

New York Law Journal

SERVING THE BENCH AND BAR SINCE 1888

NEW YORK, TUESDAY, MAY 8, 2001

OUTSIDE COUNSEL

By Laurie Berke-Weiss

Reviewing the Tort of Fraudulent Inducement

In the wake of layoffs in various sectors of the economy, terminated employees, who are generally "at-will" and without recourse against their employers, are increasingly looking at statements made to them at the time of their hire to determine whether they have been the victim of fraud.

In general, the breach of promissory statements as to what an employer will do in the future gives rise only to a breach of contract claim. An employer's false representation of present fact to an applicant for employment, however, may give rise to a separate claim in tort for fraudulent inducement.

Employees can recover for fraudulent statements that induce them to accept employment with a new employer by showing (1) the employer made a material false representation, (2) the employer intended to defraud the plaintiff thereby, (3) the employee reasonably relied upon the



Laurie Berke-Weiss is a partner in Berke-Weiss & Pechman LLP in New York

representation, and (4) the employee suffered damage as a result of such reliance.¹

This article will review the recent evolution of the tort of fraudulent inducement.

The breakthrough case which cemented fraudulent inducement as a viable claim in the employment context was *Stewart v. Jackson & Nash*.² In that

case, Stewart, an attorney in the environmental law department of a prominent New York law firm, was recruited to the Jackson & Nash law firm.

In reliance on Jackson & Nash's promises of heading its new environmental law department and serving the firm's existing, large environmental law client, Stewart joined Jackson & Nash. Once Stewart got to Jackson & Nash, however, she was given general litigation assignments, and discovered there was never a large environmental law client, and no developing environmental case work. She was terminated just over two years after her hire and sued Jackson & Nash for both negligent misrepresentation and fraudulent inducement.

The district court granted Jackson & Nash's motion to dismiss both claims. The court reasoned that Stewart's fraud claim arose from her termination from the firm and dismissed the claim on the basis of New York's seminal case on employment at-will, *Murphy v. American Home Prod. Corp.*³ The *Murphy* decision had held that because at-will employees may be freely terminated "at any time for any reason or even for no reason," they can neither challenge their termination in a contract action nor bootstrap themselves around the employment at-will rule bar by alleging that the firing was in some way tortious.

The district court also dismissed Stewart's negligent misrepresentation claim because she had not shown that Jackson & Nash owed her a fiduciary duty, the prerequisite to a negligent misrepresentation claim.

On appeal, the U.S. Court of Appeals for the Second Circuit affirmed the district court's dismissal of the negligent misrepresentation claim but reversed as to the fraud claim. The circuit rejected the district court's characterization of the fraud claim as "based on facts arising out of her termination," but rather found that Stewart's injuries commenced well before her termination and were, in several important respects, unrelated to it.

Noting that the misrepresentations caused Stewart to leave a firm with an environmental practice and spend two years at one in which she was largely unable to work in her chosen specialty, the resulting damage to her career development as an environmental lawyer was independent of her later termination.

Because Stewart's "career objective" — continuing to specialize in environmental law — was thwarted and grossly undermined during her employment with Jackson & Nash, her cause of action was distinguished from the fact of her termination.

The Second Circuit reasoned that "although *Murphy* precludes an award of damages for injuries caused by her termination, it does not prevent her from recovering for injuries that resulted from her reliance on the defendants' false statements."⁴ The *Stewart* court concluded that to the extent the misrepresentations were of present fact, they are actionable under a theory of fraudulent inducement.

Moreover, the court explained that representations of present fact include promises of future action if the declarant had no intention of fulfilling the promise at the time it was made.

Recent Developments

In *Kissner v. Inter-Continental Hotels Corp.*,⁵ Mark Kissner was hired by Inter-Continental Hotels as a general manager of a luxury resort facility being constructed in Bali, Indonesia. Three months after his hire, however, Kissner was transferred by Inter-Continental to manage a hotel in Manama, Bahrain. Kissner's preference was for an assignment in a different part of the world, and he expressed concern with the Bahrain transfer.

Nonetheless, he accepted the reassignment to Bahrain with the understanding that he was receiving a promotion and this would be a step

toward becoming a regional vice president. Four months after his transfer to Bahrain, Kissner was fired. Judge Kram denied Inter-Continental's motion to dismiss the claim of fraudulent inducement, finding that Kissner sufficiently alleged that the representation with regard to the opportunity for promotion was known to be false at the time it was made and the Inter-Continental had no intention of performing its promise.

In *Hyman v. International Business Machines Corp.*,⁴ IBM created a wholly-owned subsidiary, ESC, to perform its staff recruitment. Plaintiffs Richard Hyman and Phillip Palece, who had each been recruiters with IBM for over thirty years, were told by ESC that the company had signed a five-year contract with IBM. Relying on that representation, Hyman and Palece left IBM to work for ESC, performing substantially the same functions that they had performed at IBM. After two years, however, IBM reversed course, dissolved ESC, and returned the recruiting function — but not plaintiffs — to IBM. Plaintiffs alleged that they were fraudulently induced to leave their jobs at IBM based on ESC's false representation of the existence of a five-year contract between the two companies.

