

Lies, Damn Lies, and Lawsuits

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The purpose of this article is to provide a framework useful in analyzing when a lie, told during the ordinary course of investigative business, might give rise to legal liability. We will be limiting our discussion to civil liability, but the elements of criminal liability are similar, varying mainly in the burden of proof.

Euphemistically Speaking

Most of us don't like to admit that we lie, so we use euphemistic words like 'pretext' or 'subterfuge' to describe our actions. There really isn't much difference between these two terms, since both involve some sort of overt 'false representation' or 'misrepresentation.'

The word 'pretext' is derived from Latin, its brother, 'subterfuge,' from French. Unfortunately, 'pretexting,' the euphemism that we use so frequently, has accumulated some ugly connotations these days. As William Safire wrote recently about pretexting in the *New York Times Magazine*, September 24, 2006:

“...Its origin is in the Latin *texere*, 'to weave, to fabricate'; from that came the metaphor 'to weave a web of lies' and 'to fabricate a story.' A pretext can be mild, a mere excuse or 'white lie'; it can also be synonymous with *pretense*, rooted in the Latin *tendere*, 'to stretch,' in this sense meaning 'to stretch the truth.' No matter how you stretch it, the new participle pretexting has an aura of dishonesty about it.”

There has been a great deal of confusion both in the press and in recent congressional hearings about the meaning of the term 'pretext.' Though 'pretext' has sometimes mistakenly been used synonymously with the term 'fraudulent misrepresentation,' these two terms are definitely not interchangeable where the courts are concerned. Rather than the terms 'pretext' or 'subterfuge,' courts use the terms 'misrepresentation' or 'deceit' to describe that subdivision of the law of fraud that is based on a false statement. In other words, "The type of interest protected by the law of deceit is the interest in formulating business judgments without being misled by others..."¹

Reality Check

Whatever term we use, the important point to remember is that not every lie is fraudulent. Whether recognized or not, most people use some 'pretexting' every day in the normal business and social interactions. We all know about white lies used to spare another's feelings. And certainly no one would consider it to be unethical, let alone illegal, to tell the other party in a negotiation that 'X' is the final offer when, in fact, other offers will be made if the one on the table is refused. Business people engage in 'puffing' or 'trade talk.' Similarly, our vendors

occasionally conduct pretexts to make sure that we are using their services within the limits of our contracts.

Weighing the Burden

Proving fraud is much more difficult than proving most civil injuries or breaches of contract. There is a stigma attached to the charge of fraud, and civil fraud is viewed as quasi-criminal, with the standard of proof in a civil fraud case lying between the standard for criminal fraud and the standard for most other civil cases.

Civil fraud must be proved by '*clear and convincing evidence*' because the interests involved are deemed to be more substantial than the mere loss of money. This standard is more rigorous than the '*preponderance of the evidence*' required in a civil case, but less stringent than '*beyond a reasonable doubt*' necessary in a criminal case where a person's liberty is at stake.²

Moreover, the party claiming civil fraud must take great care in describing the fraud when filing the initial Complaint. Ordinarily, a person bringing a civil Complaint merely has to give the other party notice that an injury or a contract breach is claimed. In a case of civil fraud, the fraud must be described in great detail.³

Elements of Fraud

Unfortunately, there is no bright line that divides fraudulent lies from innocuous white lies. Fraud is an elusive term whose definition can vary from state to state, as well as from case to case. Generally speaking, a party claiming to have been defrauded must prove: (1) a false statement, (2) about a material fact, (3) made with the intent to deceive, (4) upon which the claimant relied, (5) and which resulted in damages to the claimant.

1. **False Representation.** There must be a false statement (misrepresentation).⁴

Example: If a person with whom I am communicating assumes that Ross Financial Services, Inc. represents investors or investment services, I don't have any immediate duty to explain the name of my company or the nature of my business. The law requires the other party to use reasonable care in determining facts, so there is nothing fraudulent here.

2. **Materiality.** A false representation is 'material' if the representation would have influenced a reasonable person in the claimants' position. Trivial misstatements, even though false, cannot provide a basis for a lawsuit claiming fraud.⁵

Example: A New York buyer wants to purchase a derelict property located next to the expensive office suites that he is building. He does not want to disclose that he has an interest in purchasing the derelict property, fearing that the price would be jacked up unfairly. His representative, claiming to be a Washington, DC buyer, places the call to inquire about the property. It is unlikely that a court would find this representation to be 'material' and, thus, would not find that a fraud has been committed.

3. **Deception.** The false representation must be made with the intent to deceive the claimant. The party seeking damages for misrepresentation must have been personally misled, and must have personally relied on the false statement.⁶

Example: Business A is interested in determining what financial incentives a county has offered to its competitor, Business B. Telephone contact is made to the county from an individual representing Business A, indicating interest in investing in that county. Since the call is to learn about financial incentives offered, and is made to the county, not to Business B, it is likely that this deception would not be found to be fraudulent. Moreover, the misrepresentation may not even be material.

4. **Reliance.** The courts are in disagreement over whether a claimant must justify his or her reliance on a false material misrepresentation. For instance, in the District of Columbia, the courts follow the rule that reliance cannot be deemed 'reasonable' if minimal investigation would have revealed the truth.⁷

Example: The borrower applied for a home mortgage through a lender. That lender referred the application to another lender, and the loan application was denied. The borrower claimed to have been defrauded by the false representation of the original lender indicating that it would be the entity to process the borrower's application. However, the court ruled that if the representation had been material to the borrower... that one lender rather than another process the application...it was the obligation of the borrower to determine the actual facts.

5. **Damages.** The person to whom a misrepresentation is made must prove that he/she was actually injured as a result of the misrepresentation.⁸

Example: An investigator pretends to be interested in investing in a Ponzi scheme that is being run by a salesman with no apparent criminal history. The pretext allows the investigator to obtain references from the suspect, and the subsequent investigation identifies co-conspirators, past schemes and criminal investigations, and the fraud unravels. Most courts would find that the salesman – who claims innocence – cannot then prove that he has been damaged by the misrepresentation, since the pretext was used to end the fraud that he was committing.

Conclusion

Obviously, this is far from an exhaustive study of the subdivision of fraud known as misrepresentation or deceit. Moreover, it is not a matter of black or white. Different courts in other jurisdictions could conceivably view the examples above as supporting a finding of fraud, rather than agreeing with the courts in the cases I have cited. Nor do I intend to provide legal advice about how any particular pretext would be viewed by a court or a jury. Welcome to the gray zone.

What I do hope is that this article provides you with a framework against which you can measure a pretext you contemplate using in your practice. Examine the pretext for the elements of a possible fraud case, and consider the difficulties an opponent would face in proving that you have committed fraud. Finally, as Sargeant Phil Esterhaus used to say on *Hill Street Blues*:

"Let's be careful out there."



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ENDNOTES

¹ 2 Harper, and James and Gray on Torts, Sec. 7.1 (3rd ed. 2006).

² Duncan Noble, *Evidence: Burden of Proof*, 51 Mich. L. Rev. 991-3 (1953)

³ Fed. R. Civ. P. 9(b).

⁴ Bennett Enterprises, Inc. v. Domino's Pizza, Inc., 794 F. Supp. 434 (D. D.C. 1992).

⁵ Finley v. Dalton, 164 S. E. 2d 763 (S.C. 1968).

⁶ St. Catherine Hosp. v. Rodriguez, 971 P.2d 754 (Kan. 1998)

⁷ High v. McLean Financial Corp., 659 F. Supp. 1561 (D.D.C. 1987).

⁸ Redmond v. Birkel, 933 F. Supp.1 (D.D.C. 1996).