

# LEGAL STRATEGIES

A Legal Newsletter From Hochfelsen|Kani|Louis LLP

Winter 2009

## “Liar, Liar, Pants On Fire.” The Practical Implications Of Suing Someone For Fraud

By Steven I. Hochfelsen

**M**any people use the word “fraud” in daily language to mean many things. In daily use, it means dishonesty. But the more casual use of the word often misleads people to think that they have a legal case based on fraud merely because someone lied to them. That is not always the case. In the courts, the term “fraud” has a very specific and well-defined meaning.

In fact, in order to bring a lawsuit based on fraud, you must prove certain, very specific things:

1. Someone made a misrepresentation of fact to you;
2. They knew it was not true when they said it;
3. You did not know the truth and could not have known it had you undertaken a reasonable investigation into the facts;
4. You relied on the misrepresentation in some way that was reasonable; and
5. You were damaged due to your reliance on the misrepresentation.

This seems to be a very straightforward series of conditions. However, there is a lot of



nuance that you might not recognize at first glance.

### **Misrepresentations of Fact**

It is not enough that someone lied to you. That, alone, can make you quite angry, but it is not enough to allow you to prevail in a lawsuit. The misrepresentation must be a misrepresentation of fact. For

example, “It looks like this product will make a million dollars” is really an opinion, and not a fact. You cannot sue someone for fraud because they expressed an opinion that something might be true. “I had an analysis done by X consultants, and they say that the product will make a million dollars over the next five years” is only fraud if X consultants

---

***In order to bring a lawsuit based on fraud, you must prove certain, very specific things***

---

did not actually analyze the product, or if they did not say it would make a million dollars. But, if they did, then there is no fraud. (You could have other rights against X consultants for negligence, for example, in some

circumstances. But that still is not fraud.)

**O**n the other hand, “I just invested a million dollars in this product, and if you do so, as well, it could double our money in five years” is fraud if there was no investment. In other words, if someone makes a misrepresentation about a fact, then you might have an action against them for fraud.

### **Knowledge of Falsity**

If the person speaking knew that the statement was false when they said it, that is sufficient to support a claim if the other conditions are also met. If they did not know whether it was true or false, then that is not fraud. If they should have known it was false, then, even though it is not fraud, it might support a claim for “negligent misrepresentation.” Practically, there is a big difference in the damages you can recover for fraud, as opposed to those you can recover for negligent misrepresentation. As a practical matter, judges and juries are more likely to award damages for a greater spectrum of injuries for fraud, because it is a more “immoral” act than negligent misrepresentation. In the case of fraud, you might also recover “punitive damages,” which are damages intended to punish the wrongdoer and make sure that s/he does not try something like that again. In the case of negligent misrepresentation, there can be no punitive damages.

### **You Did Not Know The Falsity And Reasonably Relied On The Statement**

These two conditions are related in most cases. If you could have undertaken a reasonable investigation and discovered the truth, then it would not be considered “reasonable” for you not to investigate. In such a case, your reliance on a misrepresentation would not be considered “reasonable.” In another instance, you could not “reasonably” rely on a statement of someone where you know that they do not have the knowledge to make such a statement.

For example, if your next door neighbor is a doctor who tells you, “I invested in this stock – it’s worth millions!” you could not go out and sue him or her if you invest a million dollars in the stock and lose all of your money. If, on the other hand, your neighbor is the CEO of the company who tells you, “we were just awarded the contract to supply Coca Cola with all of its cans for the next 15 years, so you should invest” then you might have a right to sue if no such contract was awarded.

**H**owever, what is considered “reasonable” is often a subject on which reasonable minds can differ, so it is not always possible to predict consistently whether your reliance on a false statement will be found “reasonable” by a court or jury.

---

***What is considered  
“reasonable” is often a  
subject on which reasonable  
minds can differ***

---

### **You Were Damaged By Your Reliance On The Statement**

In deciding whether – and by how much – you were damaged, courts normally apply a practical test. This is referred to by the legal term, “proximate cause.” If you give \$100,000 to someone who promises to use it to start a company in which you will be a half partner, and s/he uses it for a vacation around the world instead, you have clearly been damaged by the \$100,000 you invested. Courts also will normally award you interest on that money. If fraud is proven, most of the time you can get punitive damages, as well (normally up to \$300,000). But if you say, “had I not given him/her the money, I would have invested it in X company and would have doubled my money by now,” the law

normally considers that kind of damage to be speculative, or too “remote.” As a practical matter, the court then says that, as a matter of public policy, the failure to profit by an alternate investment was not “proximately” caused by the fraud because there is not a direct enough connection between the fraud and the loss.

**T**hat said, courts are normally willing to award a wider spectrum of damages for fraud than for a simple breach of contract. This is due primarily to the greater moral culpability in intentionally deceiving someone in order to gain a benefit from him or her. But we lawyers just state that there is a different, narrower “test” applied to determine contract damages as opposed to fraud damages.

#### **Practical Implications Of Suing Someone For Fraud**

If you decide that you want to sue someone for fraud, it is important to have a competent litigation attorney to handle your case. This is

---

***Courts are normally willing to award a wider spectrum of damages for fraud than for a simple breach of contract***

---

because there are a number of practical implications you must consider. For example, if someone has liability insurance, the insurance policy will not cover fraud claims. This is because fraud is an intentional act, which insurance policies do not cover. On the other hand, insurance will cover liability for negligent misrepresentation, because it is not intentional. When you file, it is good to consider whether having an insurance company on the other side of the case to pay any judgment, or the legal fees of your opponent, is in your best interest.

In addition, when you sue somebody for fraud, you have to list in great detail what the fraud is – for example, the exact statements made, who made them, the dates and manner in which they were made, and in some cases, the authority of the person to make the statements themselves. This is because fraud is considered a serious thing, and you can’t just accuse someone of fraudulent conduct lightly. Often, people who try to do this without the necessary experience in litigation tactics and strategy do not do it correctly, resulting in the early loss of their fraud claims in the case.

Moreover, fraud cases will often be litigated more vigorously than contract cases. This is because of the stigma that attaches to the claim and the possibility of greater damages and liability of the person who is being sued. In other words, more is at stake, so more attention and time is spent on the case by both sides.

**T**he bottom line is that you should never sue someone for fraud lightly. But, if you do, you should make sure that you have your ducks in a row first, and that you trust that your lawyer will do it correctly.

**If you have any questions, or if we can assist in your legal needs, please call us at (714) 907-0697**



**Hochfelsen|Kani|Louis** LLP