e.)

46. *Brown v. Am. Transfer & Storage Co.*, 601 S.W.2d 931, 939 (Tex. 1980) ("The Act provides for recovery of actual damages. Actual damages means those recoverable at common law."); *Investors, Inc. v. Hadley*, 738 S.W.2d 737, 739 (Tex. App.—Austin 1987, writ denied); *Hughes v. Halliday*, 471 S.W.2d 88, 90 (Tex. Civ. App.—Waco 1971, no writ).

47. *Arthur Andersen & Co. v. Perry Equip. Corp.*, 945 S.W.2d 812, 816 (Tex. 1997).

48. *Id.*

49. *Id.*

50. *Id.*

51. DAN DOBBS, *LAW OF REMEDIES* § 3.2 (2nd ed. 1993).

difference between the value of that which he has parted with, and the value of that which has been received.”⁵² The BOB approach measures the plaintiff’s expectancy interest: “The benefit-of-the-bargain measure computes the difference between the value as represented and the value received.”⁵³ The benefit-of-the-bargain method can include lost profits on the bargain if such damages are proved with reasonable certainty and on the basis of the bargain being realized as misrepresented.⁵⁴

Technically, the BOB and OOP approaches are described as measures of direct damages.⁵⁵ Special damages can be claimed under either approach, and the choice of one approach over the other will restrict the plaintiff’s claims for special damages. No holding has been found that precludes the OOP approach from being applied to special damages.⁵⁶ Only the BOB approach provides for lost profits (generally as a special damage alternative to direct damage)⁵⁷ but consequential or reliance damages have been affirmed under the OOP approach.⁵⁸ Assumptions that may allow for certain types of special damages under the BOB approach would not be permitted under the OOP approach which is largely considered the default approach to special damages in the absence of claiming expectancy damages.⁵⁹

Direct and consequential damages are subject to different causation standards. The burden is on the defendant to disprove causation for direct damages but the plaintiff must satisfy the producing cause standard under the DTPA or the proximate cause standard for claims under Section 27.01 or under the common law.⁶⁰ Foreseeability is determined by the facts known at the time of the contract⁶¹ and should be established for the types of special damages at issue; the plaintiff is not required to prove that the amount of the consequential damage was

52. *Formosa Plastics Corp., USA v. Presidio Eng’rs & Contractors, Inc.* 960 S.W.2d 41, 49 (Tex. 1998).

53. *Id.*

54. *Id.* at 50.

55. *Arthur Andersen & Co. v. Perry Equip. Corp.*, 945 S.W.2d 812, 816 (Tex. 1997); *Formosa Plastics*, 960 S.W.2d at 49.

56. *Henry S. Miller Co. v. Bynum*, 836 S.W.2d 160, 164 (Tex. 1992).

57. *See Fed. Land Bank Ass’n v. Sloane*, 825 S.W.2d 439, 442-43 (Tex. 1991); *infra* Part V.B.

58. *Bynum*, 836 S.W.2d at 164 (Phillips, C.J. concurring) (affirming special damages under the OOP approach).

59. *D.S.A., Inc. v. Hillsboro Indep. Sch. Dist.*, 973 S.W.2d 662, 664 (Tex. 1998).

60. 24 WILLISTON ON CONTRACTS § 64:12 (4th ed.).

61. *Investors, Inc. v. Hadley*, 738 S.W.2d 737, 739 (Tex. App.—Austin 1987, writ denied).

foreseeable.⁶² Similarly, Texas common law is principally concerned with the plaintiff's proving that she experienced at least some damage on a non-speculative basis, the damages in fact.⁶³ Once the fact of damage is established, the estimate or projection of damage must be reasonable and founded in sufficient fact but the measure is not expected to be exact or without some uncertainty.⁶⁴

B. *Fraudulent Inducement Widens the Plaintiff's Reach*

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

Under claims for fraudulent inducement, it is straightforward to include the defendant individually.⁶⁵ One opinion even acknowledged the tactic as a viable alternative to piercing the corporate veil.⁶⁶ Individuals can also be held liable for punitive damages.⁶⁷

62. See *Motsenbacker v. Wyatt*, 369 S.W.2d 319, 323 (Tex. 1963); E. ALLAN FARNSWORTH, FARNSWORTH ON CONTRACTS § 12.14 (3d ed. 2004) ("The magnitude of the loss need not have been foreseeable, and a party is not disadvantaged by its failure to disclose the profits that it expected to make from the contract.")

63. *ERI Consulting Engineers, Inc. v. Swinnea*, 318 S.W.3d 867, 877 (Tex. 2010); see *Sw. Battery Corp. v. Owen*, 115 S.W.2d 1097, 1099 (Tex. 1938).

64. *Sw. Battery Corp.*, 115 S.W.2d at 1099 ("The courts draw a distinction between uncertainty merely as to the amount and uncertainty as to the fact of legal damages. Cases may be cited which hold that uncertainty as to the fact of legal damages is fatal to recovery, but uncertainty as to the amount will not defeat recovery. A party who breaks his contract cannot escape liability because it is impossible to state or prove a perfect measure of damages.") (citing *Eastman Kodak Co. v. S. Photo Materials Co.*, 273 U.S. 359, 379 (1927)); see also RESTATEMENT (SECOND) OF TORTS § 912 (1977) (explaining that the rule that precludes recovery of uncertain and speculative damages applies where the fact of damages is uncertain not where the amount is uncertain; once plaintiff has established the fact of damages, uncertainty as to the amount does not bar recovery).

65. *Sheffield v. Gibson*, No. 14-06-00483-CV, 2008 LEXIS 476, at *11 (Tex. App.—Houston [14th Dist.] Jan. 22, 2008, no pet.) (mem. op.) (citing *Miller v. Keyser*, 90 S.W.3d 712, 718 (Tex. 2002)); see also *Duval County Ranch Co. v. Wooldridge*, 674 S.W.2d 332, 333 (Tex. App.—Austin 1984, no writ); *Southampton Mineral Corp. v. Coastal Oil & Gas Corp.*, 846 S.W.2d 609, 612 (Tex. App.—Houston [14th Dist.] 1993, writ denied); *Berens v. Resort Suites-Scottsdale, Inc.*, No. 14-99-00396-CV, 2001 LEXIS 3175, at *9 (Tex. App.—Houston [14th Dist.] May 17, 2001, pet. denied)(not designated for publication); *Mark Rotella Custom Homes, Inc. v. Cutting*, No. 2-07-133-CV, 2008 LEXIS 1732, at *13-14 (Tex. App.—Fort Worth Mar. 6, 2008, no pet.) (mem. op.). But see *Henry S. Miller Co. V. Bynum*, 797 S.W.2d 51, 55 (Tex. App.—Houston [1st Dist.] 1990) (O'Connor, J., dissenting), *aff'd*, 836 S.W.2d 160 (Tex. 1992).

66. *Sheffield*, 2008 LEXIS 476, at *11.

67. *Id.*

Plaintiffs that are third parties to a contract, not identified as specific beneficiaries under the contract, are now regularly granted jurisdiction for claims of fraudulent inducement.⁶⁸ Plaintiffs have generally been allowed to make a variety of claims in equity against defendants who are not signatories for constructive trusts⁶⁹ and fiduciary duty cases⁷⁰ but pecuniary claims at law are somewhat new and have succeeded against real estate brokers,⁷¹ accountants,⁷² title companies,⁷³ lenders⁷⁴ and attorneys.⁷⁵

When applied in the context of the breach of a settlement agreement, the claim of fraudulent inducement effectively allows the plaintiff to add punitive damages to his underlying claim.⁷⁶ Assuming the plaintiff can establish the defendant had the requisite intent, she can plead her claim underlying the settlement as direct damages and seek punitive damages as well.⁷⁷ In at least three cases, a court of appeals has affirmed punitive damages in excess of the amount either provided under the settlement or the amount claimed by the plaintiff underlying the settlement.⁷⁸ Thus the Eleventh District substantiated the punitive damages partially on the basis of the plaintiff's original claim.⁷⁹ The court of appeals in *McDill* justified the \$4 million of punitive damages on the basis of the value of the plaintiff's settlement or about \$2.2 million.⁸⁰

Perhaps the most colorful example of settlement fraud is to be found in family law. A prosperous lawyer convinced his wife that they needed to divorce to protect their community property

68. See, e.g., *Pope v. Garrett*, 211 S.W.2d 559, 562 (1948).

69. *Id.*

70. *Ginther v. Taub*, 675 S.W.2d 724, 728 (Tex. 1984); *Kinzbach Tool Co. v. Corbett-Wallace Corp.*, 160 S.W.2d 509, 514 (Tex. 1942).

71. *Henry S. Miller Co. v. Bynum*, 836 S.W.2d 160, 163 (Tex. 1992) (Phillips, C.J., concurring).

72. *Arthur Andersen & Co. v. Perry Equip. Corp.*, 945 S.W.2d 812, 815 (Tex. 1997).

73. *Am. Title Co. v. BOMAC Mortgage Holdings, L.P.*, 196 S.W.3d 903, 911 (Tex. App.—Dallas 2006, no pet.).

74. *Commerce Bank v. Lebeco Constr., Inc.*, 865 S.W.2d 68, 84 n.13 (Tex. App.—Corpus Christi 1993, writ denied).

75. *McCamish, Martin, Brown & Loeffler v. F.E. Appling Interests*, 991 S.W.2d 787, 791 (Tex. 1999).

76. *Myers v. Walker*, 61 S.W.3d 722, 731 (Tex. App.—Eastland 2001, pet. denied).

77. *Id.* at 728.

78. See, e.g., *id.*

79. *Id.* at 731; see also *Aquaplex, Inc. v. Rancho La Valencia*, 297 S.W.3d 768 (Tex. 2009).

80. *McDill Columbus Corp. v. Univ. Woods Apartments, Inc.*, No. 06-99-00138-CV, 2001 Tex. App. LEXIS 2560, at *28 (Tex. App.—Texarkana Apr. 19, 2001, pet. denied) (not designated for publication).

from a pending malpractice claim.⁸¹ The husband arranged for a friend to represent both of them in an agreed divorce that separated \$1.1 million of property for the wife (7.5% of the community estate).⁸² After the divorce was finalized, the husband asked his ex-wife to move out of the house and he then promptly married the ex-wife's "best friend."⁸³ In a subsequent jury trial relating to fraud on the wife's separate property, the jury split the community property 58 percent (\$8.5 million) to 42 percent (\$6.1 million) to the wife and husband, respectively; but the wife was also awarded \$1.3 million in mental anguish, \$1 million in punitive damages and \$1.5 million in prejudgment interest.⁸⁴ Subsequently, the husband and their joint counsel were also suspended from the practice of law for two years.⁸⁵

Cases and commentary provided by Dunn show that fraudulent inducement claims relating to settlement agreements are asserted in other jurisdictions.⁸⁶ The majority rule apparently does not limit actual damages in such claims to the settlement value of the claims underlying the settlement.⁸⁷ This may lead to the "trial within a trial" process that is sometimes associated with legal malpractice.⁸⁸ Defendants to claims for a fraudulent settlement might reasonably fear a jury's view of the "trial within a trial" if the jury has already determined the defendant to be a fraudfeasor.

IV. THE EVOLUTION OF DAMAGES LAW FOR FRAUDULENT INDUCEMENT

Texas was a relative latecomer to the doctrine that common law plaintiffs are entitled to expectancy damages for claims of fraudulent inducement. The Texas Supreme Court rejected the doctrine from 1849⁸⁹ until 1983⁹⁰ even though two thirds of the

81. Christa Brown, *Marital Fraud: The Tort Survives With an Appellate Twist*, 63 TEX. B.J. 630, 633 (2000).

82. *Id.*

83. *Id.*

84. *Id.*

85. *Vickery v. Comm'n for Lawyer Discipline*, 5 S.W.3d 241 (Tex. App.—Houston [14th Dist.] 1999, pet. denied); *Richards v. Comm'n for Lawyer Discipline*, 35 S.W.3d 243 (Tex. App.—Houston [14th Dist.] 2000, no pet.).

86. See ROBERT L. DUNN, RECOVERY OF DAMAGES FOR FRAUD 66-67 (3d ed. 2004).

87. See *id.* (citing *Sade v. N. Natural Gas Co.*, 488 F.2d 230 (10th Cir. 1973)).

88. See Donald G. Weiland, *Another Early Chapter: Attorney Malpractice and the Trial within a Trial: Time for a Change*, 19 J. MARSHALL L. REV. 275 (1985-1986).

89. *Graham v. Roder*, 5 Tex. 141, 149 (1849) (denying expectancy damages for common law fraudulent inducement).

states had adopted it by 1900.⁹¹ To many observers it makes little sense for the common law to allow expectancy damages for claims of unintentional breach of contract but to deny the alternative measure in cases of intentional fraud.⁹²

The Texas Supreme Court approved expectancy damages in a halting and haphazard manner. The Court first affirmed such an award in 1983 for common law⁹³ and DTPA⁹⁴ claims without much explanation until the *Formosa Plastics* opinion in 1998, which formally excluded fraudulent inducement from its prior holdings in *Delanney* and *Walter Homes*.⁹⁵

Traditionally, Texas courts have feared that juries would act in an uncontrolled or vengeful manner or that the BOB approach is too speculative.⁹⁶

But the present belongs to a different class of cases, in which [it is said] “the common law loses sight of the principle of compensation and gives damages by way of punishment for acts of malice, vexation, fraud or oppression.” (Sewg. Meas. Dam. 34). . . . In these cases it has been found difficult to set any fixed or precise limits to the discretion of the jury, or in fact to prescribe any rule whatever.⁹⁷

In a 1906 opinion, the Court argued that the OOP approach provides an appropriately similar outcome to the alternative remedy of rescission.⁹⁸ The Court further cited two U.S. Supreme

90. *Trenholm v. Ratchiff*, 646 S.W.2d 927, 933 (Tex. 1983) (affirming expectancy damages for common law fraudulent inducement).

91. *See* *George v. Hesse*, 93 S.W. 107, 107 (Tex. 1906) (noting that defendant in error cited cases for 32 states).

92. Robert B. Thompson, *The Measure of Recovery Under Rule 10b-5: A Restitution Alternative to Tort Damages*, 37 VAND. L. REV. 349 (1984).

93. *Trenholm*, 646 S.W.2d at 933.

94. *White v. Sw. Bell Tel. Co.*, 651 S.W.2d 260, 263 (Tex. 1983).

95. *Formosa Plastics Corp., USA v. Presidio Eng'rs and Contractors, Inc.*, 960 S.W.2d 41, 46 (Tex. 1998) (citing *Sw. Bell Tel. Co. v. DeLanney*, 809 S.W.2d 493, 494 (Tex. 1991); *Jim Walter Homes, Inc. v. Reed*, 711 S.W.2d 617 (Tex. 1986)).

96. *See* *Graham v. Roder*, 5 Tex. 141, 149 (1849).

97. *Id.*

98. *George v. Hesse*, 93 S.W. 107, 107-08 (Tex. 1906) (“The contract in this case was not to convey a tract of land with a ‘gusher’ on it; but was to convey a certain tract of land, which was falsely represented to have a ‘gusher’ on it, which false representation was an inducement which led to the contract. Logically, therefore, what he has lost by the transaction is the measure of his damages. Let us suppose that when the fraud was discovered George had not conveyed any of the property transferred to him, and Hesse had sued for a rescission as he would have had the right to do; the parties would simply have been placed in status quo, and the plaintiff would have recovered nothing for his failure to get the property as represented. He would have recovered his property and there would have been no loss, except the expense of the litigation. So in this case, if the

Court cases which both rejected expectancy damages for an investor that bought a worthless silver or gold mine.⁹⁹ In *Sigafus* the Court acknowledged that the plaintiff had paid about \$400,000 for a mine that would have been worth \$1,000,000 as represented but also rejected such damages as the “expected fruits of an unrealized speculation.”¹⁰⁰ The doctrine embodied in these cases became the foundation for measuring damages in federal securities claims.¹⁰¹

In 1924, the Texas Supreme Court continued to exclude expectancy damages by reversing the award of expectancy damages for fraudulent inducement.¹⁰² The Court justified the reversal solely on the basis that the underlying claim was one for deceit rather than breach of contract, acknowledging that expectancy damages would have otherwise been appropriate.¹⁰³ In 1938, the Court again rejected expectancy as too speculative to furnish a correct measure of damages.¹⁰⁴ The court did not explain why the measure was too speculative for deceit but not for breach of contract.¹⁰⁵

The legislature diverged from this doctrine in 1919 by passing statutory authority for expectancy damages in fraudulent inducement claims relating to transactions in common stock and land¹⁰⁶ as Article 4004 (now section 27.01).¹⁰⁷ In 1973,

plaintiff recovers a sufficient sum in money to make that which he has received equal to that which he has conveyed and that which he has assumed to pay, he is compensated for his loss, and, as we think, that is the measure of his damages.”)

99. *Smith v. Bolles*, 132 U.S. 125 (1889); *Sigafus v. Porter*, 179 U.S. 116 (1900).

100. *Sigafus*, 179 U.S. at 125.

101. That doctrine was challenged in a Second Circuit opinion that held that securities plaintiffs, especially securities sellers, should be awarded the benefit of their bargains if the bargain can “be established with adequate certainty” asserting that the basis of the two Supreme Court opinions was concern over the reliability of the measurement of the expectancy. *Osofsky v. Zipf*, 645 F.2d 107, 114 (2d Cir. 1980).

102. *See Booth v. Coward*, 265 S.W. 1026 (Tex. 1924).

103. *Id.* at 1027.

104. *Morriss-Buick Co. v. F. C. Pondrom*, 113 S.W.2d 889, 890 (1938) (quoting 27 C.J., p. 98).

105. To draw the distinction even a little finer, there is an interesting group of cases that has been largely ignored in the courts’ discussion which may be useful. Even before the Court’s opinion in *George v. Hesse*, both the Texas and U.S. Supreme Court held that if the defendant willfully or fraudulently breached a contract to sell real or personal property, the plaintiff was entitled to expectancy damages; otherwise the plaintiff was awarded compensatory damages. *See Phillips v. Herndon*, 14 S.W. 857, 858 (1890) (citing *Hopkins v. Lee*, 19 U.S. 109 (1821)).

106. *El Paso Dev. Co. v. Ravel*, 339 S.W.2d 360, 363 (Tex. Civ. App.—El Paso 1960, writ ref’d n.r.e.) (“Prior to the enactment of Article 4004, supra, in 1919, the Texas rule for measuring damages in fraud cases involving transactions in land was the rule announced in 1906 by the Supreme Court of Texas, in the case of *George v. Hesse* (citation omitted) and followed by that Court in *Booth v. Coward* (citation omitted). . . .”).

107. *Id.*

it also passed the precursor to the Deceptive Trade Practices Act which was intended to enable consumers to secure adequate remedies for “unconscionable” business practices, including fraud¹⁰⁸ although it never provided for any specific measure of actual damages.¹⁰⁹

A. *The Standard of Practice Since 1980*

Case opinions on remedies for fraudulent inducement surged in the early 1980s as the effects of the DTPA began to filter through the system.¹¹⁰ Most of those opinions in the 1980s and 1990s related to whether the plaintiff was entitled to expectancy damages or whether jury findings were the product of adequate instruction and sufficient evidence.¹¹¹ The general standard of practice of remedies law in the trial court and court of appeals, as represented by case opinions, was weak and inconsistent with the long-time standards for the BOB or OOP approach to direct damages for breach of contract.¹¹² Indeed, most of the corrections in the opinions were applicable to either approach on issues of general technique not just details relevant to expectancy damages.¹¹³

Jury findings were reversed for the following reasons:

Vague or broad jury instructions which failed to instruct the jury as to the accepted measures of damages;¹¹⁴

Jury instructions that asked the jury to find damages as a lump sum, applying what was

108. *Woods v. Littleton*, 554 S.W.2d 662, 663 n.1 (Tex. 1977) (“The Consumer Protection Act, originally enacted on May 21, 1973, was amended effective September 1, 1975 and effective May 23, 1977.”).

109. *See id.* at 669.

110. *See, e.g., infra* notes 115-18 and accompanying text.

111. *See, e.g., infra* notes 115-18 and accompanying text.

112. *See, e.g., infra* notes 115-18 and accompanying text.

113. *See, e.g., infra* notes 115-18 and accompanying text.

