RECENT DEVELOPMENTS IN BUSINESS LITIGATION

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This article highlights significant business litigation cases decided from October 1, 2012 through September 30, 2013, addressing: (1) civil RICO, where federal courts attempted to clarify the necessary elements to plead and prove civil RICO claims; (2) fraud and misrepresentation, in which courts considered a number of cases in the securities fraud context, includ-

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ing a Supreme Court decision on the applicability of the discovery rule to SEC investigations; (3) breach of contract, which was notable for the Supreme Court's decision that the "first sale doctrine" still protects parties' ability to convey copyrighted material without alienation; (5) breach of fiduciary duty, where the Delaware Court of Chancery, in particular, was active in reaching decisions on this issue this year; and (6) remedies, including the continued expansion and contraction in various jurisdictions of the economic loss rule—a rule initially created by the California Supreme Court in *Seely v. White Motor Co.*

I. CIVIL RICO

During the past year, federal courts decided numerous civil RICO cases, adding both clarity and confusion to the RICO landscape. The courts dismissed multiple civil RICO claims brought by plaintiffs who sought to transform claims for simple illegalities into RICO cases. Yet, this past year also saw circuit courts affirming the grant of summary judgment in favor of RICO plaintiffs, reversing dismissal of RICO claims, and affirming a jury verdict awarding damages in excess of $140 million on RICO claims. The courts decided these cases while grappling with many of the complex elements necessary to plead and prove civil RICO.

As has been the trend in recent years, federal courts dismissed civil RICO claims where plaintiffs failed to sufficiently plead a RICO scheme, a pattern of racketeering activity, or the type of concerted activity undertaken by an identifiable RICO enterprise. For example, in *Lundy v. Catholic Health System of Long Island Inc.*,[1] the plaintiffs, a putative class of hospital employees, alleged that the defendant hospital system "failed to compensate them adequately for time worked during meals and breaks, before and after scheduled shifts, and during required training sessions."[2] The plaintiffs' third amended complaint asserted that the hospital system "used the mails to defraud [the] [p]laintiffs by sending them [misleading] payroll checks" that "deliberately concealed from [the] employees that they did not receive compensation from all compensable work."[3] The Second Circuit affirmed dismissal of the plaintiffs' RICO claims for failing to allege a "pattern of racketeering activity" because the plaintiffs did not allege "what any particular Defendant did to advance the RICO scheme . . . [n]or have they otherwise pled particular details regarding the alleged fraudulent mailings" of pay stubs, which "would have revealed (not concealed)" the underpayments.[4]

1. 711 F.3d 106 (2d Cir. 2013).
2. *Id.* at 109.
3. *Id.*
4. *Id.*

In *Nowicki v. Delao*,[5] the Seventh Circuit similarly affirmed dismissal of plaintiffs' RICO claims based on the failure to sufficiently allege racketeering activity. There, the plaintiffs, after themselves being the subject of a housing discrimination complaint, alleged that the defendants participated in an ongoing criminal enterprise that targeted landlords while benefiting lawyers and bogus housing discrimination complainants.[6] The Seventh Circuit, in affirming dismissal of the RICO claims, stated that "civil RICO 'demands more than a straightforward case of malicious prosecution . . . to open up its window to treble damages' " and that, even though "plaintiffs are alleging something bigger than isolated malicious prosecution when they accuse the Fair Housing Council of training complainants to extort money from landlords," those allegations were conclusory and speculative.[7]

In *United Food and Commercial Workers Union and Employers Midwest Health Benefits Fund v. Walgreen Co.*,[8] the court made clear that "RICO is not violated every time two or more individuals commit one of the predicate crimes listed in the statute."[9] The court upheld dismissal of the plaintiff's RICO claims against Walgreens and Par Pharmaceutical, despite specific allegations of an illegal drug switching practice that "attracted scrutiny from a number of states' attorneys general and the Justice Department" because the plaintiff did not sufficiently "allege that Walgreen and Par Pharmaceutical were conducting the affairs of [a RICO] '. . . enterprise.' "[10]

In *Walgreen*, the plaintiff, "an employee benefit plan that provides health care benefits to its [members]," alleged that Walgreens "fraudulently overcharged it and other insurance providers by filling prescriptions for several generic drugs [(from Par Pharmaceutical)] with a dosage form that differed from, and was more expensive than, the dosage form prescribed to the customer."[11] Walgreens, which started the practice after a pitch by the drug manufacturer Par Pharmaceutical paid $35 million to the federal government and forty-six states to settle governmental claims relating to its practices.[12] However, the Seventh Circuit held that the plaintiff's civil RICO complaint failed to allege that Walgreens and Par Pharmaceutical were "conducting the affairs of [a RICO] 'enterprise,' as opposed to their own affairs."[13] The court noted that "Walgreens and Par Pharmaceutical were no[ ] strangers," and that "[r]epresentatives from [both] companies regularly

5. 506 F. App'x 514 (7th Cir. 2013).
6. *Id.* at 515.
7. *Id.* at 516.
8. 719 F.3d 849 (7th Cir. 2013).
9. *Id.* at 850.
10. *Id.*
11. *Id.* at 851–52.
12. *Id.* at 852.
13. *Id.* at 854–56.

communicated with one another," but found that "[t]his type of interaction . . . show[ed] only that the defendants had a commercial relationship, not that they had joined together to create a distinct entity for purposes of improperly filling . . . prescriptions."[14] In other words, "[t]he allegations in the complaint d[id] not indicate how the cooperation [among the parties] exceeded that inherent in every commercial transaction between a drug manufacturer and pharmacy, and without such an indication, [the court] cannot find a basis for inferring that Walgreens and Par were conducting the enterprise's affairs."[15]

Contrary to the above cases, the plaintiffs succeeded on RICO claims in *In re ClassicStar Mare Lease Litigation*,[16] with the Sixth Circuit affirming a grant of summary judgment based on clear evidence of intent to defraud, causation, and the existence of a RICO enterprise.[17] The plaintiffs, a group of investors, brought various claims against a group of corporations and individuals who operated a complex horse breeding investment program.[18] The plaintiffs alleged that the defendants violated, inter alia, RICO "by convincing them to invest in the [horse breeding business] . . . in order to take advantage of various tax deductions," despite the fact that the defendants knew "the assets [that] formed the basis of the . . . tax reductions were dramatically undervalued and, in some cases, wholly fictitious."[19]

"After extensive discovery, . . . [t]he district court granted summary judgment to [the] [p]laintiffs."[20] The Sixth Circuit affirmed, finding that "the record reflect[ed] no genuine dispute over any material facts."[21] In addressing RICO, the Sixth Circuit found that "a pattern of racketeering" existed through "no fewer than thirty-seven acts that would be indictable as mail and wire fraud"[22] and further noted that causation was established notwithstanding the fact that the plaintiffs allegedly had "knowledge [of] various aspects of the fraudulent scheme," because their purported knowledge "was largely irrelevant to [the plaintiffs'] decision[ ] to do business with [the] [d]efendants."[23]

The Sixth Circuit in *ClassicStar* also addressed in detail "the existence of a qualifying RICO enterprise," focusing on the "distinctness" requirement, which mandates proof of "a 'person'[ ] and . . . 'enterprise' that is

14. *Id.* at 855.
15. *Id.* at 856.
16. 727 F.3d 473 (6th Cir. 2013).
17. *Id.* at 478.
18. *Id.* at 482.
19. *Id.* at 478.
20. *Id.*
21. *Id.*
22. *Id.* at 484.
23. *Id.*

not simply the same 'person' referred to by a different name."[24] The court acknowledged that "federal courts have encountered significant . . . difficulties when attempting to apply the distinctness requirement in the context of complex relationships among affiliated and non-affiliated corporations and individuals."[25] After reviewing what it considered to be "meandering and inconsistent case law," along with the Supreme Court's decision in *Cedric Kushner*,[26] the Sixth Circuit articulated the following two principles:

> (1) individual defendants are always distinct from corporate enterprises because they are legally distinct entities, even when those individuals own the corporations or act only on their behalf; and (2) corporate defendants are distinct from RICO enterprises when they are functionally separate, as when they perform different roles within the enterprise or use their separate legal incorporation to facilitate racketeering activity.[27]

Applying those principles, the court held that "each [d]efendant [was] sufficiently distinct from the RICO enterprise to satisfy the statute's distinctness requirement."[28]