Judge Martin held that Messrs. Hyman and Palece had successfully pleaded a cause of action for fraudulent inducement. Judge Martin noted that plaintiffs were not seeking to recover from their termination from ESC and its consequent impact on their careers and pocketbooks, but rather alleged that they were induced to leave secure positions at IBM by false representations, and that this inducement led to injuries resulting from the act of resigning from IBM. Judge Martin noted that plaintiffs made a viable claim for injuries which arose from loss of security and other benefits attendant to continued employment at IBM.

In *Doehla v. Wathne Limited, Inc.*,¹ Judge Haight denied a motion to dismiss Henry Doehla's claim against a company that hired him as its President. Doehla claimed that his new employer — which fired him after only three months — fraudulently misrepresented and concealed its financial health and profitability as well as the scope of what his duties would be as President. In reliance on the misrepresentations and concealments, Doehla had resigned from his position as President of another manufacturer, foregoing a lucrative long-term contract.

Judge Haight found that Doehla's claim was actionable because the representations of the company's present financial conditions were representations of present fact.

Moreover, Judge Haight rejected the company's defense that Doehla's

claim was not compensable under New York's "out of pocket" rule. That rule provides that damages are to be calculated to compensate for what is lost because of the fraud, not to recover profits which would have been realized in the absence of fraud.

Judge Haight reasoned that Doehla might be able to demonstrate an actual pecuniary loss caused by the fraud in the inducement since he passed on a long term employment contract with his former employer to take the new position.

In *Jelks v. Citibank, N.A.*,² Gloria Jelks claimed that she was hired by Citibank as a Technical Specialist but her job duties were eliminated when the company decided to freeze the data warehouse that she was hired to modify. Jelks claimed that Citibank had already decided to discontinue use of the data system when it hired plaintiff and purposely concealed this fact during her employment so that she would stay.

Judge Martin rejected Jelks' fraudulent inducement claim, noting that she alleged no specific misrepresentation that was made to her prior to commencing employment with Citibank. Jelk's claim that she was hired for a job that didn't exist was insufficient to state a cause of action according to Judge Martin, since "a job offer is by definition central, not collateral, to the employment agreement itself, and accordingly a hidden intention not to perform gives rise to a breach of contract claim, not a fraud claim."³

Moreover, as an at-will employee, Jelks was not promised employment for any specific period of time and could not reasonably rely on a mere promise of employment. In any event, Judge Martin concluded that Jelks could not avail herself of the fraudulent inducement cause of action because she failed to specifically allege any damages that are separate from the termination of her job, such as damage to career growth, loss of reputation, or loss of benefits and security.

In *Butvin v. DoubleClick, Inc.*,¹⁰ Nikolay Butvin was offered employment as a computer software engineer at DoubleClick, with the promise of a \$46,000 salary and stock options for 13,000 shares. Butvin claimed he was told by DoubleClick that his interest in the stock options was indefeasible and that he would not have accepted the job absent such promise.

One day before DoubleClick's stock commenced trading on NASDAQ, Butvin was fired. His later attempt to exercise his options was denied because the options were not vested at the time of his termination. Butvin alleged that DoubleClick promised stock options, purposefully concealed the Stock Option Plan which explained the vesting procedure, and thus fraudulently induced

him to work for DoubleClick. Butvin asserted that he worked long, intensive and irregular hours and had foregone other lucrative employment opportunities in reliance on DoubleClick's promise.

Judge Keenan dismissed the claim of fraud, finding that Butvin was not justified in relying on DoubleClick's allegedly fraudulent representations. Butvin's Employment Letter specifically referenced that stock options would be granted in accordance with the Stock Option Plan, and he was therefore on notice from the inception of his employment that the Stock Option Plan controlled his interests. Furthermore, the Option Agreement and Amendment Agreement, which Butvin acknowledged receiving, both refer to and incorporate the Stock Option Plan.

Judge Keenan explained, "[t]he law simply does not protect someone who willingly signs an agreement which references and incorporates other controlling documents which he or she has not seen."¹¹

Conclusion

George Bernard Shaw once remarked that "the liar's punishment is, not in the least that he cannot be believed, but that he cannot believe anyone else." In the context of employment offers, you can add the tort of fraudulent inducement to that punishment. The pre-employment negotiations between employers and potential employees is particularly susceptible to hyperbole. In an economic climate of belt-tightening and layoffs, terminated employees will be eager to uncover any cause of action which may support a claim for damages.

Given the increasing exposure to claims of fraudulent inducement, employers must be vigilant that their pre-offer discussions of employment do not misrepresent existing facts and create unintended liability.

(1) *Bridgestone/Firestone, Inc. v. Recovery Credit Servs.*, 98 F.3d 13, 19 20 (2d Cir. 1996) (citations omitted).

(2) 976 F.2d 86 (2d Cir. 1992).

(3) 58 N.Y.2d 293 (1983).

(4) 976 F.2d 86, 88 (2d Cir. 1992).

(5) 1998 U.S. Dist. LEXIS 9248 (S.D.N.Y. June 24, 1998).

(6) 2000 U.S. Dist. LEXIS 15136 (S.D.N.Y. October 17, 2000).

(7) 2000 U.S. Dist. LEXIS 9913 (S.D.N.Y. July 17, 2000).

(8) 2001 U.S. Dist. LEXIS 381 (S.D.N.Y. Jan. 22, 2001).

(9) *Id.* at *11.

(10) 2001 U.S. Dist. LEXIS 2318 (S.D.N.Y. March 7, 2001).

(11) *Id.* at *16.