114. *Johnson v. Willis*, 596 S.W.2d 256, 262 (Tex. Civ. App.—Waco 1980, writ ref’d n.r.e.); *Stewart v. Moody*, 597 S.W.2d 556, 558 (Tex. Civ. App.—Beaumont 1980, writ ref’d n.r.e.); *Chrysler Corp. v. McMorries*, 657 S.W.2d 858, 865 (Tex. App.—Amarillo 1983, no writ); *Woodyard v. Hunt*, 695 S.W.2d 730, 732 (Tex. App.—Houston [1st Dist.] 1985, no writ). *But see Barnes v. Cumberland Int’l Corp.*, No. B14-93-00086-CV, 1994 WL 416563 (Tex. App.—Houston [14th Dist.] Aug. 11, 1994, writ denied) (not designated for publication); *Myers v. Walker*, 61 S.W.3d 722, 732 (Tex. App.—Eastland 2001, pet. denied); *Royal Maccabees Life Ins. Co. v. James*, 146 S.W.3d 340, 351 (Tex. App.—Dallas 2004, pet. denied).

sometimes called the ‘total loss’ approach, without distinguishing direct from special damages;¹¹⁵

Jury findings assessed without supporting evidence for the fair market value;¹¹⁶

And Jury findings assessed without any objective evidence of salvage values.¹¹⁷

Attention to detail was increasingly emphasized; if the plaintiff claimed that the service or asset received was without salvage value, for example, she was expected to establish sufficient evidence for the jury to make such a finding.¹¹⁸ Failure to comply with this search for details often led to remanding the case or denying the damages for claims even with strong cases for liability.¹¹⁹

Frequently jury instructions also failed to instruct the jury on the appropriate standard for causation or even what evidence to consider in calculating their damage findings. The issue of lump sum findings has caused difficulty for both the plaintiff and defendant at the appellate level for their inability to distinguish between appropriate or inappropriate portions of the finding.¹²⁰

115. See *W.O. Bankston Nissan, Inc. v. Walters*, 754 S.W.2d 127, 128 (Tex. 1988); *Arthur Andersen & Co. v. Perry Equip. Corp.*, 945 S.W.2d 812, 816 (Tex. 1997). *But see* *Henry S. Miller Co. v. Bynum*, 836 S.W.2d 160, 163 (Tex. 1992) (Phillips, C.J., concurring).

116. *Woods v. Littleton*, 554 S.W.2d 662, 664 (Tex. 1977); *Smith v. Kinslow*, 598 S.W.2d 910, 913 (Tex. 1980); *Johnson v. Willis*, 596 S.W.2d 256, 262 (Tex. Civ. App.—Waco 1980, writ ref’d n.r.e.); *Pontiac v. Elliott*, 775 S.W.2d 395, 398-99 (Tex. App.—Houston [1st Dist.] 1989, writ denied); *Odom v. Meraz*, 810 S.W.2d 241, 245 (Tex. App.—El Paso 1991, writ denied); *Bankston Nissan*, 754 S.W.2d at 128; *Momentum Motor Cars, Ltd. v. Williams*, No. 13-02-042-CV, 2004 LEXIS 9940, at *15 (Tex. App.—Corpus Christi Nov. 10, 2004, writ denied) (mem. op.).

117. See *Raye v. Fred Oakley Motors Inc.*, 646 S.W.2d 288, 292 (Tex. App.—Dallas 1983, writ ref’d n.r.e.); *Pontiac*, 775 S.W.2d at 398-99; *Wang v. Lee*, 256 S.W.3d 862, 869 (Tex. App.—Beaumont 2008, no pet.). *But see* *Woo v. Great Sw. Acceptance Corp.*, 565 S.W.2d 290, 297-98 (Tex. Civ. App.—Waco 1978, writ ref’d n.r.e.). For an unusual approach in proving salvage value, see *JHC Ventures, L.P. v. Fast Trucking, Inc.*, 94 S.W.3d 762, 767-68 (Tex. App.—San Antonio 2002, no pet.). *But see* *Aquaplex, Inc. v. Rancho La Valencia*, 297 S.W.3d 768, 776-77 (Tex. 2009) (remanding case for possible remitter despite the fact that plaintiff provided no evidence of the value of the plaintiff’s remaining interest in the development project).

118. See *supra* note 118 and accompanying text.

119. See *supra* notes 117 and 118 and accompanying text.

120. See *Myers v. Walker*, 61 S.W.3d 722, 732-33 (Tex. App.—Eastland 2001, pet. denied) (overruling defendant’s objection to including mental anguish damages and holding that there was sufficient evidence of damages other than mental anguish to substantiate the jury award); *Barnes v. Cumberland Int’l Corp.*, No. B14-93-00086-CV, 1994 LEXIS 2011, at *8 (Tex. App.—Houston [14th Dist.] Aug. 11, 1994, writ denied) (not designated for publication) (“When a damage issue is submitted in broad form, an

B. *Expectancy Damages*

Ironically, the Texas Legislature and courts were again out of sync as the Texas legislature discontinued statutory authority for expectancy damages in the 1983 amendments to section 27.01 which was the same year that the Supreme Court first affirmed expectancy damages for a common law claim.¹²¹

In the 1980s and 1990s, despite the fact that the appellate courts were split on the availability of the expectancy damages,¹²² there was a substantial body of opinions that affirmed the BOB approach for claims under the DTPA¹²³ and the common law.¹²⁴ In subsequent “landmark” opinions like *Leyendecker*¹²⁵ and *Bankston Nissan*,¹²⁶ the Court overlooked its own first two opinions that affirmed the BOB approach for claims under the DTPA and common law in *White*¹²⁷ and *Trenholm*,¹²⁸ respectively. The plaintiff in *Trenholm* originally pled a statutory cause of action, but the court of appeals ordered a second trial under the

appellate court cannot ascertain with certainty what amount of damages is attributable to each element.”).

121. See *Trenholm v. Ratcliff*, 646 S.W.2d 927, 933-34 (Tex. 1983).

122. See *Formosa Plastics Corp., USA v. Presidio Eng'rs & Contractors, Inc.*, 960 S.W.2d 41, 46 (Tex. 1998); *Philadelphia Life Ins. Co. v. Means*, No. 05-95-01033-CV, 1997 LEXIS 4526, at *18-19 (Tex. App.—Dallas Aug. 22, 1997, no pet.) (not designated for publication).

123. See *Woo v. Great Sw. Acceptance Corp.*, 565 S.W.2d 290, 297-98 (Tex. Civ. App.—Waco 1978, writ ref'd n.r.e.); *Johnson v. Willis*, 596 S.W.2d 256, 263 (Tex. Civ. App.—Waco 1980, writ ref'd n.r.e.); *Chrysler Corp. v. McMorries*, 657 S.W.2d 858, 866 (Tex. App.—Amarillo 1983, no writ); *White v. Sw. Bell Tel. Co.*, 651 S.W.2d 260, 263 (Tex. 1983); *Cheek v. Zalta*, 693 S.W.2d 632, 635 (Tex. App.—Houston [14th Dist.] 1985, no writ); *Naylor Indus. v. Envtl. Waste Sys.*, No. 01-85-1053-CV, 1986 LEXIS 9204, at *21-22 (Tex. App.—Houston [1st Dist.] Nov. 26, 1986, no pet.) (not designated for publication); *Henry S. Miller Co. v. Bynum*, 836 S.W.2d 160, 163 (Tex. 1992) (Phillips, C.J., concurring).

124. *Trenholm*, 646 S.W.2d at 933; *Gulftide Gas Corp. v. Cox*, 699 S.W.2d 239, 243 (Tex. App.—Houston [1st Dist.] 1985, writ ref'd n.r.e.); *New Process Steel Corp. v. Steel Corp. of Tex., Inc.*, 703 S.W.2d 209, 215 (Tex. App.—Houston [1st Dist.] 1985, writ ref'd n.r.e.); *Matthews v. AmWest Sav. Ass'n.*, 825 S.W.2d 552, 554 (Tex. App.—Beaumont 1992, writ denied); *Hedley Feedlot, Inc. v. Weatherly Trust*, 855 S.W.2d 826, 840 (Tex. App.—Amarillo 1993, writ denied); *Southampton Mineral Corp. v. Coastal Oil & Gas Corp.*, 846 S.W.2d 609, 610-11 (Tex. App.—Houston [14th Dist.] 1993, writ denied); *Streller v. Hecht*, 859 S.W.2d 114, 116 (Tex. App.—Houston [14th Dist.] 1993, writ denied); *Commerce Bank v. Lebo Constr., Inc.*, 865 S.W.2d 68, n.13 (Tex. App.—Corpus Christi 1993, writ denied); *Hiller v. Mfrs. Prod. Research Group of N. Am.*, 59 F.3d 1514, 1517-18 (5th Cir. 1995); *Peco Constr. Co. v. Guajardo*, 919 S.W.2d 736, 739 (Tex. App.—San Antonio 1996, writ denied); *Green v. Allied Invs., Inc.*, 963 S.W.2d 205, 210-11 (Tex. App.—Austin 1998, pet. denied).

125. *Leyendecker & Assocs., Inc. v. Wechter*, 683 S.W.2d 369, 373 (Tex. 1984).

126. *W.O. Bankston Nissan, Inc. v. Walters*, 754 S.W.2d 127, 128 (Tex. 1988).

127. *White v. Sw. Bell Tel. Co.*, 651 S.W.2d 260, 263 (Tex. 1983).

128. *Trenholm*, 646 S.W.2d at 933.

common law.¹²⁹ The appeal from the second trial led to the Supreme Court opinion that reinstated the jury award for lost profits under the BOB approach.¹³⁰ *Trenholm* was largely ignored until the Fifth Circuit discovered the opinion as support for switching from denying expectancy damages in 1994¹³¹ to affirming expectancy damages in 1995.¹³² Since that time, *Trenholm* has also been cited by the Texas Supreme Court.¹³³ *White* was a DTPA case but was ignored in *Leyendecker* and only belatedly remembered in *Bynum*.¹³⁴

The *Leyendecker* opinion does not state that Texas common law fraud affords expectancy damages; it merely states that Texas common law affords the out of pocket approach and that under some statutory claims, the benefit of the bargain approach is appropriate.¹³⁵ The Court's statement is also dicta for both statutory and common law fraudulent inducement; the Court held that the trial judge and court of appeals were wrong to override the jury finding that there was no difference between the value received and represented.¹³⁶ While of no precedential value, the case head notes summarize that part of the opinion as holding that Texas common law affords both the BOB and OOP approaches.¹³⁷ Ironically, the *Leyendecker* case is now effectively cited for the head note rather than the actual holding.¹³⁸

129. *Id.* at 929.

130. *Id.* at 933-34.

131. *See* *Camp v. Ruffin*, 30 F.3d 37, 38 (5th Cir. 1994) (rejecting benefit-of-the-bargain damages in common-law fraud action).

132. *Hiller v. Mfrs. Prod. Research Group of N. Am.*, 59 F.3d 1514, 1517-18 (5th Cir. 1995) ("Before we address Federal's first argument, we clarify whether Duravision and MPR can recover any lost profits under Texas law. Texas common law traditionally awarded only out-of-pocket costs in fraud cases. That measure, however, is no longer exclusive. With the enactment of the DTPA, Texas expanded the allowable methods by which damages in a fraud case can be measured, and today, Texas common law allows 'either the "out-of-pocket" or the "benefit of the bargain" damages, whichever is greater.'" (citing *Morris-Buck v. Pondrom*, 113 S.W.2d 889 (1938); *Camp*, 30 F.3d 37)).

133. *Tooke v. City of Mexia*, 197 S.W.3d 325, 346 n.104 (Tex. 2006).

134. *Henry S. Miller Co. v. Bynum*, 836 S.W.2d 160, 164 (Tex. 1992) (Phillips, C.J., concurring) (citing *White v. Sw. Bell Tel. Co.*, 651 S.W.2d 260 (Tex. 1983)).

135. *Leyendecker & Assocs. v. Wechter*, 683 S.W.2d 369, 373 (Tex. 1984) (citing *George v. Hesse*, 93 S.W. 107 (1906)) ("Texas courts have recognized two measures of damages for misrepresentation. Texas common law allows an injured party to recover the actual injury suffered measured by 'the difference between the value of that which he has parted with, and the value of that which he has received.' This measure of damages is known as the 'out of pocket' measure and is calculated as of the time of sale."); W. PROSSER, HANDBOOK OF THE LAW OF TORTS § 110 (4th ed. 1971) (citations omitted)).

136. *Leyendecker*, 683 S.W.2d at 373.

137. *See id.* at 370.

138. *Bynum*, 836 S.W.2d at 163; *Arthur Andersen & Co. v. Perry Equip. Corp.*, 945 S.W.2d 812, 817 (Tex. 1997); *Latham v. Castillo*, 972 S.W.2d 66, 70 (Tex. 1998).

The *Bankston Nissan* opinion does state that Texas common law provides for both approaches, but again the statement is dicta for the common law claim because the *Bankston Nissan* case relates to a DTPA claim for fraudulent sale of a pickup truck.¹³⁹ The plaintiff traded in a car to buy a truck that was represented to be a 1982 model but was actually a 1981 model.¹⁴⁰ When the bank determined that the truck was actually a 1981 rather than a 1982 model, it denied the plaintiff's loan application.¹⁴¹ By the time that the plaintiff returned the truck for lack of financing, his car had already been re-sold.¹⁴² The plaintiff's damages were presented as a net result claiming the value of the lost trade-in.¹⁴³

The Supreme Court acknowledged the defendant's liability but denied damages because the plaintiff had failed to establish the value of the purchase as represented and the value as delivered to the plaintiff.¹⁴⁴ At trial, the plaintiff made a "lump sum" or "total loss" claim very similar to the claim for economic rescission made in *Dallas Farm Machinery*: a transaction had gone bad and the plaintiff wanted the value of his trade-in equipment which had already been re-sold by the dealer.¹⁴⁵

In *Bankston Nissan*, the plaintiff's jury instructions and evidence both failed to meet the standard of measuring the difference between the price paid and the value received or the value represented.¹⁴⁶ In *Bynum*, the plaintiff secured a jury finding under the lump sum approach for a DTPA claim.¹⁴⁷ The plaintiff alleged that the misrepresentations of the defendant real estate broker induced the plaintiff to lease space in a

139. *W.O. Bankston Nissan, Inc. v. Walters*, 754 S.W.2d 127, 128 (Tex. 1988).

140. *Id.* at 127-28.

141. *Id.* at 128.

142. *Id.*

143. *Id.*

144. *Id.* ("Walters' burden of proof in this case was to show either the difference between the fair market value of the pickup as delivered and the value of the truck as it was represented; or the difference in value between that with which he parted and that which he received. He did neither. Walters had the burden of requesting jury issues on the proper measure of damages. Having failed to do so, his cause of action must fail.")

145. *Compare W.O. Bankston Nissan, Inc. v. Walters*, 754 S.W.2d 127, 128 (Tex. 1988) with *Dallas Farm Mach. Co. v. Reaves*, 307 S.W.2d 233, 241 (Tex. 1957) ("The money recovery awarded in this case was the market value of the trade-in machinery which petitioner had sold. It was awarded in lieu of a return of the trade-in machinery. There was evidence supporting the trial court's finding that the fair market value of the machinery was \$2100.00, and it was not error to award respondent a recovery of \$2094.00 in lieu of the return of the trade-in machinery.")

146. *Bankston Nissan*, 754 S.W.2d at 128.

147. *Henry S. Miller v. Bynum*, 797 S.W.2d 51, 54 (Tex. App.—Houston [1st Dist.] 1990), *aff'd*, 836 S.W.2d 160, 163 (Tex. 1992).

shopping center.¹⁴⁸ The plaintiff recovered as actual damages the total amount of his net capital investment in the lease venture over a 21-month period.¹⁴⁹ Even though the plaintiff did not present evidence to support an “out-of-pocket” or “benefit-of-the-bargain” measure of damages, the Supreme Court held that the evidence supported the award of these damages as part of the “actual loss” the plaintiff sustained.¹⁵⁰ In his concurring opinion, Chief Justice Phillips emphasized the fact that the plaintiff in that case only sought special or consequential damages.¹⁵¹ This point plus the fact that the plaintiff measured its damages only according to the OOP approach precluded the need to distinguish damages between direct and special damages or between the BOB or OOP approaches.

C. *Perry Equipment*

The Court’s opinion in *Arthur Andersen & Co. v. Perry Equip. Corp.* (“*Perry Equipment*”) is important because it provides the most cogent explanation of the Court’s paradigm for damages, at least in an asset transaction.¹⁵² Perry Equipment purchased Maloney Pipeline (“Maloney”) from Ramteck II in August of 1985 on the basis of two financial statements prepared by Arthur Andersen as of March 31 and June 30 of 1985, both of which showed Maloney to be profitable.¹⁵³ However, on May 20, 1985 Arthur Andersen also sent an undisclosed report to Ramteck II which indicated that Maloney was operating at an annual loss of \$600,000.¹⁵⁴ Perry Equipment paid \$4,088,237 to purchase the company and spent an additional \$1,361,231 on Maloney after the acquisition to try to salvage its investment.¹⁵⁵ Maloney filed for Chapter 11 protection in October 1986 and thereafter the case was converted to a Chapter 7 liquidation.¹⁵⁶

The jury instructions asked “What sum of money, if any, if paid now in cash, would fairly and reasonably compensate PECO

148. *Henry S. Miller Co. v. Bynum*, 836 S.W.2d 160, 161 (Tex. 1992).

149. *Bynum*, 797 S.W.2d at 54.

150. *Bynum*, 836 S.W.2d at 162-64 (Phillips, C.J., concurring).

151. *Id.* at 164.

152. *Arthur Andersen & Co. v. Perry Equip. Corp.*, 945 S.W.2d 812, 816-17 (Tex. 1997).

153. *Id.* at 814.

154. *Id.*

155. *Id.*

156. *Arthur Andersen & Co. v. Perry Equip. Corp.*, 898 S.W.2d 914, 917 (Tex. App.—Houston [1st Dist.] 1995), *rev’d*, 945 S.W.2d 812 (Tex. 1997).

for its losses which resulted from such conduct.”¹⁵⁷ The jury awarded \$5,449,468 of direct damages as well as \$3,449,468 of prejudgment interest and \$1,973,009 in legal fees in its suit against Arthur Andersen.¹⁵⁸

In a brief and problematic opinion, the First District recited the distinction between the BOB and OOP approaches but it overlooked the distinction between direct and special damages.¹⁵⁹ The First District adopted the plaintiff’s claim that Maloney, the acquired company, was a veritable sink hole into which the plaintiff threw the purchase price and subsequent additional expenditures to attempt to salvage the operation, aptly called “sinkhole expenses.”¹⁶⁰ The First District’s opinion quotes the Supreme Court’s *Bynum* opinion, following the “total loss” approach,¹⁶¹ but the First District opinion neglected to distinguish direct from special damages.¹⁶²

The Supreme Court held that the evidence supported the award of some of these damages as part of the “actual loss” the plaintiff sustained, even though the plaintiff did not present evidence to support an “out-of-pocket” or “benefit-of-the-bargain” measure of damages.¹⁶³ Justice Cornyn’s opinion remanded the case for a new trial because Perry Equipment failed to obtain a jury finding that distinguished between direct and consequential damages.¹⁶⁴ Ideally, *Perry Equipment* would have distinguished between three different types of damages according to the OOP approach:

Direct damages: the difference between the fair market value of Maloney Pipe’s equity as it actually was worth (acknowledging the prior operating losses) and the price paid in August of 1985.¹⁶⁵

157. *Id.* at 814 (describing this total as expenses incurred by Perry Equipment to salvage Maloney). The First District opinion shows that the largest single item was the cost of Perry Equipment’s “management time and expenses.” 898 S.W.2d at 920.

158. *Perry Equip.*, 945 S.W.2d at 814.

159. *Perry Equip.*, 898 S.W.2d at 919.

160. *Id.* at 920.

161. *Id.* at 919 (“The DTPA provides that a prevailing consumer may obtain ‘the amount of actual damages found by the trier of fact.’ The amount of actual damage recoverable under the DTPA is ‘the total loss sustained [by the consumer] as a result of the deceptive trade practice.’” (quoting *Henry S. Miller Co. v. Bynum*, 836 S.W.2d 160, 162 (Tex. 1992))).

162. *See id.*

163. *Perry Equip.*, 945 S.W.2d at 816-17.

164. *Id.* at 814.

165. *See Arthur Andersen v. Perry Equip. Corp.*, 898 S.W.2d 914, 919-22 (Tex. App.—Houston [1st Dist.] 1995, *rev’d*, 945 S.W.2d 812 (Tex. 1997)).

Consequential damage: the difference between the fair market value of Maloney Pipe's equity (as it was actually worth) in August, 1985 and the value when it filed for Chapter 11 protection (subject to proof of causation).¹⁶⁶

Consequential and incidental damages: the "sinkhole expenses" with which the plaintiff tried to salvage any value from Maloney Pipe after August, 1985.¹⁶⁷

The Supreme Court's opinion left two open issues. First, the opinion states that the plaintiff must show that the defendant's misrepresentation was a producing cause of the consequential damages.¹⁶⁸ It advises that the transaction causation would be insufficient, i.e. it was not enough for the plaintiff to assert that but for the misrepresentation, there would not have been any acquisition and therefore no consequential damages.¹⁶⁹ Typically, the loss causation standard is only applied in federal securities cases, not to fraudulent inducement cases, nor even for state securities claims.¹⁷⁰ Taken at face value, this additional requirement would represent a major shift in Texas common law which has not adopted the loss causation standard. Perhaps Justice Cornyn contemplated a standard in between the two alternatives or a light version of the loss causation standard as Dunn points out that there are many versions or interpretations of that standard.¹⁷¹

166. *See id.*

167. *See id.* at 920 n.7.

168. *Perry Equip.*, 945 S.W.2d at 817 ("Subsequent losses, however, are recoverable only if the misrepresentation is a producing cause of the loss. Without this limitation, an investor could shift the entire risk of an investment to a defendant who made a misrepresentation, even if the loss were unrelated to the misrepresentation. The basis of a misrepresentation claim is that the defendant's false statement induced the plaintiff to assume a risk he would not have taken had the truth been known. But to allow the plaintiff to transfer the entire risk of loss associated with his investment, even risks that the plaintiff accepted knowingly or losses that occurred through no fault of the defendant, would unfairly transform the defendant into an insurer of the plaintiffs entire investment." (citations omitted)).