The Second Circuit similarly grappled with the distinctness requirement this past year in *Cruz v. FXDirectDealer, LLC*.[29] In *Cruz*, the plaintiff commenced a proposed class action seeking to represent a class of persons who contracted with FXDirectDealer, a company that provides online foreign currency exchange trading services.[30] The plaintiff alleged that FXDirectDealer "engaged in dishonest and deceptive practices" with its online trading platform, including manipulating trades and pricing information.[31] The Second Circuit affirmed dismissal of the plaintiff's RICO claim because "the complaint [did] not allege a continuing RICO enterprise distinct from the RICO 'person.'"[32]

The plaintiff's "amended complaint allege[d] that [FXDirectDealer] [was] a RICO 'person' that conduct[ed] . . . deceptive practices of an association of individuals dubbed the 'FXDD Fraud Enterprise,' " which included FXDirectDealer; FXDirectDealer's parent company; an equity stakeholder corporation of FXDirectDealer; FXDirectDealer's corporate officers; "software companies that develop and sell [FXDirectDealer]'s

24. *Id.* at 490 (quoting Cedric Kushner Promotions, Ltd. v. King, 533 U.S. 158, 161 (2001)).
25. *Id.*
26. *Cedric Kushner*, 533 U.S. at 158.
27. *ClassicStar*, 727 F.3d at 492.
28. *Id.*
29. 720 F.3d 115 (2d Cir. 2013). *Cruz* is also discussed *infra* as a significant case regarding breach of contract.
30. *Id.* at 118.
31. *Id.* These acts included "hijacking" customer profits, "refusing to execute profitable customer trade orders," and "creating false short-term price spikes." *Id.* at 119.
32. *Id.* at 120–21.

software"; and " 'introducing brokers,' who receive[d] commissions from [FXDirectDealer] for educating consumers about [foreign exchange] trading."[33] The Second Circuit first held that, because the amended complaint made no specific allegations of knowledge of FXDirectDealer's deceptive practices by the equity stakeholder corporation, the software companies, and the introducing brokers, they could not " 'share a common purpose to engage in a . . . fraudulent course of conduct' " and were "excluded from the alleged ["association-in-fact"] enterprise."[34] The court next excluded FXDirectDealer's corporate officers from the RICO enterprise because the court has "long . . . rejected the idea that a RICO enterprise [can] consist '. . . of a corporate defendant associated with its own employees or agents carrying on the regular affairs of the defendant.' "[35] Finally, the court also addressed whether FXDirectDealer and its parent company could amount to a RICO enterprise and concluded they could not, because they " 'operate[d] within a unified corporate structure' and [were] 'guided by a single corporate consciousness.' "[36]

In *CVLR Performance Horses, Inc. v. Wynne*,[37] the Fourth Circuit held that the plaintiff's amended complaint sufficiently pleaded an open-ended pattern of racketeering activity to support a RICO claim and thus reversed the district court's order granting the defendant's motion to dismiss.[38] The defendant was

> the sole owner of Rivermont and 1650 Partners, . . . [and] [a]lthough Rivermont was not authorized . . . to engage in banking activities . . . , [the defendant] held out Rivermont as a bank as part of his enterprise and used this entity . . . to facilitate his fraudulent schemes, many of which "targeted women in financial distress."[39]

The plaintiff, CVLR Performance Horses, became a victim of the defendant when the plaintiff's president responded to an advertisement placed by the defendant. The defendant then allegedly engaged in a series of acts fraudulently holding out Rivermont as a bank.[40]

33. *Id.*
34. *Id.* (quoting First Capital Asset Mgmt., Inc. v. Satinwood, Inc., 385 F.3d 159, 174 (2d Cir. 2004)).
35. *Id.* at 121 (quoting Riverwoods Chappaqua Corp. v. Marine Midland Bank, N.A., 30 F.3d 339, 344 (2d Cir. 1994)).
36. *Id.* The court specifically did not address whether the complaint could be sustained based on an alleged single corporate enterprise, because the complaint alleged only the " 'less natural' scenario of 'a corporation . . . associated with [an] oddly constructed entity' that include[d] the corporation." *Id.* at 121 n.3 (quoting Cedric Kushner Promotions, Ltd. v. King, 533 U.S. 158, 164 (2001) (internal quotation marks omitted)).
37. 524 F. App'x 924 (4th Cir. 2013).
38. *Id.* at 925.
39. *Id.* at 926–27.
40. *Id.*

The district court dismissed the plaintiff's RICO claim due to the purported failure to sufficiently plead either closed-ended or open-ended continuity supporting a pattern of racketeering activity.[41] The Fourth Circuit reversed, holding that the amended complaint sufficiently pleaded open-ended continuity.[42] In so holding, the court stated that the defendant's conduct "projects into the future with a threat of repetition" because "Rivermont continues to advertise as a bank" and there is "no inference that Rivermont has ended its fraudulent activities."[43] Although "the [trial] court found it implausible that the racketeering activities would continue into the future because all of the victims . . . 'ha[d] been bilked' and, presumably, kn[ew] better than to do more business with [the defendant]," the Fourth Circuit held that "the threat of continu[ing] [activity] must be viewed at the time the racketeering activity occurred"—at the time this racketeering activity occurred, "there was no . . . indication that [defendant]'s conduct was to be limited to only the identified victims."[44]

Finally, in *In re: Neurontin Marketing and Sales Practices Litigation; Kaiser Health Plan v. Pfizer Inc.*,[45] the First Circuit decided an appeal from "verdicts of over $140 million . . . compensating Kaiser, a major health plan provider and insurer, for . . . injur[ies] Kaiser suffered by its payment . . . of off-label Neurontin prescriptions [that] had been induced by a fraudulent scheme by Pfizer."[46] Pfizer appealed, inter alia, a jury verdict that "concluded that '. . . Pfizer violated RICO with respect to its promotion of Neurontin for' bipolar disorder, migraine, neuropathic pain, and dosages exceeding 1800 mg per day."[47]

"On appeal, Pfizer d[id] not challenge the conclusions of the jury . . . that it engaged in a fraudulent scheme with respect to its promotion of Neurontin for off-label uses," but instead sought to vacate the finding of liability and damages against it primarily based on its claim that, as a matter of law, Kaiser could not meet RICO causation requirements.[48]

> Pfizer's primary argument [was] that . . . there [was] no proximate causation . . . because there [were] too many steps in the causal chain connecting its mis-

41. *Id.* at 927.
42. *Id.* at 929.
43. *Id.* at 928.
44. *Id.* at 929.
45. 712 F.3d 21 (1st Cir. 2013).
46. *Id.* at 25. "This is one of several related appeals regarding Neurontin, which result[ed] in separate opinions" in matters that were part of multidistrict litigation consolidated in the District of Massachusetts. *Id. See also In re* Neurontin Mktg. & Sales Practices Litig., Harden Mfg. Corp., 712 F.3d 60 (1st Cir. 2013); *In re* Neurontin Mktg. & Sales Practices Litig., Aetna, Inc., 712 F.3d 51 (1st Cir. 2013).
47. *In re Neurontin Mktg.*, 712 F.3d 21 at 26 (quoting *In re* Neurontin Mktg. & Sales Practices Litig., No,. 04-cv-10739-PBS, 2011 WL 3852254, at *1 (D. Mass. Aug. 31, 2011)).
48. *Id.* at 33.

> representations to the injury to Kaiser, particularly because th[e] injury rested on the actions of independent actors—the prescribing doctors.[49]

"Pfizer [essentially] argue[d] that its . . . misrepresentations went to [the] prescribing doctors" (not to Kaiser as the health plan provider), breaking the causal link.[50]

The First Circuit disagreed, initially noting that Pfizer was trying "to impose a direct reliance requirement on top of the statutory language providing a private right of action under RICO."[51] Relying on the Supreme Court's decision in *Bridge v Phoenix*,[52] the court held that Pfizer was foreclosed from arguing a reliance requirement, because "reliance is not an element of proximate caus[ation] in a private RICO claim predicated on mail fraud."[53] The court further held that Kaiser met the proximate cause requirement for multiple reasons, including the fact that "Kaiser was . . . a 'primary and intended victim[ ] of [Pfizer's] scheme to defraud' " because "Pfizer had . . . targeted Kaiser for Neurontin sales."[54] Ultimately, the First Circuit rejected all of Pfizer's arguments on appeal, and affirmed the lower court's entry of judgment in favor of Kaiser on all claims, including the RICO claim.[55]

II. FRAUD AND MISREPRESENTATION

During the last year, courts at both the federal and state level have published decisions that may significantly impact the landscape of fraud and misrepresentation cases. Specifically, courts have updated and clarified critical issues, resolved conflicts among authorities, and overturned well-settled precedent in this area of law.