169. *Id.* at 817-18.

170. *Duperier v. Tex. State Bank*, 28 S.W.3d 740, 753-54 (Tex. App.—Corpus Christi 2000, pet. dismissed) ("Loss causation is not an element of or a defense to a claim brought under this particular provision of the Act. Until it was amended in 1995, the federal version of article 581-33A(2), 15 U.S.C. § 771(1) (commonly known as section 12(2) of the Securities Act), did not impose loss causation criteria and federal courts did not include loss causation as an element in a cause of action brought under that section.").

171. DUNN, *supra* note 87, § 1.6, at page 19.

Justice Cornyn's opinion also volunteers an inconclusive discussion of the role that the defendant can pursue to prove that the plaintiff failed to mitigate its damages and thereby receive a limiting instruction from the court on jury instructions for damages.¹⁷² Even in fraud cases, juries have found the defendant liable but reduced the damages for failing to mitigate.¹⁷³ His suggestion is well-taken but it fails to offer any observations on the boundary between the plaintiff's burden to substantiate consequential damages and the defendant's burden of proof to establish the plaintiff's failure to mitigate.

As a "landmark opinion" on fraudulent inducement, the Court's opinion in *Formosa Plastics* is doubly ironic. First it merely confirmed that expectancy damages are available for claims of fraudulent inducement under the common law after originally making that holding in 1983 in *Trenholm* and making that statement as dicta in *Leyendecker*, *Bankston Nissan* and *Perry Equipment*.¹⁷⁴ As a part of the *Formosa Plastics* holding, the Court confirmed that its doctrine in *DeLanney*¹⁷⁵ did not apply to fraudulent inducement because "it is well established that the legal duty not to fraudulently procure a contract is separate and independent from the duties established by the contract itself."¹⁷⁶ Second, while the opinion confirmed the distinctions made in *Perry Equipment* between the OOP and BOB approaches for measuring direct damages, it struggled with the hypothetical construct for expectancy damages and failed to note differing measures between asset transactions and service contracts.¹⁷⁷ The opinion states that the proper calculation for this contractor case for expectancy damages is "Presidio's anticipated profit on the \$600,000 bid plus the actual cost of the job less the amount actually paid by Formosa"¹⁷⁸ or the expected profit plus cost over-runs. Unfortunately this approach is not

172. *Perry Equip.*, 945 S.W.2d at 817.

173. *Transmission Exch. Inc. v. Long*, 821 S.W.2d 265, 274 (Tex. App.—Houston [1st Dist.] 1991, writ denied).

174. See *Leyendecker & Assocs., Inc. v. Wechter*, 683 S.W.2d 369, 373 (Tex. 1984); *W.O. Bankston Nissan, Inc. v. Walters*, 754 S.W.2d 127, 128 (Tex. 1988); *Perry Equip.*, 945 S.W.2d at 817.

175. *Formosa Plastics Corp., USA v. Presidio Eng'rs & Contractors, Inc.*, 960 S.W.2d 41, 46 (Tex. 1998) ("Several appellate courts have considered the application of our decisions in *DeLanney* and *Reed* to fraudulent inducement claims. Some of these courts have concluded that these decisions mandate that tort damages are not recoverable for a fraudulent inducement claim unless the plaintiff suffers an injury that is distinct, separate, and independent from the economic losses recoverable under a breach of contract claim.").

176. *Id.* (citing *Dallas Farm Mach. Co. v. Reaves*, 307 S.W.2d 233, 239 (Tex. 1957)).

177. See *id.* at 49-50.

178. *Id.* at 50.

compared to or grouped with prior service contract cases like *Kish*¹⁷⁹ or *Bynum*¹⁸⁰ to help distinguish damage claims for service contracts from asset transactions. It would appear that claims for service contracts have no direct damages and must rely on the BOB approach for consequential damages.

D. *Reliance Waivers and Class Actions*

The Court's opinion in *Swanson* is important because it recognizes an effective approach to waive fraud damages.¹⁸¹ The plaintiffs in *Swanson* claimed that when they formed a venture to develop their offshore diamond lease in South Africa, they were fraudulently induced into an agreement that forfeited their interests.¹⁸² The jury awarded and the court of appeals affirmed \$15 million in actual damages and \$35 million of punitive damages based on expert appraisals.¹⁸³

The Supreme Court's opinion in *Swanson*, however, held that the contract clause in which Swanson disavowed any reliance on representations from the defendants was indeed enforceable.¹⁸⁴ Subject to public policy considerations, sophisticated parties are free to negotiate contracts that waive either party's reliance interest.¹⁸⁵ In the absence of establishing his reasonable reliance, a claimant for fraud cannot prove a prima facie case for fraud.¹⁸⁶

The Federal Trade Commission has been successful in filing quasi-class actions against alleged fraudfeasors for unjust enrichment.¹⁸⁷ The victims of the fraud are not individually named, and the settlements or awards are held in trust for the FTC to dispense to victims as they are identified.¹⁸⁸ In 2003, the FTC won about 90 judgments for total awards of about 900

179. *Kish v. Cowboy Pools*, 692 S.W.2d 463, 466-68 (Tex. 1985).

180. *Henry S. Miller Co. v. Bynum*, 836 S.W.2d 160, 163 (Tex. 1992) (Phillips, C.J., concurring).

181. *Schlumberger Tech. Corp. v. Swanson*, 959 S.W.2d 171, 181 (Tex. 1997); *see also* *Forest Oil Corp. v. McAllen*, 268 S.W.3d 51, 56 (Tex. 2008).

182. *Swanson v. Schlumberger Tech. Corp.*, 895 S.W.2d 719, 726 (Tex. App.—Texarkana 1994), *rev'd*, 959 S.W.2d 171 (Tex. 1997).

183. *Id.*

184. *Schlumberger Tech. Corp.*, 959 S.W.2d at 181.

185. *See Forest Oil Corp.*, 268 S.W.3d at 58.

186. *See id.* at 57-61.

187. George P. Roach, *A Default Rule of Omnipotence: Implied Jurisdiction and Exaggerated Remedies in Equity For Federal Agencies*, 12 FORDHAM J. CORP. & FIN. L. 1, 92-94 (2007).

188. Roach, *supra* note 188, at n.5; *see also* 31 U.S.C. § 3302.

dollars.¹⁸⁹ Recently the Texas Consumer Protection and Public Health Division prevailed in some litigation that indicates that the Deceptive Trade Practices Act may spawn in Texas an effort by state agencies to follow the FTC example.¹⁹⁰ In *Thomas v. State*, the Court held that the DTPA provided jurisdiction for the state agency to sue for restitution for unnamed plaintiffs.¹⁹¹ While most claims under the DTPA enjoy only a two year statute of limitations, the court held that claims for restitution were entitled to a four year period.¹⁹² Such statutory claims can be very powerful because of the ease of proving damages and the leverage normally associated with class claims.

V. VALUE AS A DAMAGES METRIC

In many areas of remedies law, lost value and lost profits are alternative measures of damage. For claims of fraudulent inducement relating to an asset transaction, Texas common law prefers loss in value;¹⁹³ for claims relating to service contracts, lost profits is preferred.¹⁹⁴ Special care needs to be taken to understand the basis of the plaintiff's valuation as well as possible claims for lost profits not only to maximize the plaintiff's legitimate claim but also to avoid likely pitfalls for duplication.

As a metric of damage, value can offer some significant advantages to business plaintiffs. In comparison to claiming lost profits, loss in business value offers a longer time horizon and can incorporate factors such as risk and changes in capital structure. For example, consider the claim of a new retail chain that has secured a loan agreement to finance fifteen outlets. After five successful outlets are completed, the creditor terminates the loan agreement without cause and leaves the retailer unable to secure alternative financing. If the retailer measures his damages by lost profits, he may convince a jury to award projected operating profits for the next five to ten years for

189. See George P. Roach, *Counting the Beans: Unjust Enrichment and the Defendant's Overhead*, 16 TEX. INTELL. PROP. L.J. 483, 544 (2008); Roach, *supra* note 188, at 93-94.

190. *Thomas v. State*, 226 S.W.3d 697, 707 (Tex. App.—Corpus Christi 2007, pet. dism'd).

191. *Id.*

192. *Id.*

193. *George v. Hesse*, 93 S.W. 107 (1906). *But see* *Abraxas Petroleum Corp. v. Hornburg*, 20 S.W.3d 741, 761 (Tex. App.—El Paso 2000, no pet.); *Nelson v. Data Terminal Sys., Inc.*, 762 S.W.2d 744, 747 (Tex. App.—San Antonio 1988, writ denied).

194. *Formosa Plastics Corp., USA v. Presidio Eng'rs & Contractors, Inc.*, 960 S.W.2d 41, 46 (Tex. 1998); *Formosa Plastics Corp., USA v. Kajima Int'l, Inc.*, 216 S.W.3d 436, 459 (Tex. App.—Corpus Christi 2006, pet. denied).

the additional ten outlets. By comparison, the plaintiff could claim damages as the difference in the fair market value of a five outlet chain and a fifteen outlet chain. Such a damage claim would include the difference of ten missing outlets for an infinite period of time (business valuations are based on infinite life) and the enhanced value due to increased size and diversity of a fifteen outlet chain versus a five outlet chain. In such a circumstance with the income projections based on exactly the same numbers for the first five years, I have experienced a differential of 200% greater for change in value versus lost profits.

A. *Measuring Value*

There are a number of different types of value: fair market value (the price agreed to by a willing buyer and willing seller based on complete information), use value (the economic value of an asset based on a specific use for a specific owner) or subjective value (the value of an asset to specific individual based on that individual's personal "relationship" to the asset).¹⁹⁵

To comply with business appraisal standards and the expectations of most litigation, it is important to ensure that there are no special assumptions in the estimate of fair market value that could taint or corrupt the usefulness of the estimate for direct damages.¹⁹⁶ For transactions relating to personal property, for example, the plaintiff's subjective value for the asset is irrelevant.¹⁹⁷ For claims relating to business transactions, the business needs to be valued on a stand-alone or arm's length basis.¹⁹⁸ Therefore, the fair market value of a single fast food restaurant should be the same whether it is about to be acquired by a recent retiree who plans to provide the majority of the labor

195. SHANNON PRATT, ET. AL., VALUING A BUSINESS 544 (3d ed. 1996).

196. Measuring value for expectancy damages, however, may require a valuation under the BOB approach to apply special assumptions based on the defendant's misrepresentations to provide the plaintiff with the benefit of the bargain.

197. Pontiac v. Elliott, 775 S.W.2d 395, 398-99 (Tex. App.—Houston [1st Dist.] 1989, writ denied); Momentum Motor Cars, Ltd. v. Williams, No. 13-02-00042-CV, 2004 LEXIS 9940, at *15 (Tex. App.—Corpus Christi Nov. 10, 2004, writ denied) (mem. op.).

198. DOBBS, *supra* note 52, at 324-33. *But see* RESTATEMENT (SECOND) OF CONTRACTS § 347 cmt. b (1981) ("If defective or partial performance is rendered, the loss in value caused by the breach is equal to the difference between the value that the performance would have had if there had been no breach and the value of such performance as was actually rendered. In principle, this requires a determination of the values of those performances to the injured party himself and not their values to some hypothetical reasonable person or on some market. *See* RESTATEMENT (SECOND) OF TORTS § 911. They therefore depend on his own particular circumstances or those of his enterprise, unless consideration of these circumstances is precluded by the limitation of foreseeability (§ 351).").

or by a national chain of such restaurants which enjoys substantial economies of scale in financing, purchasing and administration.

If the measure of the plaintiff's lost profits were based strictly on a free standing or arm's length relationship, i.e. no special consideration is given to the nature or special resources of the plaintiff, such a claim for lost profits would be duplicative of the direct damages that are claimed as a difference in fair market value.¹⁹⁹ However, lost profits are effectively subjective, not objective, and the plaintiff's measure of lost profits is permitted to include most special factors that would have allowed the plaintiff to gain "special use" profits.²⁰⁰

In most cases, the plaintiff who asserts direct damages as the difference in market value can also substantiate those "special use" profits as separate special damages. For example, assume that a national chain of restaurants was fraudulently induced into buying a similar individual restaurant. Before the acquisition, the national chain studied the acquisition and determined that on the basis of its proven management and

199. DOBBS, *supra* note 52, at 558 ("How duplication occurs. . . . If Blackacre, a farm, would be worth \$500,000 with the good water supply represented by the seller, but is worth only \$400,000 with the water that in fact exists, then the buyer who has paid \$400,000 for the farm has \$100,000 general damages under the loss of bargain measure. This sum reflects, as a capital sum, the expectation that, with limited water, the farm will produce fewer crops and that it will therefore earn less money. If the plaintiff is permitted to recover both \$100,000 and the estimated value of the future crops themselves, the value of the diminished crops with will have been counted twice."); *see also* Ryan Mortg. Investors v. Fleming-Wood, 650 S.W.2d 928, 936 (Tex. App.—Fort Worth 1983, writ ref'd n.r.e.).

200. *See* DOBBS, *supra* note 52, § 12.2(3), at 42 ("To see an example of consequential damages, suppose the defendant reneges on a promise to deliver a specified computer system for \$150,000. The computer is worth \$160,000. A general or market measure of damages would give the plaintiff an award in such a case (\$10,000). But suppose the plaintiff is unable to use the computer as planned to calculate factory production schedules for maximum efficiency. This in turn may cause a reduction in profits compared to those that would have been earned had the computer been available. Damages based on the market value of the computer will not compensate the plaintiff for the profits lost in this way. Nor would the general damages measure provide compensation for the added expense the plaintiff might suffer in hiring added workers to do customer billing by hand that the computer could do more efficiently. The added expense and the loss of profits are real losses not based directly on the market value of the computer. They are losses in *consequence* of not having the computer."); *but see* Checker Bag Co. v. Washington, 27 S.W.3d 625, 641 (Tex. App.—Waco 2000, pet. denied) ("Business reputation or 'goodwill' is usually considered to be a part of the value of a business. *Nelson v. Data Terminal Sys., Inc.*, 762 S.W.2d 744, 748 (Tex. App.—San Antonio 1988, writ denied). The ability of the business to make a profit is reflected in its value. *City of San Antonio v. Guidry*, 801 S.W.2d 142, 150 (Tex. App.—San Antonio 1990, no writ). Thus, the recovery of both lost profits and damage to business reputation could easily be duplicative. *See id.*; *C. A. May Marine Supply v. Brunswick Corp.*, 649 F.2d 1049, 1053 (5th Cir. 1981).").

operating system, it would improve the profitability of acquisition by \$50,000 a year over and above the level of profitability that would otherwise be reasonable to expect from such an operation. In fact, the chain can document that in the twenty prior acquisitions, the outlet's profit improvement ranged from \$40,000 to \$100,000 with an average of \$50,000 per year. Accordingly, the chain assesses a corporate charge to each restaurant of \$50,000 to reflect the corporate contribution to the outlet's performance. Therefore the defrauded chain can claim direct damages in the form of the value differential for the outlet as well as consequential damages of \$50,000 per year for the chain for the lost profit from lost corporate charges without risk of duplication.

Consider the case of *Naegli Transport* in which the plaintiff bought a piece of used machinery for \$10,000 and hired the defendant to transport and store the machinery until the plaintiff was ready to restore it.²⁰¹ In the meantime, the plaintiff found a customer to buy the equipment, restored, for \$280,000.²⁰² The plaintiff reasonably estimated that restoration would require \$25,000 of cash expenditures.²⁰³ The plaintiff sued the defendant when it became clear that the equipment was irretrievably lost while under the care of the defendant.²⁰⁴ The jury awarded damages to the plaintiff on the basis of direct damages of \$25,000 and consequential damages of \$150,000 for lost profits.²⁰⁵ The plaintiff succeeded in securing an award of most of the asset's subjective value.²⁰⁶

Many business claims relate more to limited term business ventures than established ongoing businesses such as real estate developments or even the advertising component of an existing business.²⁰⁷ In such circumstances, a claim for lost profits may seem more suitable even if such special damage claims are subject to the standard of proximate cause as opposed to the presumptive causation permitted direct damages.²⁰⁸ On the

201. *Naegli Transp. v. Gulf Electroquip, Inc.*, 853 S.W.2d 737, 737-40 (Tex. App.—Houston [14th Dist.] 1993, writ denied); see generally *Aquaplex, Inc. v. Rancho La Valencia*, 297 S.W.3d 768 (Tex. 2009) (stating that plaintiff could recover lost profits damage due to subsequent offer to buy property after misrepresentation).

202. *Naegli Transp.*, 853 S.W.2d at 740.

203. See *id.*

204. See *id.* at 738-39.

205. *Id.* at 738.

206. See *id.* at 737-41 (plaintiff was awarded damages of \$175,000 on equipment valued at \$295,000).

207. *White v. Sw. Bell Tel. Co.*, 651 S.W.2d 260, 262-63 (Tex. 1983).

208. See *Abraxas Petroleum Corp. v. Hornburg*, 20 S.W.3d 741, 758 (Tex. App.—El Paso 2000, no pet.).

other hand, the valuation of a business or venture according to the income method is nothing more than the present value of the projected profits (as adjusted for cash expenditures) and the terminal value of the venture.²⁰⁹ If an expert can measure the present value of lost profits, she can reasonably estimate the value of that business. Defendants may want to consider why damages are presented in the form of lost profits rather than lost value.²¹⁰

Alternatively, business venture plaintiffs have asserted damages based on the plaintiff's costs or expenditures made for the venture on the implied basis that the small venture is too obscure or too small to be appraised.²¹¹ Some business appraisals have been made on the basis of cost but such a practice is generally regarded as a last resort among professional business appraisers and the courts have generally criticized such practice.²¹² Such a damages measure would only be appropriate for consequential or reliance damages and only under the OOP approach.²¹³

While the topic is outside the scope of this article, it is also important to note that the cost to repair the plaintiff's damage is sometimes pled as an alternative for the plaintiff or as a limiting condition by the defendant.²¹⁴

209. See *Galveston, Harrisburg, & San Antonio Ry. v. Texas*, 210 U.S. 217, 226 (1908) (explaining that the commercial value of property consists in the expectation of income from it); see also *Abraxas Petroleum Corp.*, 20 S.W.3d at 761.

210. See *Abraxas Petroleum Corp.*, 20 S.W.3d at 760-61; *Naegeli Transp. v. Gulf Electroquip, Inc.*, 853 S.W.2d 737, 740-41 (Tex. App.—Houston [14th Dist.] 1993, writ denied); *White*, 651 S.W.2d at 262-63. For example, claims for lost profits might measure the present value of lost profits according to a “normal” discount rate of 10% when the appropriate discount rate for the business in question might be 20% which unchecked would allow the plaintiff to claim excessive damages.

211. *Henry S. Miller Co. v. Bynum*, 797 S.W.2d 51, 53 (Tex. App.—Houston [1st Dist.] 1990), *aff'd*, 836 S.W.2d 160 (Tex. 1992); see *Woo v. Great Sw. Acceptance Corp.*, 565 S.W.2d 290, 297-98 (Tex. Civ. App.—Waco 1978, writ ref'd n.r.e.); *Miles Homes Div., Insilco Corp. v. Smith*, 790 S.W.2d 382, 395 (Tex. App.—Beaumont 1990, writ denied) (Brookshire J., dissenting).

212. See *Woo*, 565 S.W.2d at 297-98. *But see Raye v. Fred Oakley Motors Inc.*, 646 S.W.2d 288, 291 (Tex. App.—Dallas 1983, writ ref'd n.r.e.) (“Woo is the only authority cited, or found, where actual damages are measured by proof of cost, rather than market value, of the product purchased where there is no proof that the product was without value in the hands of the purchaser.”).

213. See *Southampton Mineral Corp. v. Coastal Oil & Gas Corp.*, 846 S.W.2d 609, 610-11 (Tex. App.—Houston [14th Dist.] 1993, writ denied).

214. See DOBBS, *supra* note 52, § 12.2(2), at 28 (“Commonly, however, the choice in measuring expectancy damages is a choice familiar in other areas—a choice between a market value measure and a cost-of-substitute-performance measure, either of which might also be supplemented with special damages such as lost profits when the facts warrant.”).

B. Valuation Date

Texas courts generally insist that valuations be made as of the date that the contract was executed.²¹⁵ Some case opinions have allowed that date to vary within a range of dates in cases of “string along fraud” which includes fact patterns where the defendant makes significant misrepresentations to induce the contract and to either extend or hide the earlier misrepresentations after the contract is executed.²¹⁶ Outside of Texas, a minority of jurisdictions allow the relevant valuations to be made as of the date of discovery.²¹⁷

The choice of Texas courts to require valuation on the date of execution can create some complications for those plaintiffs whose purchased assets continue to decline in value after the date the contract is signed. Contrary to general theory, recent Texas case opinion defines direct damages as that damage, measured by the difference in market value, on the date the contract is signed rather than that damage that is the natural and usually result of the misrepresentation.²¹⁸ Apparently, in Texas it is possible for the plaintiff to experience damage that naturally and usually occurs as a result of the misrepresentation after the date of the contract and should therefore be treated as special damage, requiring greater proof as to causation and special pleading.²¹⁹

A 1991 opinion from El Paso shows that failing to consider the time frame of a plaintiff’s claim can result in the denial of damages.²²⁰ The plaintiff bought a house for \$135,000 that required substantial renovation.²²¹ The plaintiffs spent \$80,125 on improving the house and then tried to sell the property.²²² After they secured a contract, the plaintiffs learned that a wall of the house encroached on adjoining property and the contract fell through.²²³ Absent the encroachment, the property was

215. See *Arthur Andersen v. Perry Equip. Corp.*, 945 S.W.2d 812, 817 (Tex. 1997).

216. For an exception to this rule, see the following cases relating to string along fraud: *Hycel, Inc. v. Wittstruck*, 690 S.W.2d 914, 924 (Tex. App.—Waco 1985, writ dismissed); *Formosa Plastics Corp., USA v. Kajima Int’l, Inc.*, 216 S.W.3d 436, 458 (Tex. App.—Corpus Christi 2006, pet. denied).

217. DUNN, *supra* note 87, § 5.5 at 205.

218. See *Perry Equip.*, 945 S.W.2d at 817.

219. See *supra* Part IV.b. (discussing the Texas Supreme Court’s opinion in *Perry Equipment*); see also *supra* notes 194-95 and accompanying text (explaining how Texas Supreme Court’s definition of lost profits also abridges this common law doctrine).

220. See *Odom v. Meraz*, 810 S.W.2d 241 (Tex. App.—El Paso 1991, writ denied).

221. See *id.* at 242-43.

222. See *id.* at 243.

223. See *id.*

appraised at \$229,000 although the plaintiffs thought the property was worth \$258,000 which was the value that the defendant told the plaintiffs the property would be worth with some improvement.²²⁴

The jury instruction asked “What sum of money, if paid in cash, do you find from a preponderance of the evidence, would fairly and reasonably compensate [the plaintiffs] for their actual damages, if any?”²²⁵ After having found the defendant liable for fraudulent inducement, the jury found that actual damages were \$42,000 (likely measured as the approximate difference between \$258,000 and the plaintiffs’ cost basis of \$215,125).²²⁶ In response to the defendant’s no evidence motion, the appellate court reversed the trial court and ordered that the plaintiffs take nothing: “The Appellees’ judgment must be reversed. It was Appellees’ burden to offer proper proof to support their DTPA claim and there is no evidence in the record concerning the difference between the purchase price of the realty and its actual value as received by Sam and Carol Meraz.”²²⁷

Not only was the plaintiff’s damages strategy inadequate to substantiate the \$145,190 judgment but it probably also understated the plaintiff’s actual loss.²²⁸ If the house had a fair market value of less than the cost basis of \$215,125, the total damages would be greater than \$42,000, i.e. the difference between \$258,000 and the current fair market value.²²⁹

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

the loss in value on the date of purchase (the fair market value on the date of sale of the property as represented less the consideration paid)[; or]

the lost profit as measured by the difference between the fair market value of the house as represented and restored and the fair market value on the date of sale of the property as represented.²³⁰

224. *See id.*

225. *See id.* at 244.

226. *See* Odom v. Meraz, 810 S.W.2d 241, 243 (Tex. App.—El Paso 1991, writ denied).

227. *Id.* at 245.

228. *Id.* at 243-45.

229. *Id.*

230. *Id.* at 244.

Damages under the OOP approach generally offer less relief.²³¹ The plaintiff would be entitled to direct damages of the difference between the price paid and the fair market value of the house on the date of sale as delivered, i.e. with full knowledge of the encroachment.²³² The improvements would not qualify as reliance damages because improvements qualify as damage only to the extent that they fail to improve the value of the plaintiff's property or assets.²³³ To the extent that a defendant can prove that reliance damages would result in a loss to the plaintiff, the loss cannot be included as damage.²³⁴ However, the plaintiff might be able to prove some incidental damages for expenses that the plaintiff incurred in salvaging or re-selling his asset. Under the OOP approach, however, no consequential damages in the form of lost profits would be admitted.

VI. LOST PROFITS AS A DAMAGES METRIC

Business claims for expectancy damages in fraudulent inducement claims are generally pled as lost profits.²³⁵ Historically, Texas courts have preferred business damages to be measured as losses in value for the loss of the entire business and lost profits for damage of part of the business or loss of the business for a limited time period.²³⁶ That historical bias no longer seems prevalent and in cases of fraudulent inducement there appears to be no requirement to measure by difference in value in asset transactions.²³⁷ Opinions in service contract cases generally consider only lost profits.²³⁸

231. *See id.*

232. *See id.*

233. *Henry S. Miller Co. v. Bynum*, 836 S.W.2d 160, 163 (Tex. 1992); *Washington Mut. Bank v. Houston Windcrest W. Road I, L.P.*, 262 S.W.3d 856, 863 (Tex. App.—Dallas 2008, pet. denied); *Texarkana Motor Co. v. Brashears*, 37 S.W.2d 773, 775 (Tex. Civ. App.—Texarkana 1931, no writ).

234. *See infra* notes 401-02 and accompanying text.

235. *See Naegeli Transp. v. Gulf Electroquip, Inc.*, 853 S.W.2d 737 (Tex. App.—Houston [14th Dist.] 1993, writ denied); *Aquaplex, Inc. v. Rancho La Valencia*, 297 S.W.3d 768 (Tex. 2009).

236. George P. Roach, *Correcting Uncertain Prophecies: An Analysis of Business Consequential Damages*, 22 REV. LITIG. 1, 11-21 (2003).

237. *See Formosa Plastics Corp., USA v. Kajima Int'l, Inc.*, 216 S.W.3d 436, 458-59 (Tex. App.—Corpus Christi 2006, pet. denied). *But see* the following cases that hold that lost profits is the only appropriate measure for damages in a breach of contract: *Abraxas Petroleum Corp. v. Hornburg*, 20 S.W.3d 741, 761 (Tex. App.—El Paso 2000, no pet.); *Nelson v. Data Terminal Sys., Inc.*, 762 S.W.2d 744, 747-48 (Tex. App.—San Antonio 1988, writ denied).

238. *See Kajima*, 216 S.W.3d at 458-59.

For the purposes of fraud damages, four types of lost profits can be distinguished.²³⁹ First, there is the gain on sale or transaction profit.²⁴⁰ The best example of this form of lost profit is the opinion in *Replacement Parts* where the plaintiff had a contract to sell certain real estate lots to the defendant as a result of which the plaintiff would have enjoyed significant profits.²⁴¹ In that case lost profits were held to be direct damages.²⁴² Second, there are the normal operating profits that were lost in the past and/or that are expected to be lost in the future.²⁴³ Of course, there is significant litigation over how these lost profits should be measured. With some exceptions, this type of lost profit is only admissible under the BOB approach and is not admissible for consideration as damage for negligent misrepresentation.²⁴⁴ Third, lost profits have been asserted as evidence of the damage to the plaintiff's credit reputation or goodwill.²⁴⁵

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

239. *ERI Consulting Engineers, Inc. v. Swinnea*, 318 S.W.3d 867, 876 (Tex. 2010) (“We need not distinguish here between ERI’s causes of action – common-law and statutory fraud, breach of contract, and breach of fiduciary duty — because ERI’s lost profit damages are recoverable for any one of those claims.”).

240. *DOBBS*, *supra* note 52, § 3.3(3), at 299 (“In some cases the plaintiff’s loss is found in the fact that the plaintiff did not make the gain to which she was entitled. This is notably the case with expectancy damages in contracts. The horse purchaser has a loss in the sense that she failed to reap the \$50,000 gain that contract performance would have given him. It is appropriate to say that the plaintiff failed to reap a ‘gain’ or entitlement here but not helpful to say that he lost ‘profits,’ which would suggest that an expected income stream was lost or diminished. Although lost profits may be recoverable in some cases, they will be recoverable as consequential damages, not as market damages.”).

241. *Cnty. Dev. Serv., Inc. v. Replacement Parts Mfg.*, 679 S.W.2d 721, 725-26 (Tex. App.—Houston [1st Dist.] 1984, no writ).

242. *See id.* at 725.

243. *See Fed. Land Bank Ass’n v. Sloane*, 825 S.W.2d 439, 442-43 (Tex. 1991).

244. *See id.*; *D.S.A., Inc. v. Hillsboro Indep. Sch. Dist.*, 973 S.W.2d 662, 664 (Tex. 1998).

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

contract of the misrepresentation.²⁴⁶ These claims are generally rejected as thinly disguised claims for expectancy damages.²⁴⁷

The second form is taken more seriously as it relates to the opportunity costs or lost profits on secondary contracts or business transactions aside from the subject transaction. One such claim was regarded as too attenuated as asserting loss from a contract too far removed and speculative from the transaction at issue.²⁴⁸ Another claim was also rejected but received more serious consideration and was only rejected for want of adequate substantiation.²⁴⁹ The plaintiff claimed that the defendant had induced the plaintiff into pursuing intensified service under the existing contract in anticipation of being awarded a second and more lucrative contract.²⁵⁰ The plaintiff was awarded significant damages for consequential and reliance damages.²⁵¹ However, the plaintiff also asserted special damages in the form of profits that the company would have otherwise earned by devoting its attention to more lucrative business opportunities than the project that it was induced into pursuing.²⁵² This opportunity cost claim, as manifested in the jury's finding, was rejected on the basis of inadequate substantiation.²⁵³ It seems reasonable to note that this sort of claim, without overwhelming evidence and

246. DOBBS, *supra* note 52, § 12.3(1) at 54-55.

247. Baylor Univ. v. Sonnichsen, 221 S.W.3d 632, 636-37 (Tex. 2007) ("Damages arising from the inability to obtain employment during the 1996-1997 season and the lost opportunity to advance career and increase earning capacity are benefit-of-the bargain damages because they are premised on the assertion that Baylor is liable for not employing Sonnichsen during 1996-1997 as he expected and for not honoring an alleged contract. Sonnichsen's claim is not that he parted with or lost anything during his actual contract term, but that he did not benefit as he expected or would have if his employment by Baylor continued beyond 1995-1996."); *see also* Sterling Chems., Inc. v. Texaco Inc., 259 S.W.3d 793, 798 (Tex. App.—Houston [1st Dist.] 2007, pet. denied); Case Corp. v. Hi-Class Bus. Sys. of Am., Inc., 184 S.W.3d 760, 779 (Tex. App.—Dallas 2005, pet. denied) ("HBS's description of its claimed damages makes clear HBS was not seeking to recoup its *expenditures* made in reliance on the Hatch representations. Instead, HBS was seeking to collect any prospective additional revenues it relinquished when it contracted: (a) to produce the Case catalogs at a discount from what it normally charged for such production; and (b) to reductions in license and maintenance fees.")

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

249. Hoechst Celanese Corp. v. Arthur Bros., 882 S.W.2d 917, 929 (Tex. App.—Corpus Christi 1994, writ denied).

250. *Id.* at 923.

251. *Id.* at 928.

252. *Id.* at 928-29.

253. *Id.* at 929 ("The evidence shows, not that the increased staff and focus caused the increased sales in 1990 and 1991, only that 1990 and 1991 continued the trend of increased construction that began in 1989. We find no evidence to support the finding of lost profits. We sustain point five as to the lost profits on fraud.")

sympathetic circumstances, is bound to meet substantial resistance from judges who fear such excessive speculation and who could invoke the higher standard implicit in requiring proof of “damages in fact.”²⁵⁴

Occasionally, a plaintiff can secure lost profits aside from expectancy damages. If the plaintiff sells goods or services to the defendant and thereafter claims damages in the amount of such sales, the damages include the plaintiff’s lost profits on those sales because the plaintiff is seeking payment of the full price.²⁵⁵ Unless the defendant objects, it is unlikely that the court would notice such implied profits.²⁵⁶

Case opinions have described some strong examples of lost profit analysis. A simple example is provided from a breach of contract case relating to a cigarette distributor that lost its supply of cigarettes from the breach of a requirements contract.²⁵⁷ The plaintiff estimated the lost profits over the remaining life of the contract on the basis of both lost volume and increased cost of alternative sourcing for the cigarettes.²⁵⁸ Similarly, the Fifth Circuit recently affirmed a lost profits analysis in *Hiller*, which also related to the plaintiff’s loss of supply of a unique product.²⁵⁹ The opinion approved the damage award of \$3,995,000 because it was based on the sales revenue from specific contracts that were lost as a result of the defendant’s breach or fraud.²⁶⁰ Those revenues were offset by costs of goods sold and operating expenses to measure lost profits.²⁶¹

The lost profits analysis described in *Hycel* was sophisticated and was generally affirmed by the court of appeals.²⁶² That case relates to a dispute in which the plaintiff ordered a new blood testing machine for \$125,000 that had yet to reach actual production, but was promised for delivery by the defendant for a specific date.²⁶³ The plaintiff employed a less efficient temporary substitute with less capacity manufactured by the defendant

254. See *supra* note 40 and accompanying text.

255. See *New Process Steel Corp. v. Steel Corp. of Tex., Inc.*, 703 S.W.2d 209, 215 (Tex. App.—Houston [1st Dist.] 1985, writ ref’d n.r.e.).

256. See *id.*

257. See *Pace Corp. v. Jackson*, 284 S.W.2d 340, 343 (Tex. 1955).

258. *Id.* at 348.

259. *Hiller v. Mfrs. Prod. Research Group of N. Am., Inc.* 59 F.3d 1514, 1517 (5th Cir. 1995).

260. *Id.* at 1522.

261. *Id.*

262. *Hycel, Inc. v. Wittstruck*, 690 S.W.2d 914, 925-27 (Tex. App. —Waco 1985, writ dism’d).

263. *Id.* at 919.

because the defendant never produced a machine that met the promised specifications of the contracted equipment.²⁶⁴ For a period of at least three years, the plaintiff waited for the promised machine that the defendant reaffirmed would be soon delivered before the plaintiff returned the defendant's substitute machine and bought two machines from a competitor to replace the contracted capacity.²⁶⁵ The plaintiff sued for lost profits in the form of lost efficiency and lost capacity which was reduced to \$3,088,347 after a remittur of \$1,508,928.²⁶⁶

Hycel's success in claiming three to four years of lost profits was based in part on its proof that the defendant made a series of subsequent reinforcing misrepresentations (i.e. string-along fraud) that precluded the plaintiff from replacing the promised machine sooner.²⁶⁷ Hycel's claim also benefited from the fact that the DTPA only requires that the plaintiff show that the misrepresentation was the producing cause of the damage, not the proximate cause.²⁶⁸

In pertinent fraud cases, the issue generally reduces to the question of how far should the plaintiff be allowed to project ahead in terms of subsequent anticipated events. Lost profits from the existing contract are appropriate and subsequent contracts for resale may be affirmed especially when the plaintiff has firm agreements with third parties to buy assets or when the plaintiff can establish his business capability to reliably sell the assets. The plaintiff's goodwill or business reputation can be a significant factor. The courts did not question that Trenholm would be able to sell the houses that he was building because he had a strong track record of successful home development and Hiller had contracts with waiting customers.²⁶⁹ There have also been case opinions in which the Court of Appeals denied lost

264. *Id.* at 920.

265. *Id.*

266. *Id.* at 928.

267. *Id.* at 919-20.

268. *Hycel, Inc. v. Wittstruck*, 690 S.W.2d 914, 924 (Tex. App.—Waco 1985, writ *dism'd*) (“The evidence is by no means conclusive on whether the Laboratory waited an unreasonable length of time to mitigate. It waited over three years, from the fall of 1977 to December 1980, before purchasing the Vickers and ACA analyzers. The doctors claimed, however, that when Hycel failed to deliver the M in the fall of 1977, they continued to rely on Hycel's repeated promises to deliver the M ‘very soon’ or in another sixty or ninety days. The evidence presented a fact question on the Laboratory's diligence, but no issue was submitted to the jury.”).

269. *Trenholm v. Ratcliff*, 646 S.W.2d 927, 933 (Tex. 1983); *see also* *Barnett v. Coppell N. Tex. Court, Ltd.*, 123 S.W.3d 804, 827-28 (Tex. App.—Dallas 2003, *pet. denied*); *Hiller v. Mfrs. Prod. Research Group of N. Am., Inc.* 59 F.3d 1514, 1518 (5th Cir. 1995); *Munters Corp. v. Swisco-Young Indus., Inc.*, 100 S.W.3d 292, 301 (Tex. App.—Houston [1st Dist.] 2002, *pet. dismiss'd*).

profits on subsequent contracts.²⁷⁰ Presumably in those contrary cases, the case facts were unconvincing or the court determined that those lost profits would be excessive as courts traditionally enjoy significant discretion in the area of lost profits.²⁷¹

A. *Mitigation*

The boundary is not well defined between (1) the plaintiff's burden of proof to establish adequate causation between the defendant's misrepresentation and the damages and (2) the defendant's burden of proof to establish the plaintiff's failure to mitigate his damages. The Court in *Perry Equipment* reminds the defendant that it is possible to refute some or all of the plaintiff's assertions about damage causation by proving that the plaintiff failed to mitigate damages but the Court avoids any discussion of the dividing line even though it seems to raise the issue.²⁷²

Defendants might reasonably wonder whether a jury that finds the defendant liable for fraud will seriously consider reducing the plaintiff's damages for failing to mitigate her damages. In at least one case with "bad facts" against the defendant the jury substantially reduced actual damages.²⁷³ The First District summarized the damning case facts as follows:

Evaluating the evidence under the factors set out in *Alamo Nat'l Bank*, there was sufficient evidence to support the appellee's theory of the case that the appellant ran a dishonest repair shop; that the appellant's conduct constituted a "bait and switch" operation; that appellants habitually cheated customers, especially the "little guys;" [sic] and that when appellants realized that appellee was willing to pursue his remedies at law, they instituted a cover-up in an attempt to avoid the consequences of their actions.²⁷⁴

270. See *ISG State Operations, Inc. v. Nat'l Heritage Ins. Co.*, 234 S.W.3d 711, 717 (Tex. App.—Eastland 2007, pet. denied) ("ISG's damage model exceeds the Hoechst contractor's claim because it does not seek profits collaterally lost due to underlying events, but the profits it expected to receive from a future contract.").

271. *Mead v. Johnson Group, Inc.*, 615 S.W.2d 685, 687 (Tex. 1981) (quoting RESTATEMENT (SECOND) OF CONTRACTS: UNFORSEEABILITY AND RELATED LIMITATIONS ON DAMAGES § 365 (1981)).

272. *Arthur Andersen & Co. v. Perry Equip. Corp.*, 945 S.W.2d 812, 817 (Tex. 1997).

273. See *Transmission Exch. Inc. v. Long*, 821 S.W.2d 265 (Tex. App.—Houston [1st Dist.] 1991, writ denied).

274. *Id.* at 273.

In that case, the jury reduced actual damages of \$2,189 by \$1,677 due to the plaintiff's failure to mitigate his loss although the plaintiff was also awarded \$30,000 in punitive damages.²⁷⁵

Despite contrary holdings of the Texas Supreme Court,²⁷⁶ there is a small but continuing undercurrent of cases that wrongly assert the plaintiff has no obligation to mitigate her damages in cases of intentional torts.²⁷⁷ These statements are based on incomplete research on the appellate opinion in *Meadolake*.²⁷⁸ The initial opinion was subsequently clarified,²⁷⁹ warranting a per curiam note from the Supreme Court that the writ was denied on the basis that the First Circuit's holding had been revised to state that the defendant's point of error on mitigation was rejected because the defendant had failed to previously raise the objection.²⁸⁰

Occasionally, the plaintiff's good faith effort to mitigate damages can act as a sword as well as a shield. In *Trenholm*, the plaintiff was misled about the nature of the lots that it bought for building single family homes.²⁸¹ After building out 11 of the 18 lots, the plaintiff learned the truth: that the unsightly trailer park adjacent to the property was not going to be removed.²⁸² After learning the truth, the plaintiff continued to purchase and develop the remaining lots, later claiming that he could not stop in the middle of the development, akin to a surgeon in mid-operation.²⁸³ Reversing the court of appeals, the Court held that the plaintiff's development subsequent to learning the truth was reasonably necessary to avoid losses that would have been greater in the alternative.²⁸⁴

275. *Id.* at 274.

276. *Gunn Infiniti, Inc. v. O'Byrne*, 996 S.W.2d 854, 857-58 (Tex. 1999); *Perry Equip.*, 945 S.W.2d at 817.

277. *See Meadolake Foods, Inc. v. Estes*, 219 S.W.2d 441 (Tex. 1949); *New Process Steel Corp. v. Steel Corp. of Tex.*, 703 S.W.2d 209, 215 (Tex. App.—Houston [1st Dist.] 1985, writ *ref'd n.r.e.*); *Formosa Plastics Corp., USA v. Kajima Int'l, Inc.*, 216 S.W.3d 436, 459 (Tex. App.—Corpus Christi 2006, pet. denied) (citation omitted); *Duperier v. Tex. State Bank*, 28 S.W.3d 740, 754 (Tex. App.—Corpus Christi 2000, pet. *dism'd*); *Ameristar Jet Charter, Inc. v. Signal Composites, Inc.*, No. 3:98-CV-1360-M, 2002 U.S. Dist. LEXIS 7670, at *1 (N.D. Tex. Apr. 30, 2002, no pet.) (not designated for publication).