In a unanimous decision, the U.S. Supreme Court in *Gabelli v. Securities and Exchange Commission*[56] held that the Securities and Exchange Commission must file an enforcement action seeking civil penalties for fraud within five years from the date the fraud is complete and not from the date the fraud is discovered.[57]

49. *Id.* at 34.
50. *Id.* at 37.
51. *Id.*
52. 553 U.S. 639 (2008).
53. *In re Neurontin*, 712 F.3d at 36–37. The court ruled this way, noting nonetheless that there was "evidence of Pfizer's direct communications to Kaiser." *Id.* at 37.
54. *Id.* at 37 (quoting Bridge v. Pheonix Bond & Indemnity Co., 128 S. Ct. 2131, 2144 (2008)). The First Circuit also addressed the required "but-for" causation in its opinion and found that Kaiser presented "several categories of evidence at trial [that] clearly demonstrated but-for causation." *Id.* at 40-47.
55. *Id.* at 25.
56. 133 S. Ct. 1216 (2013).
57. *Id.*

The petitioners in *Gabelli* alleged that the SEC's enforcement action, which sought civil penalties from petitioners for aiding and abetting fraudulent conduct in violation of the Investment Advisers Act, was time-barred by the applicable five-year statute of limitations[58] when the SEC filed its complaint in April 2008 for purported misconduct that ended in August 2002.[59] The U.S. District Court for the Southern District of New York agreed with petitioners and dismissed the SEC's claim for civil penalties as time-barred.[60] The Second Circuit reversed the decision of the lower court, explaining that "for claims that sound in fraud a discovery rule is read into the relevant statute of limitation" and that "[u]nder the discovery rule, the statute of limitations for a particular claim does not accrue until that claim is discovered, or could have been discovered with reasonable diligence, by the plaintiff."[61]

The Supreme Court, reversing the decision of the Second Circuit, noted that it had historically applied the discovery rule to plaintiffs that were defrauded victims seeking recompense and had never extended the discovery rule to government enforcement actions seeking civil penalties—with good reason.[62] Unlike a private individual who is not expected to live in a state of constant investigation and thus has no reason to suspect fraud absent an obvious injury, the SEC's actual purpose is to root out fraud, and it has several legal tools at its disposal to do so.[63] Moreover, "the Government is not only a different kind of plaintiff, it seeks a different kind of relief" that extends beyond compensation and is designed to "punish, and label defendants as wrongdoers."[64] As such, applying the discovery rule to the SEC would "leave defendants exposed to Government enforcement action not only for five years . . . but for an additional uncertain period into the future."[65] Finally, a determination of when the government knew or reasonably should have known of the existence of fraud would pose unique challenges for courts considering the complex and sometimes overlapping structure of agencies.[66] Courts would also be forced to decide whether and how to account for an agency's specific priorities and resource constraints.[67] Accordingly, the Supreme Court

58. "Except as otherwise provided by Act of Congress, an action, suit or proceeding for the enforcement of any civil fine, penalty, or forfeiture, pecuniary or otherwise, shall not be entertained unless commenced within *five years from the date when the claim first accrued. . . .*" 28 U.S.C. § 2462 (emphasis added).

59. *Gabelli*, 133 S. Ct. at 1220.

60. *Id.*

61. *Id.* (citation omitted).

62. *Id.* at 1221–22.

63. *Id.* at 1222.

64. *Id.* at 1223.

65. *Id.*

66. *Id.*

67. *Id.*

concluded that "[g]iven the lack of textual, historical, or equitable reasons to graft a discovery rule onto the statute of limitations of [28 U.S.C.] § 2462, we decline to do so."[68]

The Supreme Court's decision in *Gabelli* will likely affect the expediency with which the SEC conducts its investigations to ensure that it can file actions timely. *Gabelli*, however, may also cause the SEC to file actions earlier and after less investigation to avoid missing the five-year window. This has the potential to increase litigation costs for companies, their executives, and professional liability insurers. Professional liability insurers, however, can underwrite policies with the knowledge that they will not be exposed to potential liability for certain SEC claims after the expiration of the five-year statute of limitations.

In *Amgen Inc. v. Connecticut Retirement Plans and Trust Funds*,[69] the U.S. Supreme Court resolved a circuit split by holding that proof of materiality is not a prerequisite to certification of a securities fraud class action seeking damages for purported violations of § 10(b) of the Securities Exchange Act of 1934 and Securities and Exchange Commission Rule 10b-5.[70]

The Connecticut Retirement Plans and Trust Funds "allege[d] that Amgen violated § 10(b) and Rule 10b-5 through certain misrepresentations and misleading omissions regarding the safety, efficacy, and marketing of two of its flagship drugs" that "artificially inflated the price of Amgen's stock at the time Connecticut Retirement and numerous other securities buyers purchased the stock."[71] Connecticut Retirement sought class certification under Federal Rule of Civil Procedure 23(b) and "invoked the 'fraud-on-the-market' presumption endorsed by [the U.S. Supreme] Court in *Basic Inc. v. Levinson*,"[72] whereby "a rebuttable presumption of classwide reliance on public, material misrepresentations" is recognized in those instances "when shares are traded in an efficient market."[73] The U.S. District Court for the Central District of California granted Connecticut Retirement's motion for class certification, and the Ninth Circuit affirmed.[74]

In affirming the Ninth Circuit's decision, the Supreme Court offered two reasons for its holding that proof of materiality is not necessary to satisfaction of Rule 23(b)(3)'s requirement that "*questions* of law or fact common to . . . class [members] will 'predominate over any questions affecting only individual members.' "[75] First, the Court reasoned, materiality

68. *Id.* at 1224.
69. 133 S. Ct. 1184 (2013).
70. *Id.*
71. *Id.* at 1193.
72. 485 U.S. 224 (1988).
73. 133 S. Ct. at 1193.
74. *Id.*
75. *Id.* at 1195 (quoting Fed. Rule Civ. P. 23(b)(3) (emphasis in original)).

involves an objective inquiry that "can be proved through evidence [that is] common to the class" and, as such, "is a 'common question' for purposes of Rule 23(b)(3)."[76] Second, given that materiality was an essential element of a securities fraud claim, even if the class could not ultimately prove materiality, there was "no risk" that individual issues would "overwhelm . . . questions common to the class" since "the failure of proof on the element of materiality would end the case for one and for all; no claim would remain in which individual reliance issues could potentially predominate."[77] Thus, the Court concluded that "under the plain language of Rule 23(b)(3), plaintiffs are not required to prove materiality at the class certification stage. In other words, they need not, at that threshold, prove that the predominating question will be answered in their favor."[78]

In sum, in *Amgen*, the Supreme Court expressly declined to impose an additional burden on plaintiffs seeking class certification in a securities fraud case. As such, and as recognized by Amgen, by removing an additional basis to challenge class certification in this context, plaintiffs are now in a better position to obtain an early settlement from defendants seeking to avoid the severe consequences of an adverse outcome. Accordingly, practitioners in this area should be advised that challenges to class certification in the securities fraud context based on materiality will be unavailing.