278. *Meadolake Foods, Inc. v. Estes*, 218 S.W.2d 862, 868 (Tex. Civ. App.—El Paso 1948), writ *ref'd n.r.e.*, 219 S.W.2d 441 (Tex. 1949) (per curiam).

279. *Id.* at 872.

280. *Id.*; *see also Hycel, Inc. v. Wittstruck*, 690 S.W.2d 914, 924 (Tex. App.—Waco 1985, writ *dism'd*) (citing *Meadolake Foods, Inc.*, 218 S.W.2d 862).

281. *Trenholm v. Ratcliff*, 646 S.W.2d 927, 929 (Tex. 1983).

282. *Id.*

283. *Id.* at 932.

284. *Id.* ("If *Trenholm* had abandoned the agreement after discovering the fraud, he would have given up his right to whatever profits were still possible. Additionally,

B. *Are Lost Profits Always Special Damages?*

It has already been noted that the Court's position in *Perry Equipment*, that direct damages must be measured as of the date of the contract, limits the legal doctrine that direct damages are those damages that naturally and usually result from the defendant's misrepresentation.²⁸⁵ In a case unrelated to fraudulent inducement but that cites fraudulent inducement case opinions, the Court has stated a similar limitation on claims for lost profits, that lost profits are only to be treated as special damages.²⁸⁶ In the future, the Tooke opinion could be limited to similar claims against municipalities but at least one federal district court has recently held that the Tooke opinion could be applied broadly outside claims against municipalities.²⁸⁷

The Southern District's interpretation of the *Tooke* opinion contradicts Texas precedent²⁸⁸ and other authorities.²⁸⁹ In cases of fraudulent inducement, the difference between pleading lost profits as direct or special damages lies with the higher standard of proximate cause for special damages. The distinction is less important to fraudulent inducement than to breach of contract

Trenholm testified his other loan agreements with Richardson would not have been renewed if he had abandoned the joint venture agreement. The fact that Trenholm purchased lots after the discovery of the fraud as he was obligated to do under the agreement does not conclusively establish as a matter of law that Trenholm did not rely on Ratcliff's representation, or alternatively, that he waived his claim of fraud.”)

285. *See* Arthur Andersen & Co. v. Perry Equipment Corp., 945 S.W.2d 812, 817 (Tex. 1997).

286. *Tooke v. City of Mexia*, 197 S.W.3d 325, 346 (Tex. 2006) (citing *Trenholm*, 646 S.W.2d at 933; *Henry S. Miller Co. v. Bynum*, 836 S.W.2d 160, 163-164 (Tex. 1992) (Phillips, C.J. concurring)).

287. *York Group, Inc. v. Horizon Casket Group, Inc.*, No. H-06-0262, 2007 U.S. Dist. LEXIS 50180, at *25-27 (S.D. Tex. July 11, 2007, no pet.) (not designated for publication). *But see* *Cont'l Holdings, Ltd. v. Leahy*, 132 S.W.3d 471, 475 (Tex. App.—Eastland 2003, no pet.).

288. *Cnty. Dev. Serv., Inc. v. Replacement Parts Mfg.*, 679 S.W.2d 721, 725 (Tex. App.—Houston [1st Dist.] 1984, no writ); *Hedley Feedlot, Inc. v. Weatherly Trust*, 855 S.W.2d 826, 837 (Tex. App.—Amarillo 1993, writ denied); *Tenn. Gas Pipeline Co. v. Technip USA Corp.*, No. 01-06-00535-CV, 2008 LEXIS 6419, at *30-31 (Tex. App.—Houston [1st Dist.] August 21, 2008, pet. denied) (mem. op.) (“Lost profits can take the form of direct or consequential damages.”); *Cont'l Holdings, Ltd. v. Leahy*, 132 S.W.3d 471, 475 (Tex. App.—Eastland 2003, no pet.); *Hycel, Inc. v. Am. Airlines, Inc.*, 328 F. Supp. 190, 193 (S.D. Tex. 1971).

289. DUNN, *supra* note 87, at 155 (“A careful analysis suggests that lost profits damages are not appropriately fitted into either the benefit-of-the-bargain rule or the out-of-pocket-loss rule without stretching those concepts beyond their usually accepted meanings.”); *see also* *Thor Power Tool v. Weintraub* 792 F.2d 579, 585 (7th Cir. 1986); Glenn D. West & Sara G. Duran, *Reassessing the “Consequences” of Consequential Damage Waivers in Acquisition Agreements*, 63 BUS. LAW. 777 (2008).

cases that dispute the coverage of contract provisions that waive consequential damages.²⁹⁰

C. Gross Not Net Profits

Profit is a more elusive term than most lawyers realize.²⁹¹ The most significant dispute about the definition of profit is whether it should refer to the plaintiff's profit before or after allocations of corporate costs, the distinction between "gross profits" and "net profits."²⁹² While the Restatement of Contracts does not refer specifically to gross profits or net profits, the practical result of the damage formula, lost revenues less costs saved, is the equivalent of gross profits.²⁹³ Most jurisdictions, including Texas, provide that gross profit is the relevant measure for contract disputes.²⁹⁴ In relation to fraudulent inducement claims, the case law has some opinions on either side of the issue²⁹⁵ but most discussions of the sufficiency of the evidence for certain awards of profit generally make a rough calculation of damages based on gross profits.²⁹⁶ It is a significant, ongoing

290. See *Tenn. Gas Pipeline Co.*, 2008 LEXIS 6419 at *30-31 ("Profits lost on the breached contract itself are classified as 'direct damages.'").

291. See George P. Roach, *Counting the Beans: Unjust Enrichment and the Defendant's Overhead*, 16 TEX. INTELL. PROP. L.J. 483, 500-05 (2008).

292. *Id.* For purposes of looking at this discussion, "gross profits" will be defined as the plaintiff's revenue after offsetting all expenses that vary per unit over the range of the plaintiff's continuing operations with and without unit volume at issue.

293. RESTATEMENT (SECOND) OF CONTRACTS § 347 (1981) (stating that, subject to the limitations stated in §§ 350-53, the injured party has a right to damages based on his expectation interest as measured by (a) the loss in the value to him of the other party's performance caused by its failure or deficiency, plus; (b) any other loss, including incidental or consequential loss, caused by the breach, less; (c) any cost or other loss that he has avoided by not having to perform); see also *Abraxas Petroleum Corp. v. Hornburg*, 20 S.W.3d 741, 759-60 (Tex. App.—El Paso 2000, no pet.); *Interceramic, Inc. v. S. Orient R.R. Co.*, 999 S.W.2d 920, 927-28 (Tex. App.—Texarkana 1999, pet. denied); *Lafarge Corp. v. Wolff, Inc.*, 977 S.W.2d 181, 187 (Tex. App.—Austin 1998, pet. denied).

294. Roach, *supra* note 292, at 538.

295. See *White v. Sw. Bell Tel. Co.*, 651 S.W.2d 260, 262-63 (Tex. 1983); *F.S. New Prods. v. Strong Indus.*, 129 S.W.3d 606, 624 (Tex. App.—Houston [1st Dist.] 2004), *rev'd on other grounds*, 221 S.W.3d 550 (Tex. 2006); *Lafarge Corp. v. Wolff*, 977 S.W.2d 181, 187 (Tex. App.—Austin 1998, pet. denied). *But see* *Texaco, Inc. v. Phan*, 137 S.W.3d 763, 771-72 (Tex. App.—Houston [1st Dist.] 2004, no pet.).

296. *Cmty. Dev. Serv., Inc. v. Replacement Parts Mfg.*, 679 S.W.2d 721, 725 (Tex. App.—Houston [1st Dist.] 1984, no writ) (citing *Wilfin, Inc. v. Williams*, 615 S.W.2d 242, 244 (Tex. Civ. App.—Dallas 1981, writ ref'd n.r.e.) ("Generally, lost profits are properly calculated by deducting from the actual contract price the costs of the injured party's performance supported by data. However, a witness may also prove lost profits by testifying as to what his profit would have been, based on his knowledge of the cost of performance of each element of the contract and subtracting the total of such costs from the contract price."); *B & W Supply, Inc. v. Beckman*, 305 S.W.3d 10, 17 (Tex. App.—Houston [1st Dist.] 2009, pet. denied) ("Lost profits are recoverable only if the

dispute in other areas of the law where the difference in measure between the two definitions can be surprisingly significant.²⁹⁷ Generally, the dispute can be avoided by ensuring that lost profits are measured as the difference between the profits in the actual and “but-for” cases; the difference in profit between the two cases always ignores fixed costs because truly fixed costs cancel themselves out in the calculation.²⁹⁸

D. *Ex Post v. Ex Ante Evidence*

To the extent that a court would allow the plaintiff's damages to be claimed as either loss in value or lost profits, it is useful to recognize that each offers a tactical advantage or disadvantage depending on the trends of the business in dispute.²⁹⁹ A claim for lost value is based on ex ante valuations of the business interest while lost profits can be measured in part on an ex post basis.³⁰⁰ Therefore, if the business at issue were a car dealership, bank or investment bank in the spring of 2008, the difference in resulting damages would be larger as measured by the ex ante approach of the market method to direct damages than the ex post approach of lost profits to special damages. Damages to those businesses based on the value of the businesses in the spring of 2008 would not be diminished by any events that occurred after the valuation date.³⁰¹ However, measures of lost profits could be affected by the dramatic economic downturn and financial crisis in the fall of 2008.³⁰²

evidence shows that the loss of profits was a material and probable consequence of the breach complained of and the amount due is shown with sufficient certainty.”)

297. Roach, *supra* note 292, at 488-90.

298. ERI Consulting Engineers, Inc. v. Swinnea, 318 S.W.3d 867, 879 (Tex. 2010).

299. See Robert E. Scott, *The Case for Market Damages: Revisiting the Lost Profits Puzzle*, 57 U. CHI. L. REV. 1155, 1161-62 (1990) (discussing the ex ante and ex post characteristics of damages for fraud).

300. See Arthur Andersen & Co. v. Perry Equip. Corp., 945 S.W.2d 812, 814 (Tex. 1997). By comparison, however, the equitable remedy of rescission may allow the plaintiff to more fully enjoy the advantages of a favorable change in ex post conditions. See *infra* Part X.

301. Williams v. Gaines, 943 S.W.2d 185, 193 (Tex. App.—Amarillo 1997, writ denied) (op. on reh'g) (holding that subsequent data provides no probative evidence of value).

302. For examples of cases that measure lost profits on the basis of ex post data, see Pace Corp. v. Jackson, 284 S.W.2d 340, 349 (Tex. 1955) (breach of contract); Pena v. Ludwig, 766 S.W.2d 298, 302 (Tex. App.—Waco 1989, no writ) (breach of contract); Signal Peak Enters. of Tex., Inc. v. Bettina Invs., Inc., 138 S.W.3d 915, 924-25 (Tex. App.—Dallas 2004, no pet.) (fraud).

VII. BOB V. OOP APPROACHES TO DIRECT DAMAGES

A. *Asset Transactions*

The plaintiff's choice between the BOB and OOP³⁰³ approaches is complicated by the plaintiff's election of remedies and whether the subject contract is an asset transaction or a service contract. The plaintiff to a fraudulent inducement claim must elect between accepting the contract and suing for breach of contract type of damages³⁰⁴ or rejecting the contract and seeking rescission and other equitable relief to reverse the impact of the contract.³⁰⁵

The dynamics of the election differ between asset transactions and service contracts. For an asset transaction contract, if the plaintiff chooses to deny the contract, she will choose between equitable relief or special damages under the OOP approach.³⁰⁶ Expectancy or direct damages are inapplicable when the plaintiff chooses to deny the contract.³⁰⁷ After denying the contract the plaintiff would typically seek rescission of the contract which generally also allows for some forms of special damages,³⁰⁸ including punitive damages.³⁰⁹ After denying the

303. DOBBS, *supra* note 52, § 9.2(1), at 549. Dobbs notes that the name for the OOP approach causes significant confusion among practitioners and the judiciary. *Id.* Here "OOP" carries a special meaning of "out-of-pocket." The out of pocket measure is a "general measure," meaning one that is computed with reference to the value of the very thing purchased or sold. *Id.* The term thus does not refer to collateral expenses the plaintiff may have incurred as a result of the misrepresentation, although such expenses may be recoverable as consequential damages. *Id.*

304. *Texarkana Motor Co. v. Brashears*, 37 S.W.2d 773, 775 (Tex. Civ. App.—Texarkana 1931, no writ) ("The plaintiff elected to keep the property, never attempting to rescind the sale, but bringing his action for damages, and thus affirming the transaction. Thus it is clear that the expenditures for improvements were expenditures made upon his own property, and that he necessarily had the benefit of them.").

305. *Dallas Farm Mach. Co. v. Reaves*, 307 S.W.2d 233, 238-39 (Tex. 1957); *see also* *Foley v. Parlier*, 68 S.W.3d 870, 882 (Tex. App. —Fort Worth 2002, no pet.) (noting the trial court required Parlier to choose between recovery for breach of contract and fraud, and telling Parlier to either rely on the contract, or say there was no contract and rely on the fraud); DOBBS, *supra* note 52, § 9.4, at 603-04 ("Remedies are traditionally found to be 'inconsistent' when one of the remedies results from 'affirming' the transaction and the other results from 'disaffirming' a transaction. Most typically the plaintiff has elected, or is forced to elect, between rescission and damages remedies, but the election rule may apply to any pair of affirming and disaffirming remedies, such as replevin and damages.").

306. *D.S.A., Inc. v. Hillsboro Indep. Sch. Dist.*, 973 S.W.2d 662, 664 (Tex. 1998) ("Speaking technically, the BOB and OOP approaches only specifically apply to direct damages although the BOB approach allows for lost profits which are considered special damages. Effectively however, in the absence of the BOB approach, the OOP approach becomes the default approach.").

307. DOBBS, *supra* note 52, § 9.4, at 603-04.

308. *See infra* notes 454-61 and accompanying text.

contract under the OOP approach, the plaintiff could seek special damages in the form of incidental, consequential or reliance damages based on the assumption that the plaintiff knew the truth about the defendant's misrepresentations.³¹⁰ (This assumption usually leads the plaintiff to claim that she would not have executed the contract if she had known the truth.)³¹¹ Generally, rescission or other equitable relief would be the superior alternative but there may be circumstances under which equitable relief may not be available.

Electing to deny a service contract is more problematic for equitable relief as rescission may not be possible. However, under the OOP approach, the plaintiff can claim special damages on the theory that had she known the truth, she would not have executed the contract and that therefore her purchase price and other special damages were lost as a result (adjusted for any remaining benefit of the service).³¹²

When the plaintiff elects to accept an asset transaction contract, she can choose the BOB or OOP approaches to measure direct and special damages. Direct damages are measured either as the difference between the value received and the value as represented (BOB), or the value received and the value paid (OOP). Since the value as represented will exceed that of the value paid (otherwise the plaintiff would reject the contract), direct damages under these circumstances will be greater under the BOB approach. Furthermore, special damages as determined under the BOB approach are generally broader than non-expectancy damages under the OOP approach because they enjoy

309. *United Enters., Inc., v. Erick Racing Enters.*, No. 07-01-0467-CV, 2002 LEXIS 9271 (Tex. App.—Amarillo Dec. 31, 2002, pet. denied) (not designated for publication).

310. *See Matrix Oncology, L.P. v. Priority Healthcare Corp.*, No. 08-10191, 2009 LEXIS 14183, at *24-27 (5th Cir. June 30, 2009) (per curiam) (not designated for publication).

311. *See id.* at *26-27.

312. The Supreme Court's opinion in *Kish v. Van Note* is a good example in which the plaintiff had to elect between the direct damages of accepting the contract and the special damages of denying the contract. 692 S.W.2d 463, 466 (1985). The plaintiff made a claim under the DTPA for a contract to build a swimming pool which turned out to be defective. *Id.* at 465. The jury found damages as: "(A) The difference between the value received and the price paid for the swimming pool was \$1500. (B) The cost of removing the pool and restoring the Kishes' back yard to its original condition would be \$4000. (C) The cost of removing the mechanic's lien from the real property owned by the Kishes would be \$8,000." *Id.* at 466. The Court affirmed the plaintiff's election to reject the contract and claim findings in (B) and (C) which would otherwise have been excluded if the plaintiff chose the \$1,500 of direct damages measured according to the OOP. *See id.* at 466-67. For a recent opinion on rescinding a service contract, *see Chubb Lloyds Ins. Co. of Tex. v. Andrew's Restoration, Inc.* 323 S.W.3d 564 (Tex. App.—Dallas 2010, pet. filed)

the broader standard of assuming the truth of the defendant's representations.

Barring unusual circumstances, the BOB approach will offer the plaintiff greater damages than the OOP approach for both asset transactions and service contracts. As an alternative to direct damages, claims for lost profits are also available under the BOB approach.³¹³

The key to applying the BOB approach is to determine a clear concept of the nature of the benefit of the bargain, to explain how the value of the "but-for" contract changes by assuming that the misrepresentation(s) are true. How is this construct case different from the actual result or the truth? It is surprising how some artful pleading can try to adjust the construct to the plaintiff's advantage.³¹⁴ Thus a plaintiff's attorney claimed that his expectancy damages from the client's non-payment of a fee was the loss of \$500,000 of future contingency fees for various unnamed cases that were lost because the lawyer's cash shortage precluded financing contingency fee cases.³¹⁵ Similarly, a plaintiff in a dispute over investing in feedlot cattle claimed that the failure of the defendant to pay the amount owed precluded him from successfully investing in five years of cattle feeding, realizing the same substantial profit for each lot of cattle.³¹⁶ Both claims were quickly dismissed for lack of foreseeability and factual support, respectively.³¹⁷

In two opinions, the plaintiff succeeded in slightly adjusting the bargain to their advantage.³¹⁸ Coastal Oil agreed to buy 50% of a wildcat interest for a fixed amount that was represented to

313. See *supra* notes 200-01 and accompanying text (discussing the possible duplication of direct damages and lost profits).

314. See *Stuart v. Bayless*, 964 S.W.2d 920, 921-22 (Tex. 1998) (per curiam); see also *Penner Cattle, Inc. v. Cox*, 287 S.W.3d 372, 372 (Tex. App.—Eastland 2009, pet. denied).

315. *Stuart*, 964 S.W.2d at 921-22.

316. *Penner Cattle, Inc.*, 287 S.W.3d at 372 ("The trial court awarded Cox breach of contract damages totaling \$252,712.14. This represented \$34,000 in attorney's fees, direct damages of \$43,712.14, and consequential damages in the form of lost profits of \$175,000. Cox calculated this by assuming that Penner had timely paid for the cattle's medicine, feed, and transportation and that he had then invested this money in the cattle business. Cox testified that he would have purchased a load of cutting bulls and sold them in 50 to 60 days for a profit of \$6,000 to \$7,000. Cox testified that he was familiar with the market and that he could have repeated this investment every 60 days. Cox testified that, because over four years had elapsed since the dispute arose, he had lost 25 cattle investment opportunities and a total of \$175,000.").

317. *Stuart*, 964 S.W.2d at 921; *Penner Cattle, Inc.*, 287 S.W.3d at 372-73.

318. See *Southampton Mineral Corp. v. Coastal Oil & Gas Corp.*, 846 S.W.2d 609 (Tex. App.—Houston [14th Dist.] 1993, writ denied); *Gulftide Gas Corp. v. Cox*, 699 S.W.2d 239 (Tex. App.—Houston [1st Dist.] 1985, writ ref'd n.r.e.).

be the seller's cost basis in the property.³¹⁹ Discovery revealed that the defendant had not actually expended the represented cost basis in cash outlays.³²⁰ The mineral lease was not independently appraised but an employee of the plaintiff testified that wildcat interests are generally valued at their cost.³²¹ The court accepted this testimony and affirmed the award of the difference between the amount paid by Coastal and 50% of actual cash cost basis for the defendant.³²² Thus, the contract to buy a wildcat at a fixed price was effectively transformed into an agreement to buy the wildcat at half of cash cost (or at least the damages were measured on that basis).

Similarly, there was a First District opinion involving the sale of natural gas to a gas pipeline in which the pipeline misrepresented the initial sales price for the gas in the first year, understating the initial price by 10 cents per MCF.³²³ The contract provided that in the future 80% of any increases over the initial price secured by the pipeline would be passed on to the owners of the natural gas.³²⁴ The court affirmed the jury finding that awarded 80% of the ten cent differential to the plaintiffs.³²⁵ A contract that provided for a fixed price in the first year subject to a formula adjustment was slightly changed to a formula contract starting on day one.³²⁶

In *Fortune Products Co. v. Conoco, Inc.*, the Supreme Court contradicted the First District in a case with similar facts but a different outcome.³²⁷ There was no necessary formula adjustment in the contract, but the gas buyer understated the original sales price of the natural gas by 10 cents per MCF.³²⁸ At the appellate level, the First District affirmed a damages remedy

319. *Southampton Mineral Corp.*, 846 S.W.2d at 610-11.

320. *Id.* at 610.

321. *Id.*

322. *Id.* at 611.

323. *Gulftide Gas Corp. v. Cox*, 699 S.W.2d 239, 243 (Tex. App.—Houston [1st Dist.] 1985, writ ref'd n.r.e.).

324. *Id.* at 241.

325. *Id.* at 244.

326. *Id.* at 245 (“The damage award was also based on fraud in the inducement and performance of the contract. The jury found that appellant falsely and knowingly represented that it had an ‘agreement’ to resell the gas at a base price of \$1.95, and that it falsely and knowingly represented that it had a ‘contract’ for \$1.95, when the contract price in effect with Allied at all relevant times was \$2.05/mcf. Thus, the measure of damages would be the difference between the value received by appellees under the agreement, \$1.90/mcf, and the value appellees parted with, or, stated differently, what appellees would have sold the gas for had they known that the actual resale price was to be \$2.05/mcf.”).

327. *See Fortune Prod. Co. v. Conoco, Inc.*, 52 S.W.3d 671, 681-82 (Tex. 2000).

328. *See id.* at 674.

of the full ten cents.³²⁹ The Supreme Court opinion rejected that remedy as totally hypothetical.³³⁰ There was no evidence that the gas buyer had paid that much in any other contract, except that the defendant buyer had passed on the greater price to one other seller for about 10% of the contract volume.³³¹ The Court remanded the case and warned that, in the absence of some evidence of the terms that both parties would have reached in negotiation,³³² the plaintiffs would have lost the case for failure to prove damages. The Court now demands proof that the alternate contract claimed by the plaintiffs would have actually happened.³³³

B. *Service Contracts*

The Court's opinion in *Formosa Plastics* is sometimes regarded as the first opinion that affirmed expectancy damages common law fraud.³³⁴ While the Court actually first affirmed expectancy damages for common law claims in *Trenholm*,³³⁵ its opinion in *Formosa Plastics* was the first opinion that explained why its prior opinions in *Delanney* and *Walter Homes* did not apply.³³⁶ The case related to a construction contract in which the customer misrepresented the requirements of the construction project and the contractor experienced substantial cost over-

329. *Conoco, Inc. v. Fortune Prod. Co.*, 35 S.W.3d 23, 32 (Tex. App.—Houston [1st Dist.] 1998), *rev'd*, 52 S.W.3d 671 (Tex. 2000).

330. *Fortune Prod. Co.*, 52 S.W.3d at 681-82.

331. *Id.* at 682 (“The evidence showed that, at best, the plaintiffs could have negotiated a price based on the \$3.50 Lone Star price for only ten percent of their respective shares of residue gas. Under these circumstances, the plaintiffs’ fraud claims must be remanded to the trial court for another trial.”).

332. *Id.* at 682 (“The bargain that the plaintiffs say they could have struck with Conoco is not ‘hypothetical,’ as the dissent argues, because of the evidence of the bargain that Conoco did in fact strike with IP. . . . We acknowledged in *Formosa Plastics* that if there is evidence of the bargain that would have been struck had the defrauded party known the truth, there can be a recovery for benefit-of-the-bargain damages.” (citing *Formosa Plastics Corp., USA v. Presidio Eng’rs & Contrs.*, 960 S.W.2d 41, 50 (Tex. 1998)).

333. *Case Corp. v. Hi-Class Bus. Sys. of Am., Inc.*, 184 S.W.3d 760, 779-80 (Tex. App.—Dallas 2005, *pet. denied*) (“However, despite language of the *Formosa Plastics* opinion suggesting otherwise, recovery under the benefit of the bargain measure requires proof only that the lost bargain would have been made but for the defendant’s misrepresentation, not that such a bargain was actually made.”).

334. *See Formosa Plastics Corp., USA v. Presidio Eng’rs & Contractors, Inc.*, 960 S.W.2d 41 (Tex. 1998).

335. *Trenholm v. Ratcliff*, 646 S.W.2d 927, 933 (Tex. 1983).

336. *Formosa Plastics*, 960 S.W.2d at 44-47 (explaining that the nature of the injury sustained determines whether the claim is in contract or tort and an injury of economic losses caused solely by non-performance of a contract does not give rise to a separate fraud claim).

runs.³³⁷ The Court's opinion affirmed expectancy damages but rejected the BOB damage model affirmed by the Thirteenth District.³³⁸ The contractor claimed expectancy damages based on a profit mark-up on the cost overruns, claiming damages on the basis of the contract price that the contractor would have demanded under full information.³³⁹ The Court rejected the measure because there was no evidence that the defendant would have agreed to the contractor's terms.³⁴⁰ In the absence of such evidence, the contractor was only entitled to its original expected profit with reimbursement for the cost overruns but no additional profit mark-up.³⁴¹

Measuring direct damages as the difference between values, the market method, works best in the environment of UCC-type claims in which the assets transacted trade in broad liquid markets that provide immediate opportunities for the plaintiff to quickly "cover" his damages with a minimum of incidental expense. When the transactions relate to services and eclectic assets like business operations, especially smaller business operations, the value difference paradigm becomes impractical.³⁴²

One of the ancillary holdings of the appellate court in the *Formosa Plastics* opinion is that the market approach does not have to be applied by rote in all cases: "We disagree with the basis for Formosa's contention. As an initial matter, the *Arthur Anderson* construct, which measures damages at the time the contract is signed, applies to a purchase and sale of a business. As such, it is inapplicable to a construction contract."³⁴³ In both contract and employment cases, courts have adapted the

337. *Id.* at 43.

338. *Id.* at 50-52.

339. *Id.* at 50 ("Burnette's testimony as to what he would have bid had he known the truth simply does not establish the benefit of any bargain made with Formosa. It is not based on the expenses incurred and profits lost on this contract because of Formosa's representations, but rather is based on an entirely hypothetical, speculative bargain that was never struck and would not have been consummated. This testimony is therefore not legally sufficient evidence supporting an award of \$700,000 in damages.")

340. *Id.* at 50.

341. *Id.* at 50-51.

342. See *Buck v. Morrow*, 21 S.W. 398, 398 (Tex. Civ. App. 1893, no pet.) ("The rule . . . seems to rest upon the assumption that the tenant can go at once into the market and obtain like property. Where the reason of the rule does not exist, it would seem that the rule itself should not apply, to the exclusion of all other considerations in estimating the damages." (citation omitted)); DUNN, *supra* note 87, § 3.1, at 92 ("The benefit of the bargain and out of pocket rules generally do not fit the loss suffered in these cases, as sales of property are not involved. The courts have been forced to draw upon basic notions of proximate cause to reach just results.")

343. *Formosa Plastics Corp., USA v. Kajima Int'l, Inc.*, 216 S.W.3d 436, 458 (Tex. App.—Corpus Christi 2006, pet. denied).

standard model and measure damages as the difference between actual profit and the contractor's expected profit assuming all misrepresentations are true.³⁴⁴

Employment cases similarly depart from the standard difference in market value approach to direct damages except that damages sometimes need to be distinguished between the direct damages of salaries and perquisites versus the consequential damages of bonuses or profit sharing. Thus, a contingency fee for a litigator was found to be a lost profit and a special damage.³⁴⁵ Alternatively, in two cases contingency fees were found to be direct damages. The Third District Court of Appeals held that a bonus fee to a professional conditioned on a damages award exceeding a certain dollar amount was direct damage.³⁴⁶

A plaintiff employee without a contract has few options or remedies for fraudulent inducement. Such plaintiffs are rarely awarded lost wages or bonuses.³⁴⁷ Many times, they are left with claims only for reliance damages: by electing to deny the contract, the plaintiff can claim expenditures made and losses incurred to take the new job.³⁴⁸

Claims of fraudulent inducement by lenders do not apply the *Perry Equipment* model literally. In a literal application, the lender would assert direct damages for the discount in the loan

344. *Formosa Plastics Corp., USA v. Presidio Eng'rs & Contrs.*, 960 S.W.2d 41, 49 (Tex. 1998); *see also Kajima*, 216 S.W.3d at 458 ("There is evidence to support the jury's award . . . Hutchison testified that . . . the abnormal conditions concealed by Formosa resulted in an additional \$18 million being spent to complete the project. Accordingly, Kajima parted with approximately \$35 million and actually received only \$10 million.").

345. *Miller v. Kennedy & Minshew, Profl Corp.*, 142 S.W.3d 325, 346 (Tex. App.—Fort Worth 2003, pet. denied) ("The evidence also supports the jury's finding that appellees were entitled to recover \$500,000 as benefit-of-the-bargain damages. . . . Under this measure of damages, the defrauded party may recover lost profits that he would have made if the bargain actually struck had been performed as promised."); *see Coffel v. Stryker Corp.*, 284 F.3d 625, 638 (5th Cir. 2002) (holding that the Appellant had established his lost bonuses under the benefit-of-the-bargain analysis).

346. *See Green v. Allied Interests, Inc.*, 963 S.W.2d 205, 207-08 (Tex. App.—Austin 1998, pet. denied); *see also Khalaf v. Williams*, 814 S.W.2d 854, 857 (Tex. App.—Houston [1st Dist.] 1991, no writ) (holding that there was sufficient evidence to support a damage award to the Appellee based on the Appellants' fraudulent conduct).

347. *See Columbia/HCA Healthcare Corp. v. Cottey*, 72 S.W.3d 735, 746-47 (Tex. App.—Waco 2002, no pet.). *But see Sanchez v. Johnson & Johnson Med., Inc.*, 860 S.W.2d 503, 514-15 (Tex. App.—El Paso 1993), *rev'd*, 924 S.W.2d 925 (Tex. 1996) ("[W]hen there has been fraud in the employment relationship, damages in the form of lost wages and benefits would appear to be the only appropriate remedy. In addition, with the availability of consequential damages seemingly limited, to deny Appellant recovery would allow Appellee to commit fraud with impunity.").

348. *See Carr v. Christie*, 970 S.W.2d 620, 625-26 (Tex. App.—Austin 1998, pet. denied) (holding that Appellant produced a claim of reliance damages based on the representations made by the Appellee).

that would be appropriate for the undisclosed risk that the borrower had misrepresented.³⁴⁹ Actual loan losses in excess of direct damages would then be claimed as consequential damages. In this case, Section 549 of the Restatement of Torts intervenes and suggests treating actual loan losses, measured ex post, as direct damages as they are experienced.³⁵⁰ Interestingly, very few lenders ever claim expectancy damages, which would include lost interest and principle as direct damages.³⁵¹

Claims from borrowers against fraudulent lenders are generally entitled to the difference in borrowing costs.³⁵² Claims from borrowers that cannot obtain alternative financing are alternatively entitled to expectancy damages, but their claims may evoke concerns about disproportionate expectancy damages, including that the plaintiffs are making speculative claims. The proof required of these plaintiffs may reflect the courts' concern that such claims would otherwise resemble the wishful pleading of *Bayless* or *Penner*.³⁵³ Cases emphasize the need for plaintiff borrowers to detail the foreseeability of the plaintiff's damages by requiring the plaintiff to prove that the lender was specifically aware of both the borrower's plans for the loan proceeds and the fact that the borrower would be unable to borrow elsewhere.³⁵⁴ On a practical basis, the first awareness should be much easier to prove than the second. Most loan agreements or loan applications include sections on the borrower's proposed use of proceeds; in some loans, the borrower is even restricted from applying the loan outside of the declared uses. On the other hand, few creditors ordinarily think of their roles as "lenders of

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

350. RESTATEMENT (SECOND) OF TORTS § 549 cmt. a; *see also* Am. Title Co. v. BOMAC Mortg. Holdings, L.P., 196 S.W.3d 903, 911 (Tex. App.—Dallas 2006, pet. granted, judgment vacated w.r.m.) (quoting § 549 of the Restatement).

351. DUNN, *supra* note 87, § 3.4, at 100 (citing Commercial Nat'l Bank v. Fed. Deposit Ins. Corp., 131 Ill. App. 3d 977, 984 (1985)).

352. *Berens v. Resort Suites-Scottsdale, Inc.*, No. 14-99-00396-CV, 2001 LEXIS 3175, at *6 (Tex. App.—Houston [14th Dist.] May 17, 2001, pet. denied) (not designated for publication) (citing the trial court's ruling that the plaintiffs were entitled to the extra costs attributed to obtaining a secondary loan as a result of the fraudulent misrepresentations of the defendant).

353. *See* *Stuart v. Bayless*, 964 S.W.2d 920, 921-22 (Tex. 1998) (per curiam); *Penner Cattle, Inc. v. Cox*, 287 S.W.3d 370, 371-72 (Tex. App.—Eastland 2009, pet. denied).

354. *Basic Capital Mgmt. v. Dynex Commercial, Inc.*, 254 S.W.3d 508, 520 (Tex. App.—Dallas 2008, pet. granted), *rev'd*, No. 08-0244, 2011 WL 1206376 (Tex. Apr. 1, 2011) ("[I]n the event of a breach of contract to lend money, the borrower can recover . . . expenses and lost profits, if the . . . lender knew . . . (1) that the contracted financing was for a specific venture; and (2) . . . the borrower probably would be unable to obtain other financing. . . .").

last resort"; they want to lend money to credits that are sufficiently creditworthy to be able to obtain the loan elsewhere.

C. *Expectancy Claims In Business Acquisitions*

Even after the Supreme Court has handed down numerous opinions that distinguish the BOB and OOP approaches, the opinions of various courts of appeal have demonstrated confusion by failing to adequately distinguish between the two approaches in business acquisitions. There have been four opinions handed down since 2000 that include a common business pattern:³⁵⁵ the plaintiff has a business or venture and then forms a new entity or partnership with a new partner who seizes control and then either destroys the business or takes it away from the original owners. Direct damages under the BOB approach should be measured by comparing the value of the plaintiff's business on the date of the contract under the new agreement and compare that to the value of the plaintiff's share of the business as represented; under the OOP approach, direct damages would be measured as the difference between the value of the plaintiff's share of the business immediately before the contract and the value of the plaintiff's share of the business upon the execution of the contract. In all but the second example, the plaintiff claimed to apply the OOP approach but damages were actually measured or awarded under the BOB approach. In the second case, the Court affirmed lost profits for a plaintiff that failed to plead special damages.

In *Rogers v. Alexander*, the original owners of a successful business entered into a contract in late January of 2003³⁵⁶ and left the company at the end of June of 2003. The new partner promised to manage the company's accounting and

355. There are two additional cases in which the plaintiffs pled a comparable fact pattern. The opinion in *Barnes* has already been discussed previously and was shown to make a poorly substantiated claim for lost profits. *Barnes v. Cumberland Int'l Corp.*, No. B14-93-00086-CV, 1994 LEXIS 2011, at *9-10 (Tex. App.—Houston [14th Dist.] Aug. 11, 1994, writ denied) (not designated for publication). The second alternative is *Swanson*, in which the plaintiff made a substantiated claim for \$15 million of direct damages under the OOP approach and the court of appeals affirmed that award as well as \$35 million in punitive damages. *Swanson v. Schlumberger Tech. Corp.*, 895 S.W.2d 719, 744 (Tex. App.—Texarkana 1994), *rev'd*, 959 S.W.2d 171 (Tex. 1997). The basis for the \$15 million claim was the value of the plaintiff's interest conveyed in the transaction, not the value of what they received as represented. *Id.* at 739. The Supreme Court reversed that opinion based on the applicability of the reliance waiver clause and made no comment on the damage issues. *Schlumberger Technology Corp. v. Swanson*, 959 S.W.2d 171, 180-81 (Tex. 1997).

356. *Rogers v. Alexander*, 244 S.W.3d 370, 377-78 (Tex. App.—Dallas 2007, pet. denied).

administration while directing substantial new business to the operation.³⁵⁷ The Dallas Court of Appeals affirmed the award of approximately \$2.5 million based on the appraised value of the business in June, 2003.³⁵⁸ The plaintiffs introduced no evidence of the company's value in January 2003 (under any assumption) and no proof of the salvage value of the plaintiffs' interest.³⁵⁹ More importantly, the plaintiffs' interest in the company was appraised after the contract was executed and capitalized the company's financial performance after the new partner had started to direct new business to the company.³⁶⁰ Finally, the damages included lost profits in the form of undistributed profits.³⁶¹ Lost operating profits are relevant only as an alternative to loss in value but only when plaintiffs are entitled to claim expectancy damages.³⁶² Without values as of the contract date, before the impact of the new partner, it is difficult to reconcile the resulting damages with the OOP approach.³⁶³ In addition, the Fifth District affirmed that the investment agreement between the plaintiffs and defendant was void.³⁶⁴ The court's explanation remains unclear of why it is not duplicative to void the investment agreement and awarding the plaintiffs the value of the entire company on June 30, 2003 (five months after the transaction was executed).³⁶⁵

In *Khalaf v. Williams*, the plaintiff contractor agreed in 1980 to build a country and western club at cost in exchange for a 30 percent share of the club.³⁶⁶ When the plaintiff, Williams, discovered that the club was incorporated without providing for his 30 percent interest, he quit.³⁶⁷ In the six years of motion practice before the actual trial, Williams asserted a cause of action for fraud but he filed no pleading for special damages.³⁶⁸

357. See *id.* at 376-77.

358. *Id.* at 387.

359. See *id.* at 386-87 (explaining that the plaintiff's expert calculated the value of the interests as of June 2003).

360. See *id.*

361. *Id.* at 386-87.

362. *Rogers v. Alexander*, 244 S.W.3d 370, 386-87 (Tex. App.—Dallas 2007, pet. denied).

363. See *id.* at 390.

364. *Id.*

365. For an example of how equitable relief can duplicate lost value in claims for intellectual property, see *DSC Commc'n v. Next Level Commc'n*, 107 F.3d 322, 329-330 (5th Cir. 1997).

366. *Khalaf v. Williams*, 814 S.W.2d 854, 856 (Tex. App.—Houston [1st Dist.] 1991, no writ).

367. *Id.* at 856.

368. *Id.* at 858 ("Williams asked for actual damages for his cause of action for breach of contract, but Williams did not ask for actual damages for his cause of action for fraud.

The First District mistakenly found adequate substantiation for the damage award of \$185,032 on the basis of the expert's review of the club's income tax returns for 1980 to 1984 and a financial statement for the club as of October, 1985.³⁶⁹ The First District affirmed the damages in part because the expert found that the value of 30 percent of the club's income was \$90,000 to \$450,000.³⁷⁰ This evidence of lost profits is irrelevant without having pled for special damages.³⁷¹ The First District alternatively substantiated the jury finding on the expert's assertion that the value of 30 percent of the value of the club assets was \$250,000.³⁷² This assertion is also irrelevant as the supporting evidence, as the assertion was based on the October, 1985 financial statement which was issued five years after the contract was executed.³⁷³

In *Westheimer*, the plaintiff owner of a location for an adult entertainment establishment agreed to enter into a contract with an experienced manager who would pay the plaintiff a share of the operation's profits.³⁷⁴ The First District held that the award of \$465,000 could be substantiated on one of two bases: either that the plaintiff had a historical cost basis in the property of \$600,000 or that sufficient damages were established, including \$346,068.07 of lost profits which are only available under the BOB approach.³⁷⁵ Finally, the only evidence recited to justify a zero salvage value was that the plaintiff had received no distributions.³⁷⁶

The fact pattern of the fourth case is a little different but reveals similar confusion. In *Matrix Oncology*, the plaintiff owned 40% of an LLC which the plaintiff and defendant (who

However, Williams requested exemplary damages for his cause of action for fraud. Williams' first amended cross-action also contained a general prayer 'for such other and further relief . . . [he] may be justly entitled.')

369. *Id.* at 857.

370. *Id.*

371. *Sherrod v. Bailey*, 580 S.W.2d 24, 28 (Tex. Civ. App.—Houston [1st Dist.] 1979, writ ref'd n.r.e.) ("When items of special damage are claimed, they shall be specifically stated." (citing Rule 56 of the Texas Rules of Civil Procedure)).

372. *Khalaf v. Williams*, 814 S.W.2d 854, 857 (Tex. App.—Houston [1st Dist.] 1991, no writ).

373. *Id.*

374. *Tex. Westheimer Corp. v. 5647 Westheimer Assocs.*, 68 S.W.3d 15, 18 (Tex. App.—Houston [1st Dist.] 2001, pet denied).

375. *Id.* at 26 ("In our opinion, the jury could have reasonably concluded that \$464,963.83 was a proper amount to compensate plaintiff for its out-of-pocket losses as a result of defendant's fraud.")

376. *Id.*

owned 60% of the LLC) decided to dissolve.³⁷⁷ The plaintiff agreed to sell its 40% interest for \$600,000 and a fee of \$3 million contingent on whether the contemporaneous merger discussions between the defendant partner and an identified suitor were successfully completed.³⁷⁸ After the plaintiff sold its interest in the LLC, the former partner agreed to merge with a different, unidentified merger partner who had been negotiating to buy the partner at the same time as the other, acknowledged suitor.³⁷⁹ The jury awarded damages of \$3 million which prompted the defendant to object that the jury had awarded expectancy damages in the form of the contingency fee, even though the defendant had only been found liable for negligent misrepresentation, which is not entitled to expectancy damages.³⁸⁰ The Fifth Circuit affirmed the damage award based on the hindsight observation that the plaintiff's expert had testified that the plaintiff's 40% interest was worth between \$2.3 to \$4.2 million.³⁸¹ This observation technically complies with the *Perry Equipment* paradigm but it makes little sense: why would the owner of a business interest worth \$2.3 to \$4.2 million agree to sell her interest for a mere \$600,000 and a contingency fee of \$3 million?³⁸²

D. *Disconnected Values*

The damage analysis in *Matrix Oncology* raises an important characteristic of damages models for fraud: the values substantiated by either party at trial bear no necessary relationship to the transaction values. The plaintiff's range of values in *Matrix Oncology* may justify the verdict, even applying the OOP approach, but they seem super-imposed on the case as an afterthought.³⁸³ Furthermore, the examples of juries accepting disconnected values may constitute additional evidence, however anecdotal, that juries tend to punish liars.