Continuing the trend of avoiding the determination of merit-based issues at the class certification stage and easing the path for plaintiffs seeking class certification in securities fraud cases, in *Erica P. John Fund, Inc. v. Halliburton Co.*,[79] the Fifth Circuit held that defendants are "not entitled to use evidence" of a lack of impact on the price of a company's stock at the class certification stage to rebut the fraud-on-the-market presumption and demonstrate "that common issues among class members do not predominate and that class certification is unwarranted."[80]

In *Halliburton*, the Erica P. John Fund, Inc. alleged that the Halliburton Company violated § 10(b) of the Securities Exchange Act of 1934.[81] Following many appeals and remands to the Fifth Circuit and the U.S. Supreme Court, the U.S. District Court for the Northern District of Texas granted class certification and "declined to consider Halliburton's evidence"—offered to rebut the fraud-on-the-market presumption invoked by plaintiffs—"that its alleged fraud did not affect the market

76. *Id.* at 1195–96 (quoting Basic Inc. v. Levinson, 485 U.S. 224, 242 (1988)).
77. *Id.* at 1196.
78. *Id.*
79. 718 F.3d 423 (2013), *cert. granted*, 82 U.S.L.W. 3119 (U.S. Nov. 15, 2013).
80. *Id.* at 426, 428.
81. *Id.* at 426.

price of the stock."[82] The district court found that that "price impact evidence did not bear on the critical inquiry of whether common issues predominated under Rule 23(b)."[83]

The Fifth Circuit, in affirming the lower court, noted that the U.S. Supreme Court in *Amgen* had not addressed the question of whether price impact evidence could be used to refute the fraud-on-the-market presumption. The Fifth Circuit nevertheless relied on the two-part analytical framework set forth by the *Amgen* decision to resolve the issue.[84] Turning to the first inquiry under *Amgen*, the Fifth Circuit noted that "price impact is [merely] a measure of [a misrepresentation's] effect . . . on a security's price"—typically determined by expert evaluation of a stock market's price after a specific event and inherently applicable to all class members—and is unquestionably "an objective inquiry."[85] With respect to the second inquiry suggested by *Amgen*, the Fifth Circuit noted that while price impact is not an element of a securities fraud claim, it directly impacts whether plaintiffs will be able to establish another element, namely, loss causation.[86] Specifically, "because a showing of negative price impact is required to establish loss causation, plaintiffs who cannot establish price impact cannot establish loss causation."[87] As such, "if Halliburton [could] successfully rebut the fraud-on-the-market presumption" by demonstrating that there was no impact on price, "the claims of all individual plaintiffs would fail because they could not establish an essential element of the fraud action."[88]

Thus, the Fifth Circuit held,[89] under the test set forth in *Amgen*, "price impact fraud-on-the-market rebuttal evidence should not be considered at class certification" since "[p]roof of price impact is based upon common evidence" and individual claims would not continue in the face of later proof demonstrating a lack of impact on price.[90]

In the landmark decision of *Riverisland Cold Storage, Inc. v. Fresno-Madera Production Credit Association*,[91] the California Supreme Court ended the state's seventy-eight years of adherence to the rule set forth in *Bank of America National Trust and Savings Association v. Pendergrass*[92] and brought California in line with the majority of other states by holding that a party

82. *Id.* at 427.
83. *Id.*
84. *Id.* at 433.
85. *Id.*
86. *Id.* at 434.
87. *Id.*
88. *Id.*
89. Petition for certiorari filed on September 9, 2013 (No.13-317).
90. *Erica P. John Fund*, 718 F.3d at 435.
91. 291 P.3d 316 (2013).
92. 48 P.2d 659 (1935).

may rely upon oral statements that directly contradict the written terms of an agreement in order to prove fraud.[93]

In *Riverisland*, plaintiffs sought damages for fraud and negligent misrepresentation based on statements purportedly made by defendant that conflicted with the actual terms of the parties' written agreement.[94] Relying on *Pendergrass*, the trial court awarded defendant summary judgment, concluding that the fraud exception to the parol evidence rule does not permit parol evidence of promises that conflict with the terms of a written agreement.[95] The California Court of Appeal reversed the decision of the lower court, finding that application of *Pendergrass* is limited to cases involving promissory fraud.[96]

While the Court of Appeal distinguished *Pendergrass*, the California Supreme Court explicitly overruled it.[97] In support of its decision to overturn this well-settled precedent, the court noted that *Pendergrass* "failed to account for the fundamental principal that fraud undermines the essential validity of the parties' agreement. When fraud is proven, it cannot be maintained that the parties freely entered into an agreement reflecting a meeting of the minds."[98] Moreover, the court observed, *Pendergrass*'s "restriction on the fraud exception [to the parol evidence rule] was inconsistent" with the relevant statutory and settled case law, and engendered "instability in the law as courts [struggled] to avoid abuses of the parol evidence rule."[99] The court thus overruled the "aberration" that was the *Pendergrass* decision and reaffirmed that "it was never intended that the parol evidence rule should be used as a shield to prevent the proof of fraud."[100]

In *Wyeth, Inc. v. Weeks*,[101] the Supreme Court of Alabama resolved an intrastate split by rejecting the majority approach and holding that

> [u]nder Alabama law, a brand-name drug company may be held liable for fraud or misrepresentation (by misstatement or omission), based on statements it made in connection with the manufacture of a brand-name prescription drug, by a plaintiff claiming physical injury caused by a generic drug manufactured by a different company.[102]

The plaintiffs in *Weeks* alleged injury caused by long-term use of the prescription drug metoclopramide, which is the generic version of the

93. *Riverisland*, 291 P.3d at 316.
94. *Id.* at 318.
95. *Id.*
96. *Id.*
97. *Id.* at 324.
98. *Id.*
99. *Id.*
100. *Id.* at 323–24 (citation omitted).
101. No. 1101397, 2013 WL 135753, at *19 (Ala. Jan. 11, 2013).
102. *Id.*

brand-name drug Reglan.[103] Specifically, the plaintiffs claimed that three brand-name manufacturers "falsely and deceptively misrepresented or knowingly suppressed facts about Reglan or metoclopramide such that [plaintiff's] physician, when he prescribed the drug to [plaintiff], was materially misinformed and misled about the likelihood that the drug would cause the movement disorder tardive dyskinesia and related movement disorders."[104] Despite the fact that the plaintiffs did not ingest any Reglan manufactured by the brand name manufacturers, the plaintiffs alleged that the brand name manufacturers "had a duty to warn [plaintiffs'] physician[s] about the risks associated with the long-term use of metoclopramide and that the [plaintiffs], as third parties, ha[d] a right to enforce the [purported] breach of that duty."[105]

In reaching its conclusion, the Supreme Court of Alabama noted that "brand-name drug manufacturer[s] could reasonably foresee that a physician . . . would rely on the warning [provided] by the brand-name manufacturer even if the patient ultimately consumed the generic version of the drug."[106] The court relied heavily on the U.S. Supreme Court's decision in *PLIVA, Inc. v. Mensing*[107] that "a generic manufacturer's label must be identical to the brand-name label and that a generic manufacturer cannot unilaterally change its label to update a warning."[108] Thus, the Alabama Supreme Court concluded that

> it is not fundamentally unfair to hold the brand-name manufacturer liable for warnings on a product it did not produce because the manufacturing process is irrelevant to misrepresentation theories based, not on manufacturing defects in the product itself, but on information and warning deficiencies, when those alleged misrepresentations were drafted by the brand-name manufacturer and merely repeated by the generic manufacturer.[109]

As noted by the U.S. District Court for the Middle District of Alabama in its certification of the issue to the Alabama Supreme Court, the latter's resolution will impact not only current and future cases in Alabama, but also the countless Alabama resident cases pending in courts throughout the country.[110] Moreover, the significance of this decision may extend beyond the pharmaceutical context and be applied in situations where a plaintiff sues a brand name manufacturer of a product on grounds of

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103. *Id.* at *1.
104. *Id.* at *2.
105. *Id.*
106. *Id.* at *15.
107. 131 S. Ct. 2567 (2011).
108. *Weeks*, 2013 WL 135753, at *15.
109. *Id.* at *19.
110. *Id.* at *2.

fraud and/or misrepresentation, even though the plaintiff purportedly was injured while using the product's generic equivalent.[111]

III. BREACH OF CONTRACT

A. *First-Sale Doctrine and Copyrighted Works*

This past year, the U.S. Supreme Court issued an important ruling regarding an individual or entity's ability to safely sell or receive a copyrighted work in the United States, even if created overseas.[112] The dispute in *Kirtsaeng v. John Wiley & Sons, Inc.* arose when publishers sued an individual who was selling to individuals in the United States textbooks that were purchased in Thailand, circumventing publishers' distribution and importation agreements with other publishers and distributors.[113] A consortium of copyright holders sought to punish and prevent foreign purchasers—as opposed to printers or publishers from re-selling copyrighted works in the United States.[114] The publishers argued that foreign purchasers' copies of copyrighted works were not "lawfully made" under their interpretation of a copyright owners' exclusive right to control his or her work.[115] Conversely, a group of libraries, used book sellers, and collectors argued that the longstanding "first sale" doctrine should be upheld, allowing the buyer of the first sale to own an unencumbered, "unalienated" interest in the copy of the copyrighted work.[116]

The court was not convinced. Appearing to fear a "parade of horribles," which could result from the publishers' desired interpretation of the first sale doctrine, the court found that a copy purchased under a legitimate, international licensing arrangement was lawfully created and conveyed.[117] The court was not willing to force libraries, importers, and museums from verifying the correct licensing and permission of their imported works and greatly feared the wide-ranging and unpredictable implications which could result from negating the doctrine.[118]

Kirtsaeng is sure to affect contract law in the near future. In any contract involving the sale or licensing of goods or information subject to copyright, patent (through its related exhaustion doctrine), or even trademark protection, sellers (especially international sellers) are likely to increase the self-protecting language in their sales contracts or even attempt to retain portions of the intellectual property redistribution rights.

111. *Id.*
112. Kirtsaeng v. John Wiley & Sons, Inc., 133 S. Ct. 1351 (2013).
113. *Id.* at 1356.
114. *Id.*
115. *Id.* at 1356–57.
116. *Id.* at 1363.
117. *Id.* at 1366.
118. *Id.*

Finally, the court's sustaining of the first sale doctrine should have interesting effects on the lucrative patent infringement industry.

B. *Contractual "Best Efforts" Claims*

Historically, a party's obligations under its promise to use its "best efforts" have been murky at best.[119] New York has permitted limited cases to proceed based on a breach of a "best efforts" clause,[120] but some jurisdictions have declined to enforce them at all without further specificity.[121] In the post-*Iqbal* and *Twombly* era, a lawsuit based on a breach of a "best efforts" clause would seem to be destined for failure.[122] At the district court level, Hugo Cruz's "best efforts" lawsuit was, in fact, dismissed for failing to state a claim before being recently revived.[123]

The dispute in *Cruz v. FXDirectDealer, LLC* began when Cruz lost nearly $300,000 investing in the online foreign currency exchange, allegedly because FXDirectDealer did not make attempts to execute his orders at a certain market level.[124] The Second Circuit dismissed several of Cruz's complaints as invalid or duplicitous, but importantly held that he stated sufficient facts to allow his breach of contract claim to proceed based on FXDirectDealer's lack of "best efforts."[125] Interestingly, the court allowed Cruz's contract claims to proceed despite his failure or inability to articulate exactly what those efforts should have been, instead allowing him to simply allege that FXDirectDealer took no efforts at all.[126] Previous "best efforts" cases had held that while "best efforts" requires more than "good faith," "an implied covenant in all contracts"[127] in New York, plaintiffs must provide a "reasonable degree of certainty to the meaning of the phrase best efforts."[128]

Although Cruz has not won his case, in allowing his case to proceed beyond the motion to dismiss phase, the Second Circuit may have allowed a wave of individual or class suits based on previously ambiguous "best efforts" clauses.

119. *See* Strauss Paper Co. v. RSA Exec. Search, Inc., 688 N.Y.S.2d 641, 642 (App. Div. 1999); Timberline Dev. LLC v. Kronman, 702 N.Y.S.2d 237, 241 (App. Div. 2000).

120. Van Valkenburgh, Nooger & Neville v. Hayden Publ'g Co., 30 N.Y.2d 34, 46–47 (1972).

121. *See* Kevin M. Ehringer Enters., Inc. v. McData Services Corp., 646 F.3d 321 (5th Cir. 2011).

122. *See* Ashcroft v. Iqbal, 129 S. Ct. 1937 (2009); Bell Atlantic Corp. v. Twombly, 127 S. Ct. 1955 (2007).

123. Cruz v. FXDirectDealer, LLC, 720 F.3d 115, 125 (2d Cir.2013). The *Cruz* case is also discussed under Part I (Civil RICO).

124. *Id.* at 120–25.

125. *Id.* at 124–25.

126. *Id.*

127. *Id.*

128. *Id.* at 124 (quoting Maestro W. Chelsea SPE LLC v. Pradera Realty Inc., 954 N.Y. S.2d 819, 825 (N.Y. App. Div. 2012).

C. Deepwater Horizon *Settlement Agreement*

Newspaper readers throughout America recently viewed the widely publicized advertising campaign by BP Exploration and Production, Inc. criticizing the claims administrator overseeing the class action settlement resulting from the infamous Deepwater Horizon oil rig collapse and spill.[129] After the spill, BP negotiated a class settlement with a complicated claim structure involving loss of income, earnings, or profits.[130] The settlement required a claimant to have "conducted commercial activities in the Gulf Coast region during the relevant period" and "must have suffered loss of income, earnings, or profits as a result of the . . . accident" or spill.[131] The claims process quickly ran into problems.

According to BP, the settlement language and the administrator made the claims process fraught with abuse.[132] BP claimed the administrator was paying damages to entities with inflated losses or no losses at all as a result of its "policy announcement" regarding the computation of damages.[133] Following the policy announcement, BP sued the administrator and appealed to the district court to force the administrator to compute the damages differently.[134] In combating BP's assertions of fraud and abuse, the class counsel and administrator argued that BP agreed to the administrator's position in the policy announcement to achieve "global peace," and that BP cannot now renegotiate the settlement agreement.[135]

In its *In re Deepwater Horizon* opinion, the majority of the panel of the Fifth Circuit sided with BP on grounds that will surely affect the enforcement of class settlements and the ability of parties to reach class settlements at all. First, the Fifth Circuit found that the administrator's method of computation of damages was "completely disconnected from any reasonable understanding of calculation of damages" and remanded much of the case with orders to use computational methods based on more sound accounting principles.[136] Second, and more importantly, the Fifth Circuit held that a settlement agreement, no matter how liberal its terms in an effort to resolve the process, cannot give rise to claims for a party that did not have standing in the first place.[137] Essentially, the Fifth Circuit held that even if a defendant agrees to compensate uninjured

129. Tom Gara, *BP's New Ad: Who's the Real Victim of Deepwater Horizon?*, WALL ST. J., July 25, 2013.
130. *In re* Deepwater Horizon, 732 F.3d 326 (5th Cir.2013).
131. *Id.* at 329–30.
132. *Id.* at 331.
133. *Id.*
134. *Id.*
135. *Id.* at 338.
136. *Id.* at 339.
137. *Id.* at 340.

plaintiffs to reach a settlement with a class, it cannot pass judicial muster.[138] By contrast, the vigorous dissent questioned the feasibility of requiring each settlement beneficiary to file a separate, new complaint, allowing BP to file a motion to dismiss if the parties disagree about a settlement claimant's standing.[139]

The ramifications from *In re Deepwater Horizon* have yet to be realized, but legal scholars have already opined that the opinion should help class action settlement objectors as well as those hoping to block certification.[140] Although commentators agree with the majority that no court can give standing where none exists, both the plaintiff and the defense bars will be closely watching whether *In re Deepwater Horizon* makes it more difficult for class settlements to be reached and enforced.

IV. BREACH OF FIDUCIARY DUTY

Courts, particularly the Delaware Court of Chancery, have been quite active in the past year with regard to breach of fiduciary claims. In *In re Trados*, the court found that the board of directors of the defendant corporation, Trados, Inc., made a fair decision in merging with another corporation.[141] The plaintiff disputed the merger because the common stockholders received no compensation.[142] The plaintiff claimed that the board of directors had breached its fiduciary duty in approving the merger "[b]ecause a board majority comprised of disinterested and independent directors [had] not approve[d] the [m]erger."[143] In fact, the plaintiff was able to prove that a board majority comprised of disinterested and independent directors had not approved the merger, which shifted the "burden . . . to the defendants to establish that [the merger] decision[] w[as] . . . fair."[144]

The plaintiff's claim that the board of directors had breached its fiduciary duty hinged largely on the allegation that their vote for the merger benefitted preferred stockholders over common stockholders.[145] In analyzing the claims made by the plaintiff, the court applied the fairness test to determine if there had been a breach of fiduciary duty.[146] With regard to

138. *Id.*
139. *Id.* at 359.
140. Alison Frankel, *5th Circuit's BP Opinion Adds to Hot Debate on Use of Class Actions*, REUTERS BLOGS (Oct. 3, 2013), http://blogs.reuters.com/alison-frankel/2013/10/03/5th-circuits-bp-opinion-adds-to-hot-debate-on-use-of-class-actions/.
141. No. 1512-VCL, 2013 WL 4511262 (Del. Ch. Aug. 16, 2013).
142. *Id.* at *1.
143. *Id.*
144. *Id.*
145. *Id.*
146. *Id.* at *29.

mergers, the fairness test involves determining whether both fair dealing occurred and a fair price was achieved during the transaction.[147]