The defendant's recourse to disconnected values is to provide alternative valuation opinions and to pursue a rigorous line of cross-examination against the principal parties. In *Matrix*

377. *Matrix Oncology, L.P. v. Priority Healthcare Corp.*, No. 08-10191, 2009 U.S. App. LEXIS 14183, at *4-7 (5th Cir. June 30, 2009) (per curiam).

378. *Id.* at *6-8.

379. *Id.* at *5.

380. *Id.* at *23-26.

381. *Id.* at *25.

382. *See Arthur Andersen & Co. v. Perry Equip. Corp.*, 945 S.W.2d 812, 816-17 (Tex. 1997).

383. *See Matrix Oncology, L.P. v. Priority Healthcare Corp.*, No. 08-10191, 2009 LEXIS 14183, at *25-27 (5th Cir. June 30, 2009) (per curiam).

Oncology defendant's counsel should have forced the plaintiff CEO to make one or more of the following admissions for the plaintiff:

- (1) He made what appears to be a foolish bargain;
- (2) When he made the bargain he had no accurate idea of the fair market value of the interest in the LLC; or
- (3) He didn't believe at the time that the LLC was worth as much as \$2.3 to \$4.2 million.³⁸⁴

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

Consider a different case in which a buyer contracts to buy an apartment project for \$2,950,000, only to find that a third party signed an earlier contract to purchase the property for \$2,615,000.³⁸⁵ The property was eventually sold to the third party and the plaintiff sued for expectancy damages according to the BOB approach.³⁸⁶ The jury found direct expectancy damages of \$2 million.³⁸⁷

The defective foundation case summarized in the introduction, *Carpenter v. Holmes Builders*, consists of values and damages that seem similarly possible but unlikely.³⁸⁸ The defendant built the home for \$641,000 while the jury found damages to the house of \$657,000 in addition to other damages of \$1,411,000.³⁸⁹ The court's opinion provides few details about the necessary repairs, except that there is no evidence that the plaintiffs had major difficulty living in their house; those difficulties ensued only when they attempted to sell the house.³⁹⁰

Assume that a plaintiff has entered into a contract to buy a ranch for \$1,200 per acre. The day before closing he is told that the seller cannot complete the sale because there was an outstanding right of first refusal on the property for any offers

384. The case opinion did not disclose whether or not such a cross examination did or did not occur. See *id.* at *26-27 (“[T]he testimony simply indicates that: had it known the truth, it would not have entered into the terms of *this* transaction.”).

385. Ryan Mortg. Investors v. Fleming-Wood, 650 S.W.2d 928, 931 (Tex. App.—Fort Worth 1983, writ ref'd n.r.e.).

386. *Id.*

387. *Id.* at 935 (“No objection was ever made at trial when evidence was introduced concerning the value of the complex. Appellants themselves introduced evidence that the complex was worth \$4,585,000.00 as townhomes and \$3,100,000.00 as apartments.”).

388. *Carpenter v. Holmes Builders, Inc.*, No. 11-02-00132-CV, 2004 LEXIS 1649, at *1-3 (Tex. App.—Eastland Feb. 19, 2004, pet. denied) (not designated for publication).

389. *Id.*

390. See *id.* at 9-10.

that the seller received in excess of \$1,000 per acre. As the plaintiff was totally unaware of the right of first refusal, he sues for fraudulent inducement and seeks expectancy damages. How much would you expect the ranch to appraise for (assuming no right of first refusal)? Many observers would expect a value near \$1,200 an acre because that is the amount that the plaintiff agreed to pay when he was unaware of the outstanding option. Is there a minimum that you would expect in the defendant's appraisal? Would it make sense for the appraisal to be less than \$1,000 per acre (which was the trigger price for the option)? In 1983, the Fourteenth District affirmed the jury's award on the basis of \$1,800 an acre which was close to the average of the defendant's appraisal of \$900 an acre and the plaintiff's appraisal of \$2,500 per acre.³⁹¹

From a national perspective, Dunn has noted this widespread phenomenon and offers the explanation of the Arizona Supreme Court: "The fact that plaintiffs may have negotiated a very advantageous purchase price with defendants Lux should have no bearing on their right to recover damages for fraud."³⁹² Of course, such acknowledgement and acceptance of the notion of the benefit of a great bargain would not excuse the plaintiff's appraiser from a potentially scathing cross examination.

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

391. See *Citizens State Bank of Dickinson v. Bowles*, 663 S.W.2d 845, 847-848 (Tex. App. 1983); see also *Momentum Motor Cars, Ltd. v. Williams*, No. 13-02-042-CV, 2004 Tex. App. LEXIS 9940, at *15 (Tex. App.—Corpus Christi Nov. 10, 2004, pet. denied) (mem. op.) ("However, sale or contract price constitutes some evidence of market value and is sufficient to support a represented value." (citing *Jack Roach Ford v. De Urdanavia*, 659 S.W.2d 725, 728 (Tex. 1983)).

392. *Carrel v. Lux*, 420 P.2d 564, 575 (Ariz. 1966); see also J. F. Rydstrom, *Comment note—"Out of Pocket" or "Benefit of Bargain" as Proper Rule of Damages for Fraudulent Representations Inducing Contract for the Transfer of Property*, 13 A.L.R.3d 875 (1967). Rydstrom notes the effects that occur when the value of the property is greater or equal to the price paid: "It sometimes happens that notwithstanding the defendant's fraudulent representations, the property received by the defrauded party, while not as represented, does in fact equal or exceed in value the price paid therefor. Under such circumstances, it has been argued that it would be improper, even under the 'benefit of the bargain' rule, to allow the defrauded party a further recovery. Such an allowance is, however, perfectly consistent with the theory of that rule, and has frequently been approved by the courts." *Id.*

years, courts are experiencing difficulty in distinguishing the two approaches in cases relating to business entity transactions.

VIII.SPECIAL DAMAGES

There are some structural differences between the three forms of special damages (incidental, consequential and reliance). Incidental damages generally include expenses and expenditures made by the plaintiff to cope with or mitigate the immediate problems caused by the fact that the asset transacted was misrepresented.³⁹³ In practice, consequential damages are frequently described in a broader context, leaving potential overlap between consequential and incidental damages. Generally, consequential damages include:

items of expense reasonably incurred to minimize the effects of the fraud, damages caused to other property suffered because of the fraud, travel expenses incurred to deal with the problem, commissions paid or added tax burdens, other items of loss or expense not adequately reflected in the general damages recovery based on market value of the property itself. If the defendant's misrepresentations to the plaintiff impel the plaintiff to litigate with third persons, then the reasonable expenses of that litigation, including the plaintiff's own attorney fees, are recoverable as items of damages consequent upon the misrepresentation.³⁹⁴

393. See *Wade & Sons, Inc. v. Am. Standard, Inc.*, 127 S.W.3d 814, 823 (Tex. App.—San Antonio 2003, writ denied); TEX. BUS. & COM. CODE ANN. § 2.715(a) (West 1994) (“Incidental damages resulting from the seller’s breach include expenses reasonably incurred in inspection, receipt, transportation and care and custody of goods rightfully rejected, any commercially reasonable charges, expenses or commissions in connection with effecting cover and any other reasonable expense incident to the delay or other breach.”); RESTATEMENT (SECOND) OF CONTRACTS § 347 cmt. c (1981) (“Incidental losses include costs incurred in a reasonable effort, whether successful or not, to avoid loss, as where a party pays brokerage fees in arranging or attempting to arrange a substitute transaction.”).

394. DOBBS, *supra* note 52, at 557; see also TEX. BUS. & COM. CODE ANN. § 2.715(b) (West 1994) (“Consequential damages resulting from the seller’s breach include (1) any loss resulting from general or particular requirements and needs of which the seller at the time of contracting had reason to know and which could not reasonably be prevented by cover or otherwise; and (2) injury to person or property proximately resulting from any breach of warranty.”).

Section 347 of the Restatement of Contracts, relating to expectancy damages, offers the following definition of special damages which may be limited to claims for expectancy damages:

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

³⁹⁵

Consequential damages would therefore include additional losses to the plaintiff, including lost profits and further loss in market value of the asset transacted such as envisioned in *Perry Equipment*³⁹⁶ or discussed previously.³⁹⁷ Caselaw is clear that incidental and consequential damages must be specially pled³⁹⁸ which would presumably apply to reliance damages also.³⁹⁹

The Restatement of Contracts defines reliance damages as follows:

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

395. RESTATEMENT (SECOND) OF CONTRACTS § 347 cmt. c (1981).

396. See *supra* Part IV.c.

397. See *supra* Part IV.c.

398. See *Sherrod v. Bailey*, 580 S.W.2d 24, 28 (Tex. Civ. App.—Houston [1st Dist.] 1979, writ ref'd n.r.e.); Jeffrey R. Cagle, et. al, *The Classification of General and Special Damages for Pleading Purposes in Texas*, 51 BAYLOR L. REV. 629, 666 (1999).

399. See *Nance v. Resolution Trust Corp.*, 803 S.W.2d 323, 329-30 (Tex. App.—San Antonio 1990, writ denied); Cagle, *supra* note 399, at 668.

injured party would have suffered had the contract been performed.⁴⁰⁰

For the purposes of overall damages strategy, three key issues on proposed special damages should be evaluated:

Whether the special damage is available in general;⁴⁰¹

Whether the special damage is excluded by one's choice for measuring direct damages;⁴⁰² and

Whether the proposed special damage is duplicative with other special damages.⁴⁰³

While it has been widely acknowledged that the common law anticipates the finding of non-speculative special damages that are the foreseeable result⁴⁰⁴ of a misrepresentation,⁴⁰⁵ some forms

400. RESTATEMENT (SECOND) OF CONTRACTS: DAMAGES BASED ON RELIANCE INTEREST § 349 (1981); *see also* DOBBS, *supra* note 52, at § 12.3(1) (“The object of reliance damage awards is to protect the plaintiff against actual losses resulting from contracting even while denying him the gains or expectancy he would have had upon performance.”); *Hart v. Moore*, 952 S.W.2d 90, 97 (Tex. App.—Amarillo 1997, pet. denied) (“Reliance damages, similar to out-of-pocket recovery, reimburse one for expenditures made towards the execution of the contract in order to restore the *status quo* before the contract.”); *Quigley v. Bennett*, 227 S.W.3d 51, 56 (Tex. 2007) (Brister, J., concurring and dissenting) (“[R]eliance damages compensate for the plaintiff’s out-of-pocket expenditures.”); *Fretz Constr. Co. v. S. Nat’l Bank of Houston*, 626 S.W.2d 478, 483 (Tex. 1981) (“Damages recoverable in a case of promissory estoppel are not the profit that the promisee expected, but only the amount necessary to restore him to the position he would have been in had he not acted in reliance on the promise.”).

401. *See Haase v. Glazner*, 62 S.W.3d 795, 800 (Tex. 2001) (holding that the statute of frauds bars a fraud claim for expectancy damages); *see also Baylor Univ. v. Sonnichsen*, 221 S.W.3d 632, 636-37 (Tex. 2007) (holding that the plaintiff was not entitled to claim expectancy damages); *GWTP Invs., L.P. v. SES Americom, Inc.*, 497 F.3d 478, 483-84 (5th Cir. 2007) (holding that reliance damages are appropriate for both fraud claims distinct from breach of contract as well as for contract claims where expectation damages are barred by the Statute of Frauds).

402. *See Kish v. Van Note*, 692 S.W.2d 463, 466-67 (Tex. 1985) (holding that recovery under the DTPA does not preclude recovery under other legal theories); *D.S.A., Inc. v. Hillsboro Indep. Sch. Dist.*, 973 S.W.2d 662 (Tex. 1998) (holding that when the benefit of the bargain is used to calculate direct damages, independent injury is required for the recovery of special damages).

403. *See Playboy Enters., Inc. v. Editorial Caballero, S.A. de C.V.*, 202 S.W.3d 250, 270-71 (Tex. App.—Corpus Christi 2006, pet. denied).

404. *See DUNN*, *supra* note 87, § 1.1 (“The proximate cause test is not only a limitation on recoverable damages beyond which the courts may not go. It is also the grant of a charter to the courts to award damages up to the extent of proximate causation. The test becomes particularly important in cases dealing with claims for fraud in transactions other than sales of property and cases where substantial consequential damages are claimed. Here, without the familiar benefit-of-the-bargain and out-of-pocket-loss rules as a guide, the courts are set adrift with no other test to determine

of special damage are subject to exclusion depending on the plaintiff's approach to direct damages. The Restatement of Contracts clearly provides that a claim for reliance damages is an alternative to a claim for expectancy damages.⁴⁰⁶ The Texas Supreme Court has applied this principle in the scrutiny of reliance damages for duplication with expectancy damages, especially claims for lost profits. Claims under the OOP approach can be scrutinized to ensure that such damage claims do not rely on an underlying expectation that the misrepresentation were true.⁴⁰⁷

Given the Court's opinion in *D.S.A.*, however, costs to repair or refurbish the misrepresented asset to meet misrepresented specifications are not admissible under the OOP approach.⁴⁰⁸ In that opinion, the Court rejected the plaintiff's claim for the costs to repair the construction to meet the misrepresented specifications.⁴⁰⁹ The Court held that the plaintiff was only entitled to the difference in consideration paid and the value of the construction as rendered.⁴¹⁰

As noted above, there has been substantial litigation about the nature of consequential damages in a breach of contract when such damages are waived in a contract that is the subject of a

whether damages are recoverable. The advocate with that kind of case should use the proximate cause test to establish a damage claim—or to rebut one.”).

405. See *Formosa Plastics Corp., USA v. Presidio Eng'rs & Contractors, Inc.*, 960 S.W.2d 41, 49 n.1 (Tex. 1998) (“It is possible that, in the proper case, consequential damages could include foreseeable profits from other business opportunities lost as a result of the fraudulent misrepresentation.”); see also *El Paso Dev. Co. v. Ravel*, 339 S.W.2d 360, 364 (Tex. Civ. App.—El Paso 1960, writ ref'd n.r.e.) (“We believe the law to be well settled in Texas . . . that an injured party is entitled to recover in a tort action such damages as result directly, naturally and proximately from fraud.”).

406. RESTATEMENT (SECOND) OF CONTRACTS: DAMAGES BASED ON RELIANCE INTEREST § 349 (1981) (“As an alternative to the measure of damages stated in § 347, the injured party has a right to damages based on his reliance interest, including expenditures made in preparation for performance or in performance, less any loss that the party in breach can prove with reasonable certainty the injured party would have suffered had the contract been performed.”).

407. See *D.S.A., Inc. v. Hillsboro Indep. Sch. Dist.*, 973 S.W.2d 662 (Tex. 1998). As the court observed, “HISD did not meet its burden of proving the independent injury required under section 552 of the Restatement. HISD's theory of recovery and charge to the jury did not attempt any distinction between its out-of-pocket damages and the benefit of the bargain. Instead, by seeking recovery for its costs to replace the roof, repair the plumbing, and re-grade the parking lots, HISD in essence asked for the benefit of its bargain—in this case, the reasonable costs needed to bring the school up to the ‘bargained-for’ standard. Consequently, HISD is not entitled to any recovery under the theory of negligent misrepresentation.” *Id.* at 664 (citation omitted).

408. *Id.*

409. *Id.*

410. *Id.*

breach of contract claim.⁴¹¹ To date, such disputes over the exact definition of incidental or consequential damages have not been wide spread in claims for fraudulent inducement. However, in light of the Court's opinion in *D.S.A.*, it might be reasonable to expect future disputes as to whether certain damages can be found as either incidental or consequential damages under the OOP approach as opposed to the BOB approach.

The discussion of potential damages under the OOP approach in the Restatement of Torts does not seem to be as restrictive as the *D.S.A.* opinion assumes. Sub-section (1)(a) of Section 549 provides that the plaintiff, under the OOP approach, is entitled to special damages defined as "pecuniary loss suffered otherwise as a consequence of the recipient's reliance upon the misrepresentation."⁴¹²

Comment d offers further explanation of the OOP approach:

d. Although the most usual form of financial loss caused by participation in a financial transaction induced by a fraudulent misrepresentation is the lessened value of the subject matter due to its falsity, the loss may result from a purchaser's use of the article for a purpose for which it would be appropriate if the representation were true but for which it is in fact harmfully inappropriate. So, too, it may be the expense to which he has gone in preparation for a use of the article for which it would have been appropriate if the representation had been true.⁴¹³

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

411. See *supra* notes 12-13 and accompanying text.

412. RESTATEMENT (SECOND) OF TORTS: MEASURE OF DAMAGES FOR FRAUDULENT MISREPRESENTATION § 549(1)(a)(1977).

413. *Id.* § 549 cmt. d; see also § 549 cmt. a ("Loss may result from a recipient's reliance upon a fraudulent misrepresentation in a business transaction in one of several ways. The most usual is when the falsity of the representation causes the article bought, sold or exchanged to be regarded as of greater or less value than that which it would be regarded as having if the truth were known. The rule applicable in this situation is that stated in Clause (a). The damages so resulting, being those which normally result from a misrepresentation in such transactions, are often called general damages."); § 549 cmt. b.

have led the plaintiff to avoid the damages detailed in comment d.

IX. RELIANCE DAMAGES

Our understanding of reliance damages can suffer from semantic confusion similar to that of damages under the OOP approach. When a court recites that a plaintiff may claim damages incurred in reliance on the defendant's misrepresentation, it is not necessarily referring to reliance damages. Numerous case opinions refer to consequential damages as those incurred in reliance on the defendant's misrepresentation.⁴¹⁴

Reliance damages can duplicate expectancy damages, depending on which type of reliance damages are claimed.⁴¹⁵ Dobbs distinguishes between essential reliance and incidental reliance damages:

Essential reliance is that reliance necessary or essential for the plaintiff's performance of his promises under the contract. If he contracted to produce unique machinery for the defendant, then expenses in making dies for the machinery would be essential reliance expenses. . . . [E]ssential reliance expenses are elements in the computation of the plaintiff's expectancy; the amount that the plaintiff will gain from completion of the contract on both sides depends on the amount of these essential expenses. So the plaintiff must not recover *both* essential reliance expenses *and* expectancy damages. . . .

Incidental reliance expenses could include any kind of collateral outlay by the plaintiff, but it

414. See, e.g., *Trenholm v. Ratcliff*, 646 S.W.2d 927, 933 (Tex. 1983) (finding "that Trenholm's damages directly and naturally resulted from reliance on the misrepresentation"); *Duval Cnty. Ranch Co. v. Wooldridge*, 674 S.W.2d 332, 336 (Tex. App.—Austin 1984, no pet.) (reasoning that the bank's judgment against Wooldridge, based upon his reliance on misrepresentations which the bank refused to honor, caused his damages); *El Paso Dev. Co. v. Ravel*, 339 S.W.2d 360, 365 (Tex. Civ. App.—El Paso 1960, writ ref'd n.r.e.) (stating that the common law damages for a fraudulent misrepresentation include the "pecuniary loss suffered otherwise as a consequence of the recipient's reliance upon the truth of the representation"); *Hiller v. Mfrs. Prod. Research Grp. of N. Am., Inc.*, 59 F.3d 1514, 1517-18 (5th Cir. 1995) (reciting the rule that fraud victims are entitled to recover for losses suffered as a result of their reliance upon a misrepresentation).

415. See DOBBS, *supra* note 52, § 12.3(2), at 58-59.

would not include expenses of performing his own promises to the defendant.⁴¹⁶

Relying on this distinction, only essential reliance damages would be duplicative with expectancy damages.⁴¹⁷

Section 349 of the Restatement (Second) of Contracts describes reliance damages as an alternative to the expectancy damages provided in section 347.⁴¹⁸ The Restatement also provides that if the defendant can prove that plaintiff's completion of the contract would have resulted in a loss, that loss must be offset against the reliance damages claimed.⁴¹⁹ Similarly, full expectancy damages are said to act as a maximum limit or ceiling on the amount of reliance damages possible.⁴²⁰ Less explicit but equally applicable is that only cash expenditures or expenses may be found as reliance damages.⁴²¹

One of the clearest examples of reliance damages was in a case in which a borrower claimed that a lender orally agreed to a loan and told the borrower to commence the renovations that were envisioned in the borrower's proposed use of proceeds.⁴²² No contract was ever executed, and the putative borrower asserted a claim for reliance damages for the monies expended in anticipation of the loan (supposedly net of any benefit to the plaintiff).⁴²³

Reliance damages would seem to be least likely to include opportunity cost claims that are not related to cash outlays or expenditures, but there are at least two case opinions that defy this reasoning. The first case involves a legal assistant who

416. *Id.* § 12.3(2), at 58.

417. *See id.*

418. *Mistletoe Express Serv. v. Locke*, 762 S.W.2d 637, 638 (Tex. App.—Texarkana 1988, no writ); *see also* DOBBS, *supra* note 52, § 12.3(1), at 50-51 (“When the defendant breaches an enforceable, bargained-for promise, the plaintiff has the option of claiming and recovering reliance expense or loss rather than the expectancy.”).