On the issue of fair dealing, the court found that the plaintiff found evidence of unfairness.[148] The court noted that it was unfair to allow only the preferred stockholders to vote on the merger and to deny that right to the common stockholders, who would receive no compensation when the companies merged.[149] However, the court's analysis on the fair price issue weighed heavily in favor of the board of directors, who were able to produce evidence that the stock price set in the merger was fair.[150] The court noted that the common stock had no value before the merger.[151] Because the "common stock had no economic value before the [m]erger, . . . the common stockholders received the substantial equivalent in value of what they had [received] before" the merger.[152] Based on these findings, the court found that the board of directors had not breached a fiduciary duty to the plaintiff.[153]

In contrast to *Trados*, the court reached the opposite conclusion on the issue of fair dealing and fair price in *Gatz Properties, LLC v. Auriga Capital Corp*.[154] In *Gatz Properties*, the Delaware Supreme Court addressed the fiduciary duty of a member-manager of a limited liability company regarding the sale of the company at an auction.[155] In this case, the court upheld the findings of the trial court, which had held that the member-manager, Gatz Properties violated its fiduciary duty by selling the company to itself without negotiating with a third party bidder and "by causing the company to be sold . . . at an unfair price in a flawed auction that the [member-]manager [had] engineered."[156]

The *Gatz Properties* court held first that the LLC agreement at issue in the case "imposed fiduciary duties . . . between the LLC and affiliated persons."[157] The court found that Gatz violated its fiduciary duty by selling the company to itself, and it had no defense with regard to fair dealing and fair price.[158] First, the court noted that Gatz could not establish that a fair price had been paid because the company was worth much more than that amount.[159] Second, the court noted that Gatz was self-dealing in the

147. *Id.*
148. *Id.* at *35–36.
149. *Id.*
150. *Id.* at *44.
151. *Id.* at *46.
152. *Id.*
153. *Id.*
154. 59 A.3d 1206 (Del. 2012).
155. *Id.* at 1208.
156. *Id.*
157. *Id.* at 1213.
158. *Id.* at 1214.
159. *Id.* at 1215.

acquisition by running a sham auction and selling the company to itself, thus it could not establish that fair dealing had occurred.[160] Upon finding a breach of fiduciary duty, the court awarded damages in the amount of nearly $800,000 to the plaintiff.[161]

The Delaware Court of Chancery also issued a significant decision in the case of *Koehler v. Netspend Holdings, Inc.*[162] In *Koehler*, the plaintiff stockholder sued the defendant corporation, Netspend Holdings, Inc. and its board of directors for breach of a fiduciary duty in agreeing to be acquired by another corporation.[163] The plaintiff alleged that the sales process undertaken to confect the sale "was not designed to produce the best price for the stockholders."[164] Although the court ultimately agreed with the plaintiff, it would not issue an injunction to stop the acquisition, finding that the plaintiff failed to demonstrate that injunctive relief was proper, particularly because there were no other bidders for the company and the amount offered was "a substantial premium over market" price.[165]

The relevant aspects of the court's decision are found in its analysis of the sales process. The focus of this analysis is found in the court's discussion of the fairness opinion the defendants used to base their decision to agree to be acquired. The court found that the fairness opinion was weak.[166] The opinion was based largely on the corporation's stock price, which the board of directors acknowledged was undervalued.[167] In addition, the court noted that the fairness opinion relied on the analysis of dissimilar companies and transactions in comparison to the companies and transaction involved in this matter.[168] Finally, the court found that the fairness opinion was also unreliable because it was speculative, going outside the normal time frame of stock-price projections.[169] This detailed analysis may lead other courts to more thoroughly review fairness opinions in future acquisitions that are challenged in court.

The Seventh Circuit examined a rather novel procedural issue on a breach of fiduciary duty claim in a notable shareholder derivative lawsuit in *Westmoreland County Employee Retirement System v. Parkinson*.[170] In this case, the issue was whether a corporation's directors and officers breached

160. *Id.* at 1215–16.
161. *Id.* at 1221.
162. No. 8373-VCG, 2013 WL 2181518 (Del. May 21, 2013).
163. *Id.* at *1.
164. *Id.*
165. *Id.*
166. *Id.* at *16.
167. *Id.*
168. *Id.*
169. *Id.*
170. 727 F.3d 719 (7th Cir. 2013).

their fiduciary duties by disregarding their responsibility to bring the corporation into compliance with a consent decree entered into with the Food and Drug Administration.[171] The plaintiff, a retirement system, filed suit against the defendant company and its board of directors for breaching their fiduciary duty.[172] The allegation was that the company and its board had not fixed a number of problems with a medical device that they had agreed to fix per a consent decree with the FDA.[173] This led to the violation of a number of health and safety laws, causing a mandated FDA recall of the product and over $500 million in losses.[174]

The trial court dismissed the lawsuit because the plaintiff had not first asked the defendant corporation's board to pursue the claim, but the appellate court reversed.[175] The plaintiff admitted that it had not first brought the claim before the defendant's company's board, but contended that it should not have to do so because such an action would be futile.[176] The court noted that " 'where the fiduciary intentionally fails to act in the face of a known duty to act, demonstrating a conscious disregard for his duties,' such conduct establishes a failure to act in good faith."[177] As such, the plaintiff did make a threshold showing in its complaint that its claims have merit.[178] "Because the particular[] facts" in the complaint "cast a reasonable doubt that the [company's decision not to follow the consent decree] was not a valid exercise of business judgment," the appellate court reversed the dismissal of the case.[179]

Finally, *Weinstein v. Colborne Foodbotics, LLC*, the Colorado Supreme Court explored a very important distinction with regard to the fiduciary duty owed to creditors by managers of a LLC and directors of a corporation.[180] In *Weinstein*, a corporate creditor brought an action against the sole members of a limited liability company, on a breach of fiduciary claim that managers of LLC had authorized and accepted distributions that made the company insolvent.[181] The issue in this case was whether a creditor could sue individual members and managers of a LLC on such a claim.[182]

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171. *Id.* at 721.
172. *Id.* at 722.
173. *Id.* at 721.
174. *Id.*
175. *Id.*
176. *Id.* at 724.
177. *Id.* at 730 (citing Stone v. Ritter, 911 A.2d 362, 369 (Del. 2006) (quoting *In re* Walt Disney Co. Derivative Litig., 906 A.2d 27, 67 (Del. 2006))).
178. *Id.* at 729.
179. *Id.* at 730.
180. 302 P.3d 263 (Colo. 2013).
181. *Id.* at 264.
182. *Id.*

The trial court in *Weinstein* dismissed the lawsuit, finding that a creditor does not have a right to sue individual members and managers of a LLC. The appellate court reversed, however.[183] The Colorado Supreme Court then took the case and reversed the court of appeal.[184] The court found that "members [only] are liable to [a] LLC[,] . . . not the LLC's creditors."[185] In addition, the court held that "the manager of an insolvent LLC does not owe the LLC's creditors the same fiduciary duty that an insolvent corporation's directors owe a corporation's creditors."[186]

The court had previously found that based on the Colorado corporation statutes, "directors and officers of an insolvent corporation act as 'trustees' for the corporation's creditors and owe the creditors a limited fiduciary duty 'that requires officers and directors to avoid favoring their own interests over creditors' claims.' "[187] The court, however, distinguished that finding with the Colorado LLC Act, which on its face sets forth that a LLC manager has no personal liability.[188] The court held that "absent statutory authority, the manager of an insolvent LLC does not owe the LLC's creditors the same fiduciary duty that an insolvent corporation's directors owe the corporation's creditors."[189] This decision clarifies the liability to creditors in cases of LLCs and corporations.

V. REMEDIES

The last year has seen the continued expansion and contraction in various states of the economic loss rule, which was created by the California Supreme Court in *Seely v. White Motor Co.*[190] and adopted by the U.S. Supreme Court in *East River Steamship Corp. v. Transamerica Delaval, Inc.*[191]

The economic loss rule

> is a judicially created doctrine that seeks "(1) to maintain the fundamental distinction between tort law and contract law; (2) to protect commercial parties' freedom to allocate economic risk by contract; and (3) to encourage the party best situated to assess the risk [of] economic loss, the commercial purchaser, to assume, allocate, or insure against that risk. . . . [It] generally provides that a contracting party who suffers purely economic losses must seek his remedy in contract and not in tort.[192]

183. *Id.*
184. *Id.*
185. *Id.*
186. *Id.*
187. *Id.* at 268 (quoting Alexander v. Anstine, 152 P.3d 497, 502 (Colo. 2007)).
188. *Id.* at 269.
189. *Id.* at 269.
190. 403 P.2d 145 (Cal. 1965).
191. 476 U.S. 858 (1986).
192. Gen. Elec. Co. v. Lowe's Home Centers, 608 S.E.2d 636, 637 (Ga. 2005).

Economic loss includes both direct economic loss, which involves the "loss in value of the product itself," and consequential economic loss, which is "all other economic loss attributable to the product defect."[193] Although the economic loss rule was first developed in connection with product liability, it quickly expanded outside the parameters of product liability to bar other claims for economic loss where there is no underlying contract or privity between the claimant and the alleged tortfeasor.[194] The economic loss rule generally does not bar a tort claim that is based on a recognized independent duty of care that is outside the scope of the contract, however.[195]

The following decisions by five state supreme courts during the past year show the differences among the states in applying the economic loss.

A. *Florida*

In *Tiara Condominium Association, Inc. v. Marsh & McClennan Cos., Inc.*,[196] the Florida Supreme Court used a certified question case received from the Eleventh Circuit to substantially reduce the application of the economic loss doctrine in the State of Florida to only product liability cases.[197] The certified question from the Eleventh Circuit asked the Florida Supreme Court whether the professional liability exception of the economic loss rule recognized by the state's high court in *Indemnity Insurance Co. of North America v. American Aviation, Inc.*[198] applied to insurance brokers.[199] The dissent in *Tiara* by Chief Justice Polston points out that the court had previously held that "insurance agents [were] not . . . 'professional' for purposes of the [Florida] professional malpractice statute of limitations,"[200] so the answer to the Eleventh Circuit should have been

193. Daanen & Janssen, Inc. v. Cedarapids, Inc., 573 N.W.2d 842, 845 (Wis. 1998).

194. *See* BRW, Inc. v. Dufficy & Sons, Inc., 99 P.3d 66 (Colo. 2004) (steel subcontractor's claims for negligence and negligent misrepresentation against a design engineering firm and professional inspector for public-works project were barred by the economic loss rule despite lack of privity between the steel subcontractor, the design engineering firm and the inspector). The economic loss rule encourages parties to a commercial contract to negotiate risk distribution and other legal protections into their contracts if they are concerned about economic damages flowing from the commercial transaction. *See* Berschauer/Phillips Const. Co. v. Seattle Sch. Dist. No. 1, 881 P.2d 986, 992 (Wash. 1994). "[T]hree policies support[ ] the application of the economic loss [rule] to commercial transactions": (i) "preserv[ing] the fundamental distinction between tort law and contract law"; (ii) "protect[ing] the parties' freedom to allocate economic risk by contract"; and (iii) "encourag[ing] the purchaser, which is the party best situated to assess the risk of economic loss, to assume, allocate, or insure against that risk." *See* Wausau Tile, Inc. v. Cnty. Concrete Corp., 593 N.W.2d 445, 451–52 (Wis. 1999).

195. Grynberg v. Agri Tech, Inc., 985 P.2d 59, 62 (Colo. Ct. App. 1999).

196. 110 So. 3d 399 (Fla. 2013).

197. *Id.* at 407.

198. 891 So. 2d 532, 537 (Fla. 2004).

199. *Tiara*, 110 So. 3d at 399.

200. *Id.* (citing Pierce v. AALL Ins. Co. of N. Am. v. Am. Aviation, Inc., 531 So. 2d 84 (Fla. 1988)).

that Florida's existing cases control.[201] The court instead provided a detailed summary of the origin and history of the economic loss rule in the state from the seminal case of *Florida Power & Light Co. v. Westinghouse Elec. Corp*.[202] to the present, culminating with the following admissions and holding of the court:

> . . . in *Moransais, Comptech, and American Aviation*, this Court clearly expressed its desire to return the economic loss rule to its intended purpose—to limit actions in the products liability context. In each instance, however, we left intact a number of exceptions that continue the rule's unprincipled expansion. We simply did not go far enough.
>
> Having reviewed the origin and original purpose of the economic loss rule, and what has been described as the unprincipled extension of the rule, we now take this final step and hold that the economic loss rule applies only in the products liability context. We thus recede from our prior rulings to the extent that they have applied the economic loss rule to cases other than products liability.[203]

The court, therefore, responded to the Eleventh Circuit that it was no longer necessary to respond to the certified question concerning professional services exceptions to the economic loss rule given the fact that the economic loss rule no longer extended to the facts of the case, which did not involve products liability.[204]

The court acknowledged in its discussion of the history of the economic loss rule in Florida that the economic loss rule is "the fundamental boundary between contract law, which is designed to enforce the expectancy interests of the parties, and tort law, which imposes a duty of reasonable care and thereby encourages citizens to avoid causing physical harm to others."[205] Since the economic loss rule no longer applies outside products liability cases, the court's decision throws into question how the boundary between contract law and tort law will be maintained outside of products liability cases. In his dissenting opinion, Chief Justice Polston provided a listing of cases to "illustrate the type of cases that are now overruled by [*Tiara*]" and are now open to "a wide arsenal of tort claims previously barred by the economic loss rule."[206] As stated by Chief Justice Polston in his dissent: ". . . the majority obliterates the use of the [economic loss rule] doctrine when the parties are in contractual privity,

201. *Id.* at 411.
202. 510 So. 2d 899 (Fla. 1987).
203. *Tiara*, 110 So. 3d at 407 (citations omitted).
204. *Id.*
205. *Id.* at 401.
206. *Id.* at 410 n10.

greatly expanding tort claims and remedies available without deference to contract claims. Florida's contract law is seriously undermined by this decision."[207]

Justice Canady's dissent in *Tiara* is equally concerned that with the advent of the decision ". . . we face the prospect of every breach of contract claim being accompanied by a tort claim."[208] Given the above, it remains to be seen how the boundary between contract law and tort law will be maintained by the Florida Supreme Court outside of products liability cases and whether Florida courts will soon find themselves in such cases "drown[ing] in a sea of tort."[209]

B. *Idaho*

In *Stapleton v. Jack Cushman Drilling and Pump Co. Inc.*,[210] the Idaho Supreme Court held that the economic loss rule precluded a homeowner's negligence claims against a well driller where the homeowner entered into an oral contract with a well driller, and the water well later caved in and was rendered unusable.[211] The court previously held that "[i]t is the subject of the transaction that determines whether a loss is property damage or economic loss"[212] and that the "subject of the transaction" in the context of a contract is "the subject matter of the contract."[213] In the *Stapleton* case, the court held that the subject of the transaction was the water well drilled by the well driller, "which included drilling the well and installing casing, the pump, and related items necessary for the well to produce water."[214] Since this "subject of the transaction" constituted economic loss under the contract, the court held that the homeowner was precluded from suing in negligence by the economic loss rule.[215] Broadly stated by the court in *Stapleton*, "[u]nless an exception applies, the economic loss rule prohibits recovery of purely economic losses in a negligence action [in the State of Idaho] because there is no duty to prevent economic loss to another."[216]

207. *Id.*
208. *Id.*
209. *Id.* (quoting Casa Clara condominium Ass'n, Inc. v. Charley Toppino & Sons, Inc., 620 So. 2d 1244, 1247 (Fla. 1993) (quoting E. River Steamship Corp. v. Transamerica Delaval, Inc., 476 U.S. 858, 866 (1986))).
210. 291 P.3d 418 (Idaho 2012).
211. *Id.* at 425.
212. *Id.* (quoting Blahd v. Richard B. Smith, Inc. 108 P.3d 996, 1001 (2005))).
213. *Id.* at 425 (citing Aardema v. U.S. Dairy Systems, Inc., 215 P.3d 505, 511 (Idaho 2009)).
214. *Id.*
215. *Id.*
216. *Id.* (citing Blahd v. Richard B. Smith, Inc., 108 P.3d 996, 1000 (Idaho 2005)).