419. *See* RESTATEMENT (SECOND) OF CONTRACTS § 349 cmt. a (1981); *Mistletoe Express Serv.*, 762 S.W.2d at 638-39.

420. DOBBS, *supra* note 52, § 12.3(1), at 55.

421. *See Iron Mountain Bison Ranch, Inc. v. Easley Trailer Mfg., Inc.*, 42 S.W.3d 149, 159 (Tex. App.—Amarillo 2000, no pet.) (“As appellee notes in its brief, the proof it offered as to damages was the quote sheet price amounts and the bills of sale. These were not represented to be expenditures, costs to produce the trailers or amounts to restore appellee to its position before it manufactured the trailers. The quote sheet prices were purported to be merely the price agreed upon for manufacturing and sale of the trailers by appellee. The evidence of reliance damages is legally insufficient. Appellants’ issue is sustained.”).

422. 1001 McKinney Ltd. v. Credit Suisse First Boston Mortg. Capital, 192 S.W.3d 20, 29 (Tex. App.—Houston [14th Dist.] 2005, pet. denied).

423. *Id.*

agreed to take a cut in salary for a share in a contingency fee.⁴²⁴ The agreement was not documented precluding benefit of the bargain damages; but the court affirmed an award for the foregone wages.⁴²⁵ In the second case, the plaintiff orally contracted for the defendant to furnish and haul rock.⁴²⁶ The defendant failed to deliver 40,000 tons of rock, forcing the plaintiff to expedite the job with a third party for \$6.59 as opposed to the \$5.50 per ton that the plaintiff would have incurred if it had adequate notice.⁴²⁷ The court inexplicably justified the recovery of a “partial expectancy interest” in this promissory estoppel case.⁴²⁸ Normally it seems unlikely that such a theory would prevail to justify special damages for either reliance damages or consequential damages when the plaintiff elects the OOP approach.

In 2008, the Austin Court of Appeals handed down an interesting opinion on promissory estoppel that disagrees with the theory behind these prior two cases.⁴²⁹ In this case, a pipeline company asserted a claim of negligence against an excavator for rupturing its pipeline and polluting nearby land.⁴³⁰ The promissory estoppel issue arose only in relation to the plaintiff’s claim for legal fees.⁴³¹

Citgo claimed reliance damages on the basis of the pipeline rupture damages that resulted from its reliance on an agreement with the defendant that no work would occur near the pipeline without prior notice, as CITGO desired to have a representative present in such a situation.⁴³² Citgo argued that defendants breached this agreement by working in close proximity to the pipeline without notice.⁴³³ The Third District rejected the claim as disguised expectancy damages.⁴³⁴ According to the court, the pipeline company did not expend any money separate from the damages incurred from its reliance on the excavator’s

424. See *Cent. Tex. Micrographics v. Leal*, 908 S.W.2d 292, 294 (Tex. App.—San Antonio 1995, no writ).

425. See *id.* at 297-98.

426. See *Frost Crushed Stone Co. v. Odell Geer Constr. Co.*, 110 S.W.3d 41, 44 (Tex. App.—Waco 2002, no pet.).

427. *Id.* at 47.

428. *Id.*

429. See *Bechtel Corp. v. Citgo Prods. Pipeline Co.*, 271 S.W.3d 898, 928 (Tex. App.—Austin 2008, no pet.).

430. *Id.* at 898.

431. *Id.* at 925.

432. *Id.* at 906.

433. *Id.*

434. *Bechtel Corp. v. Citgo Prods. Pipeline Co.*, 271 S.W.3d 898, 928 (Tex. App.—Austin 2008, no pet.).

assurances.⁴³⁵ Therefore, the result of the plaintiff's reliance was inaction from which damages and losses followed:

CITGO's damages are not reimbursement for any amounts it expended in reliance on the promises, but compensation for consequential losses CITGO claimed it incurred when appellants failed to perform their promises. Such damages are in the nature of expectancy damages: they place CITGO in the position it claims it would have been had the promises been kept. Such damages are not recoverable through promissory estoppel.⁴³⁶

One case offers the opportunity to compare reliance and compensatory damages. Two businesses, Shell and Main Street, created a joint venture to build and operate gas stations that offered food courts.⁴³⁷ After getting started, the Main Street representatives negotiated extensively with Shell Oil about possible investment.⁴³⁸ The plaintiff, Main Street, claimed that Shell agreed to fund the investment but acknowledged that no written investment agreement was ever executed, precluding expectancy damages.⁴³⁹ The jury found reliance damages of \$1.7 million for money spent on developing the company, and that the plaintiff suffered consequential damages of \$4 million, representing the plaintiff's lost opportunity to obtain \$4 million of investment from an identified, alternative source, and consequential damages of \$1.667 million in debts that the plaintiff incurred and was unable to repay "as a natural, probable and foreseeable consequence of Shell's conduct."⁴⁴⁰

The Fifth District rejected the reliance damages because most of the \$1.7 million was spent before Shell had any contact with the plaintiff.⁴⁴¹ However, the court of appeals accepted the jury's finding on the \$1.67 million in consequential damages despite Shell's assertion that "there is no evidence or insufficient evidence that (1) the amount of debts awarded by the jury were incurred by Main Street and (2) that Main Street's inability to

435. *Id.* at 927.

436. *Id.* at 928.

437. *Shell Oil Prods. Co. v. Main St. Ventures, L.L.C.*, 90 S.W.3d 375, 379 (Tex. App.—Dallas 2002, pet. dism'd).

438. *Id.* at 380.

439. *Id.*

440. *Id.*

441. *Id.* at 384.

pay any debt was caused by Shell.”⁴⁴² The court provided the following justification:

Main Street’s theory at trial was that its reliance on Shell’s promises and representations caused the destruction of its business and resulted in its inability to pay its debts. Blair testified that Main Street’s failure to pay these debts was caused by its reliance on Shell’s promises. Because there is evidence that Main Street is ultimately responsible for these debts and its inability to pay them was caused by Shell’s conduct, we conclude that the evidence is legally and factually sufficient to support the jury’s award on this element of damage.⁴⁴³

As it applies to that case, the opinion fails to explain how Main Street’s inability to pay debts in bankruptcy is a loss to Main Street, as opposed to Main Street’s creditors. As a general matter, the substantiation of damages based on the evidence of debt is troubling because just as all cash flow is fungible, debts to general creditors are not necessarily the result of specific expenditures that comply with the standards for special damages. Absent further evidence, it is possible that the debt could be the result of the reliance damages that the court otherwise rejected, also suggesting the potential for duplicative damages.

X. EQUITABLE REMEDIES

The proprietary relief available from remedies in equity can be uniquely advantageous but they also offer unusual challenges. A significant challenge in pleading remedies in equity is that they are generally regarded as obscure, that they are poorly understood not only by the Bar but also by most jurists.⁴⁴⁴ Texas

442. *Shell Oil Prods. Co. v. Main St. Ventures, L.L.C.*, 90 S.W.3d 375, 385 (Tex. App.—Dallas 2002, pet. dism’d).

443. *Id.* at 386.

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

case law, especially relating to unjust enrichment, is no exception. For example, a number of Texas appellate courts currently hold that unjust enrichment is not a cause of action, but only a remedy for the cause of action of constructive trust or restitution.⁴⁴⁵ These opinions fail to acknowledge the distinction between unjust enrichment in equity or at law⁴⁴⁶ or even the holdings of the Texas Supreme Court relating to the applicable limitations period for the cause of action of unjust enrichment.⁴⁴⁷ Fortunately, Texas case law on rescission and constructive trusts, the principal remedies in equity for fraud, does not vary outside the normal range of interpretation embodied in the Restatement of Restitution.

Both the plaintiff and defendant to litigation in equity also need to be aware that a court sitting in equity exercises unusually broad discretion, so-called “equitable discretion.” A court in equity has the discretion to decide if the plaintiff has jurisdiction in a court in equity by determining if the plaintiff could otherwise secure an adequate remedy in a court sitting at law, under what is now known as the doctrine of irreparable injury.⁴⁴⁸ This discretion was first established during the reign of James I to resolve the dysfunctional competition between courts at law and courts in equity for jurisdiction in the same cases.⁴⁴⁹ Once the claim is granted jurisdiction in equity, the judge has the authority to pursue “total equity,” which authorizes a judge to fashion his judgments and remedies to suit his sense of the total

445. See, e.g., *Friberg-Cooper Water Supply Corp. v. Elledge*, 197 S.W.3d 826, 832 (Tex. App.—Fort Worth 2006), *rev'd on other grounds*, 240 S.W.3d 869 (Tex. 2007); *Barnett v. Coppell N. Tex. Court, Ltd.*, 123 S.W.3d 804, 816 (Tex. App.—Dallas 2003, pet. denied); *Oxford Fin. Cos. v. Velez*, 807 S.W.2d 460, 465 (Tex. App.—Austin 1991, writ denied). *But see* *Bank of Saipan v. CNG Fin. Corp.*, 380 F.3d 836, 842-43 (5th Cir. 2004); *McNair v. Cedar Park*, 993 F.2d 1217, 1220-21 (5th Cir. 1993); DOBBS, *supra* note 52, § 4.1(2) (stating that unjust enrichment may be its own cause of action); RESTATEMENT (THIRD) OF RESTITUTION AND UNJUST ENRICHMENT § 1 cmt. h (Tentative Draft No. 7, 2010) (“The identification of unjust enrichment as an independent basis of substantive liability in common-law legal systems was the central achievement of the first Restatement of Restitution. That conception of the subject is carried forward here.”); Laycock, *supra* note 445, at 1277 (“The law of restitution offers substantive and remedial principles of broad scope and practical significance.”).

446. See *Tri-State Chems., Inc. v. W. Organics, Inc.*, 83 S.W.3d 189, 194 (Tex. App.—Amarillo 2002, pet. denied). *But see* George P. Roach, *How Restitution and Unjust Enrichment Can Improve Your Corporate Claim*, 26 REV. LITIG. 265, 275-85 (2007) (distinguishing six different sources of jurisdiction for claims of unjust enrichment).

447. See *Elledge v. Friberg-Cooper Water Supply Corp.*, 240 S.W.3d 869, 870 (Tex. 2007).

448. *Chenault v. County of Shelby*, 320 S.W.2d 431, 433 (Tex. Civ. App.—Austin 1959, writ ref'd n.r.e.); see generally Douglas Laycock, *The Death of the Irreparable Injury Rule*, 103 Harv. L. Rev. 687, 770 (1990).

449. See Roach, *supra* note 447, at 289-91.

justice of the case, and therefore is not restricted to the limits of the parties' pleadings.⁴⁵⁰ For example, it is reversible error for the court to fail to award the defendant proper credit for benefits that the benefit received in the transaction to be rescinded.⁴⁵¹

The equitable remedy of rescission is based on the concept that the plaintiff and defendant should be restored to their condition prior to executing the contract (subject to equity).⁴⁵² The inability of a party to restore the *ex ante* status quo does not necessarily preclude rescission but it is considered a significant adverse factor.⁴⁵³ Rescission is also said to be available to plaintiffs with less rigorous causes of action such as claims by disappointed buyers.⁴⁵⁴ Under appropriate circumstances the plaintiff is entitled to claim special damages,⁴⁵⁵ sometimes including pre-contract expenses⁴⁵⁶ as well as punitive damages.⁴⁵⁷

450. See Roach, *supra* note 292, at 511.

451. Davis v. Estridge, 85 S.W.3d 308, 311 (Tex. App.—Tyler 2001, pet. denied) (“There was no credit given for the benefits derived by the Estridges while in possession of the house and acreage. Consequently, the trial court failed to do equity, and it was an abuse of discretion to grant rescission of the real estate contract and a constructive trust on the Davis’ homestead.”).

452. See Gentry v. Squires Const., Inc., 188 S.W.3d 396, 410 (Tex. App.—Dallas 2006, no pet.) (“However, an inability to return the parties to their former position should be considered in determining whether rescission would be inequitable.”) (citing Ennis v. Interstate Distributors, Inc., 598 S.W.2d 903, 906 (Tex. App.—Dallas 1980, no writ)).

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

454. See Smith v. Nat’l Resort Cmty., Inc., 585 S.W.2d 655, 658 (Tex. 1979) (The court notes that there is “less strictness in recognizing a right of rescission.”); DOBBS, *supra* note 52, § 9.3(2), at 583 (“A number of cases have permitted the plaintiff to rescind for a misrepresentation, and thus to avoid all losses associated with the transactions, including those losses not resulting from the misrepresentation.”); DOBBS, *supra* note 52, § 9.1, at 547 (“[R]escission may be permitted for some kinds of wholly innocent misrepresentation even though damages might not.”).

455. Smith v. Nat’l Resort Cmty., Inc., 585 S.W.2d 655, 660 (Tex. 1979); United Enters. v. Erick Racing Enters., No. 07-01-00467-CV, 2002 LEXIS 9271, at *2 (Tex. App.—Amarillo Dec. 31, 2002, pet. denied) (not designated for publication); Denver City Ind. School Dist. v. Moses, 51 S.W.3d 386, 391 (Tex. App.—Amarillo 2001, no pet.); SeaQuest Diving LP v. S & J Diving Inc. (In re SeaQuest Diving LP), 579 F.3d 411, 424-25 (5th Cir. 2009).

456. United Enters., 2002 LEXIS 9271, at *2-4 (holding that plaintiff’s closing costs were appropriate damages).

457. Nabours v. Longview Sav. & Loan Ass’n, 700 S.W.2d 901, 904-05 (Tex. 1985); Int’l Bankers Life Ins. Co. v. Holloway, 368 S.W.2d 567, 568 (Tex. 1963) (“The consideration paid as a result of fraud constitutes actual damages and will serve as the basis for the recovery of exemplary damages.”); Tex. Capital Secs., Inc. v. Sandefer, 58 S.W.3d 760, 774 (Tex. App.—Houston [1st Dist.] 2001, pet. denied).

Perhaps the unique advantage of rescission is that the remedy is not subject to proof of causation, even when the effect of the remedy is enhanced by favorable, *ex post* changes in economic conditions. For example, damage theorists conclude that a plaintiff that is induced to buy stock due to financial fraud may not have a claim for monetary damages if the decline in the stock price is due to an intervening event.⁴⁵⁸ Even in such extreme circumstances, the remedy of rescission would permit the total refund of the investor's money.⁴⁵⁹

One of the best examples of the singular effectiveness of rescission or specific restitution⁴⁶⁰ in case patterns that enjoy favorable *ex post* change is described in an unusual Ninth Circuit opinion.⁴⁶¹ In that case, the defendant wrongfully obtained control of the plaintiff's inactive website, *www.sex.com*, that greatly appreciated in value and generated cash large flow after the defendant began to operate the website. Under the remedy of specific restitution, the court ordered the return of the web site as well as \$40 million of unjust enrichment and \$25 million of punitive damages.⁴⁶² By comparison, monetary damages would have related merely to the value of the website on the date of conversion.

458. DOBBS, *supra* note 52, § 9.3(2) at 583.

459. *Id.* § 9.1, at 547 ("Rescission is readily available and perhaps somewhat more readily available in some cases than damages; rescission may be permitted for some kinds of wholly innocent misrepresentation even though damages might not."); RESTATEMENT (THIRD) OF RESTITUTION & UNJUST ENRICHMENT § 13 cmt. c (Tentative Draft No. 1, 2001) ("A transfer is not subject to invalidation for misrepresentation, fraudulent or otherwise, unless the misrepresentation induced the transfer. Subject to this test of causation, a transfer induced by fraud is subject to rescission without regard to materiality; whereas a transfer induced by innocent misrepresentation is subject to rescission only if the misrepresentation was material."); *see also* *Randall v. Loftsgarden*, 278 U.S. 647, 659 (1986) ("We may therefore infer that Congress chose a rescissory remedy when it enacted § 12(2) in order to deter prospectus fraud and encourage full disclosure as well as to make investors whole. Indeed, by enabling the victims of prospectus fraud to demand rescission upon tender of the security, Congress shifted the risk of an intervening decline in the value of the security to defendants, whether or not that decline was actually caused by the fraud. Thus, rescission adds an additional measure of deterrence as compared to a purely compensatory measure of damages." (citations omitted)).

460. DOBBS, *supra* note 52, §4.4, at 625 ("Specific restitution is not the result of an incantation. It does not matter whether the words constructive trust or reformation are used. If the plaintiff traces his real property into the hands of the defendant and the plaintiff is entitled to restitution, then specific restitution is appropriate. If a court wants to speak of rescission rather than constructive trust, an order requiring specific restitution is still appropriate.").

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

462. For a discussion of *Kremen v. Network Solutions, Inc.*, 337 F.3d 1024 (9th Cir. 2003) and *Kremen v. Cohen*, 325 F.3d 1035, 1037-39 (9th Cir. 2003) *see* Roach, *supra* note 447, at 265, 269-70.

While courts have provided general guidelines for when a court should grant a constructive trust,⁴⁶³ the actual criteria are much more subjective and flexible.⁴⁶⁴ The unique advantage of a constructive trust is that it allows the plaintiff to “prime” the security interest of secured creditors or bankruptcy courts.⁴⁶⁵ In the form of a constructive trust or equitable lien, a claim for unjust enrichment can achieve seniority to most other creditors, including secured lenders, life insurance policies, tax liens, and even homestead provisions.⁴⁶⁶ A constructive trust can even “prime” or supersede statutes of descent.⁴⁶⁷ Professor Kull, Reporter for the (Third) Restatement of Restitution and Unjust Enrichment, claims that the only real advantage of a constructive trust occurs when the defendant is on the verge of bankruptcy.⁴⁶⁸

XI. AVOIDING OR MINIMIZING THE MINEFIELD

The easiest way for business participants to avoid the minefield of fraudulent inducement is to adopt the practice of negotiating a reliance waiver clause in contracts.⁴⁶⁹ Depending on circumstances, a blanket waiver seems unlikely to become popular; more likely is a negotiation process in which the parties to a contract explore the areas of positive or negative assurance that are important and foreseeable to the transaction. Significant representations would then be added or modified in the specific language of the contract. Misunderstandings that would otherwise result in claims for fraudulent inducement would thereby be waived or converted to claims for breach of warranty or contract.

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

464. *Ginther v. Taub*, 675 S.W.2d 724, 728 (Tex. 1984) (“In *Meadows* we further stated that a transaction may, depending on the circumstances, provide the basis for a constructive trust where one party to that transaction holds funds which in equity and good conscience should be possessed by another.” (citing *Meadows v. Bierschwale*, 516 S.W.2d 125, 131 (Tex. 1974))).

465. Andrew Kull, *Restitution in Bankruptcy: Reclamation and Constructive Trust*, 72 AM. BANKR. L.J. 265, 281, 290 (1998).

466. *TMG II v. United States*, 1 F.3d 36, 39 (D.C. Cir. 1993); *Hamblet v. Coveny*, 714 S.W.2d 126, 129 (Tex. App.—Houston [1st Dist.] 1986, writ ref’d n.r.e.); *DOBBS*, *supra* note 52, § 4.3(1), at 587; RESTATEMENT (FIRST) OF RESTITUTION § 202 (1937).

467. *Pope v. Garrett*, 211 S.W.2d 559, 561 (Tex. 1948).

468. Kull, *supra* note 466, at 290. Kull writes: “the truth about constructive trust and bankruptcy is that only in bankruptcy does constructive trust really matter.” *Id.*

469. *See supra* Part IV.d.

Assuming that fraudulent inducement claims cannot be avoided, the damages minefield can best be minimized by paying ruthless attention to the details of the case and the requirements in relevant case opinions.⁴⁷⁰ This process lends itself to establishing grids or tables that would distinguish each component of a damage claim by the damages method, approach and type of damage (direct, incidental, consequential and reliance damages).

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

XII. CONCLUSIONS

Fraudulent inducement is a powerful cause of action that allows the plaintiff to name defendants otherwise difficult to reach and to stack punitive damages on top of expectancy damages. It also provides for an unusual range of remedies, financial or equitable. Financial remedies can be measured as loss of value, loss of profits or as special damages for expenditures and losses. Alternative methods, alternative approaches and elections abound. The comparative suitability of these options for the case facts and trial limitations need to be reviewed. Additional determinants of the plaintiff's strategy could include the advantage of *ex ante* or *ex post* measures, the difficulty of proving causation and the defendant's ability to pay the judgment. The resulting damages strategy can, in turn, change either party's discovery process, selection of experts and motion practice.

Whether the Texas judiciary applies greater scrutiny to cases of fraudulent inducement or whether that scrutiny is due to a traditional fear of speculative damage measures or a fear of impressionable juries is itself speculative. Definite proof is unlikely to be established. Whether or not these traditional fears have been significant to the case law, it is nevertheless true that many of the appellate opinions in this area of remedies were prompted by the weak state of practice for submitting jury

470. See, e.g., *Burke v. Union Pac. Res. Co.*, 138 S.W. 3d 46, 69 (Tex. App.—Texarkana 2004, pet. denied) (noting that plaintiff failed to include veterinary costs as source of damages and substantiate ownership of cattle that died).

instructions and substantiating the plaintiff's measure of damages. To be fair to litigators, it also seems clear that some appellate opinions manifest significant confusion on these issues among the judiciary as well.

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