C. *Kansas*

In *Rinehart v. Morton Buildings, Inc.*,[217] the Kansas Supreme Court held that negligent misrepresentation claims arising under the Restatement (Second) of Torts § 552, which was adopted by the Kansas Supreme Court in *Mahler v. Keenan Real Estate, Inc.*,[218] are not subject to the economic loss doctrine. "[T]he duty at issue arises by operation of law and the doctrine's purposes are not furthered by its application under the[ ] circumstances" of the case.[219]

The Rineharts owned the property and contracted with the defendant builder, Morton Buildings, to construct and install a pre-engineered building to serve as their personal residence and the business location for the business that they owned with co-plaintiff Midwest Slitting, LLC.[220] Midwest Slitting was not a party to the contract between the Rineharts and Morton Buildings, which gave rise to the negligent misrepresentation claims under Restatement (Second) of Torts § 552.[221] The "jury returned a verdict for the Rineharts on their breach of contract and warranty claims. . . . The jury also found for the Rineharts on their deceptive acts and practices claim under the Kansas Consumer Protection Act"[222] by determining that the defendant Morton Buildings "willfully misrepresented that the building complied with the plans and specifications and would include anchor bolts, roof fasteners, fire stops, a vapor barrier, and truss repairs."[223] Given these findings, the jury also found for Midwest Slitting on its negligent misrepresentation claims against Morton Buildings.[224]

Morton Buildings ultimately appealed the case to the Kansas Supreme Court and requested that the court apply the economic loss doctrine to preclude the negligent misrepresentations of Midwest Slitting.[225] After discussing the history and development of the economic loss doctrine in the United States and Kansas, the court declined to do so.[226] Among other things, the court stated that the negligent misrepresentation tort was sufficiently "confine[d] [to] the universe of potential claimants . . . for whose benefit the defendant supplied the information and whom the defendant intended to influence,"[227] and the court noted that the

217. 305 P.3d 622 (Kan. 2013).
218. 876 P.2d 609 (Kan. 1994).
219. *Rinehart*, 305 P.3d at 632–33.
220. *Id.* at 625.
221. *Id.*
222. Kan. Stat. Ann. § 50-623 (2012).
223. *Rinehart*, 305 P.3d at 632–33.
224. *Id.*
225. *Id.* at 626.
226. *Id.* at 627–33.
227. *Id.* at 630.

defendant "had the opportunity to limit its liability by contracting with Midwest Slitting but did not" do so.[228]

D. *Nevada*

In the case of *Halcrow, Inc. v. Eighth Judicial District Court*,[229] the Nevada Supreme Court held, as a case of first impression, that "the economic loss doctrine applied to bar claims against design professionals [in a construction project] for negligent misrepresentation [arising under *Restatement (Second) of Torts* § 552] where the damages alleged were purely economic" damages."[230]

To construct the Harmon Tower in Las Vegas, the MGM Mirage Design Group retained an architectural firm and a general contractor, Perini Building Company, Inc., to assist in the project's development, which in turn retained the defendant Halcrow, Inc. as the architectural firm to design the Harmon's structure; prepare drawings; and perform ongoing structural engineering services, including observations and inspections, throughout the construction of multiple structures.[231] Century Steel, Inc. was retained on the project to provide the steel installation. Century Steel assigned its assets, including the contract for the Harmon, to Pacific Coast Steel (PCS).[232] PCS subsequently filed claims against several entities, including negligent misrepresentation claims under Restatement (Second) of Torts § 552 against Halcrow.[233]

Halcrow filed a motion to dismiss the negligent misrepresentation claims in the trial court based on the Nevada Supreme Court's prior holding in *Terracon Consultants Western, Inc. v. Mandalay Resort Group*,[234] which "bars unintentional tort claims against design professionals in commercial construction projects when the claimant incurs purely economic losses."[235] The district court granted Century Steel and PCS the right to amend third- and fourth-party complaints to add a claim against the engineer/designer for negligent misrepresentation under Restatement (Second) of Torts § 552. In response, Halcrow filed a petition for writ of mandamus with the Kansas Supreme Court to bar such claims.

In reviewing the writ submitted by Halcrow, the Nevada Supreme Court recognized that the *Terracon* decision did not specifically address negligent misrepresentation claims against design professionals under Restatement (Second) of Torts § 552. As a case of first impression, the

228. *Id.* at 632.
229. 302 P.3d 1148 (Nev. 2013).
230. *Id.* at 1154.
231. *Id.* at 1150.
232. *Id.*
233. *Id.*
234. 206 P.3d 81 (2009).
235. *Halcrow*, 302 P.3d at 1151; *see Terracon*, 206 P.3d at 83.

court specifically held that negligent misrepresentation claims against design professionals under Restatement (Second) of Torts § 552 are barred by the economic loss doctrine in the context of commercial construction projects because "any duty breached arises from the contractual relationship *only*."[236] In so holding, the court acknowledged, among other things, that "in commercial construction situations, the highly interconnected network of contracts delineates each party's risks and liabilities in case of negligence, which in turn 'exert significant financial pressures to avoid such negligence.' "[237]

E. *South Dakota*

In the case of *Jorgensen Farms, Inc. v. Country Pride Corp., Inc.*,[238] the South Dakota Supreme Court held that the economic loss doctrine barred the third-party plaintiff Country Pride Cooperative from asserting negligence claims against Agrium, the seller of urea, which was part of fertilizer that was allegedly discovered to have been contaminated with rye. The court barred the plaintiff's claim notwithstanding the fact that the plaintiff argued for application of the "other property" exception to the economic loss doctrine because the damages in question were to a winter wheat crop.[239] The court acknowledged the previous adoption of the economic loss doctrine in Uniform Commercial Code cases and that claims in such circumstances were "limited to the commercial theories found in the UCC."[240] The court stated that the economic loss doctrine has two exceptions: (i) "tort damages are not barred in cases where personal injury is involved," and (ii) the "other property exception" "applies 'when the damage is to 'other property' as opposed to the specific goods that were part of the transaction.' "[241]

Regarding the "other property exception," the court stated that "[w]hen a defect in a component part damages the product into which that component was incorporated, economic losses to the product as a whole are not losses to 'other property' and are therefore not recoverable in tort."[242] In *Jorgensen*, the urea sold by Agrium "was a component part that was later incorporated into both the fertilizer and the wheat crop," and "[t]he alleged defect, the rye-contamination, damaged the fertilizer

236. *Halcrow*, 302 P.3d at 1153–54 (citing *Terracon*, 206 P.3d at 90) (emphasis in original).
237. *Halcrow*, 302 P.3d at 1153 (quoting *Terracon*, 206 P.3d at 88).
238. 824 N.W.2d 410 (S.D. 2012).
239. *Id.* at 418–19.
240. *Id.* at 418 (quoting Diamond Surface, Inc. v. State Cement Plant Comm'n, 583 N.W.2d 155, 161 (quoting City of Lennox v. Mitek Indus., Inc., 519 N.W.2d 330, 333 (S.D. 1994))).
241. *Id.* (citing *City of Lennox*, 519 N.W.2d at 333) (internal quotation marks omitted)).
242. *Id.* at 419 (quoting *City of Lennox*, 519 N.W.2d at 333).

and [winter-]wheat crop, resulting in lost profits."[243] Since the Cooperative's "claimed damages are consequential losses, specifically lost profits, from defective fertilizer rather than damage to collateral property," the Cooperative's negligence claims fell under the scope of the economic loss doctrine and did not qualify for the "other property" exception to the economic loss doctrine.[244]

The above cases demonstrate the conflict that arises when the economic loss rule is used to define the boundary between tort law and contract law. This conflict has led some judges and commentators to liken the economic loss rule to "the ever-expanding, all-consuming alien life form portrayed in the 1958 B-movie classic *The Blob*" and "a swelling globule on the legal landscape of [the] state."[245] At other times, the economic loss rule is simply described as "one of the most confusing doctrines in tort law."[246] In any event, this conflict will undoubtedly continue to be played out in cases across the country for years to come. Thus, it is incumbent on legal practitioners to keep abreast of these changes as they occur in their particular state.

243. *Id.*

244. *Id.*

245. Grams v. Milk Prods., Inc., 699 N.W.2d 167, 180 (Wis. 2005); *see also* 1325 North Van Buren, LLC v. T-3 Grp., Ltd., 716 N.W.2d 822, 841 (Wis. 2006).

246. R. Joseph Barton, *Drowning in a Sea of Contract: Application of the Economic Loss Rule to Fraud and Negligent Misrepresentation Claims*, 41 WM. & MARY L. REV. 1789 (2000); *see also* Paul J. Schwiep, *The Economic Loss Rule Outbreak: The Monster That Ate Commercial Torts*, FLA. BUS. J., Nov. 1995 at 34 ("[I]t is clear that judges, lawyers, and commercial clients alike are all desperately struggling to define the parameters of the economic loss doctrine.").