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Enforcing Exculpatory Provisions Against Meritless Claims

Law360, New York (March 17, 2014, 5:54 PM ET) -- When faced with exculpatory provisions that limit or preclude their damages, plaintiffs use several tactics to avoid their contractual promises.^[1] Common examples include sensationalizing ordinary breach-of-contract claims so they resemble claims for gross negligence, fraud and consumer fraud. The opinions discussed below illustrate how arguments should be made during the pleadings stage to defeat plaintiffs' attempts to turn a mere breach of contract into something much more.

Common Pleading Tactics to Void Exculpatory Provisions

Gross Negligence

Many states refuse to enforce exculpatory provisions if the party seeking to enforce one committed gross negligence. So, not surprisingly, plaintiffs frequently assert claims for gross negligence, essentially alleging that the defendant performed its contractual obligation in a grossly negligent manner. The problem with this approach is, in a contractual relationship, the defendant likely did not breach a common-law duty; rather, the defendant breached a contractual duty. Because the defendant breached only a contractual duty, the negligence claim fails for lack of a common-law duty, and the exculpatory provision therefore applies to the remaining claim for breach of contract.

This occurred in *Valenzuela v. ADT Security Services Inc.*^[2] There, criminals successfully burglarized a jewelry store. The store's owners asserted a gross-negligence claim against ADT, alleging that the company "failed to properly install Valenzuela's alarm system and failed to provide notification services when it received an alarm signal from the system."^[3]

The Central District of California dismissed the gross-negligence claim, noting that, "California courts have repeatedly held ... that the alarm company's failure to notify the relevant parties of a received signal neither constitutes gross negligence nor evidences a duty arising outside of the contract."^[4] Because ADT's alleged failure to provide its contractual obligations amounted to only a breach of contract, and not a breach of a common-law duty that could support a gross-negligence claim, the district court dismissed the gross-negligence claim and limited the Valenzuelas' recoverable damages to the contractually agreed-upon amount.

The Ninth Circuit affirmed, holding that "ADT's legal obligation to provide either service arose solely from its contractual relationship with Valenzuela, not from any duty independent of the parties' contract."^[5]

Similarly, in *Nirvana International v. ADT Security Services Inc.*, Nirvana alleged that ADT's security

system failed to detect a burglary that resulted in thieves stealing approximately \$2.4 million in jewelry from Nirvana's jewelry store.[6] Like the Valenzuelas, Nirvana sought to void the contract's limitation-of-liability provision by alleging that ADT's failure to properly install and connect the security system constituted a grossly negligent performance of its contractual obligations.[7]

The Southern District of New York dismissed Nirvana's gross-negligence claim, holding that "there is no tort liability for a breach of contract unless an independent legal duty has been violated ..."[8] The Second Circuit affirmed, noting that, because Nirvana "simply alleged that ADT failed to install and connect properly the security system," the district court properly dismissed Nirvana's gross-negligence claim and enforced the contract's limitation-of-liability provision.[9]

Fraud

Like gross negligence, exculpatory provisions generally do not apply if the defendant committed fraud. So plaintiffs will recast breach-of-contract claims as fraud to avoid the effects of exculpatory provisions on their contract claims. But again, because the relationship is typically a contractual one, plaintiffs have a difficult time successfully pleading the requisite elements of fraud.

For instance, a plaintiff will allege that the defendant represented that its service would be adequate or reliable at some future time, which turned out to not be true. Courts routinely dismiss these "fraud" claims because they are premised on a promise of future performance instead of on misrepresentations of a past or existing fact.

In *Ram International Inc. v. ADT Security Services Inc.*, for example, a jewelry store alleged that burglars stole \$1 million in jewelry due to ADT's failure to perform its contractual obligations of adequately installing and monitoring a security alarm system at the jewelry store.[10] The plaintiffs asserted fraud, alleging that ADT fraudulently represented in the parties' contract that:

(1) [The d]efendant would electronically and continuously monitor [p]laintiffs' telephone lines; (2) upon receipt of an alarm signal [the d]efendant would immediately dispatch the police and a guard to [the p]laintiffs' premises; and (3) if the telephone lines were cut, [the d]efendant would immediately receive notice and dispatch the police and a guard to [the p]laintiffs' premises.[11]

The Eastern District of Michigan granted ADT's motion to dismiss as to Ram's fraud claim, holding that "an action for fraudulent misrepresentation must be predicated upon a statement relating to a past or an existing fact." [12] ADT's alleged fraudulent representations, on the other hand, "relates to services [ADT] would perform" under the contract.[13] The alleged representations therefore did not constitute fraud because future promises are contractual in nature.

Importantly, the court noted that "allowing every broken promise in an agreement to become an actionable fraud claim would allow contract law to 'drown in a sea of tort.'" [14]

In *Jhaveri v. ADT Security Services Inc.*,[15] the Central District of California dismissed the Jhaveris' fraud claim on similar grounds. The Jhaveris alleged that, despite promising to do so in the parties' contract, ADT failed to notify the Jhaveris of an alarm activation at their home and to immediately dispatch the police and ADT security services patrol.[16] The Jhaveris argued that ADT's alleged failure to perform its contractual promises constituted fraud. The district court noted that the Jhaveris' fraud claim was a subspecies of fraud called promissory fraud, which "permits a plaintiff to state a cause of action in tort when a defendant fraudulently induces him to enter into a contract."[17] The court noted that, although

failure to perform a contract does not constitute fraud, “a promise made without intention to perform can be actionable fraud.”[18]

The court granted ADT’s motion for judgment on the pleadings as to the Jhaveris’ fraud claim because the Jhaveris’ complaint failed to “allege facts from which the [c]ourt can infer that [ADT’s] contractual assurances were false when made.”[19] Like the court in Ram, the court noted that permitting such flimsy allegations to survive the pleading stage would drown contract law in a sea of tort:

That [the d]efendant failed to perform on these promises does not plausibly give rise to an inference that [the d]efendant never intended to honor the contract — “[s]uch an assumption is unwarranted because it contradicts the heightened pleading requirements [for fraud] and would allow ‘every breach of contract [to] support a claim of fraud so long as the plaintiff adds to his complaint a general allegation that the defendant never intended to keep her promise.’”[20]

Because the Jhaveris failed to adequately plead their fraud claim (and claims for gross negligence, willful misconduct, breach of fiduciary duty and violation of California’s Unfair Competition Law), the court limited their recoverable damages to the amount noted in the parties’ contract.[21]

Consumer Fraud Statutes

Most states’ consumer-fraud statutes prevent parties from relying on exculpatory provisions to limit or exclude damages if the defendant violated the statute. So another method plaintiffs commonly use to avoid adverse contractual provisions is to transform a breach-of-contract claim into a consumer-fraud statutory violation. Courts typically do not fall for these tactics and dismiss such claims at the pleading stage because a mere failure to adequately perform a contractual obligation does not amount to a consumer-fraud statute violation.

In Bahringer v. ADT Security Services Inc., Bahringer alleged that his fire alarm system failed to detect a fire, which resulted in property damages and personal injuries.[22] Bahringer asserted a claim for violation of the South Carolina Unfair Trade Practices Act, alleging that “ADT employs deceptive advertising that states that the company notifies the fire department ‘[a]s soon as an ADT fire or smoke detector signals an alarm.’”[23] Bahringer contended that a discrepancy between ADT’s advertising and the terms of ADT’s contract constituted a deceptive practice.[24]

The District of South Carolina dismissed Bahringer’s statutory claim, finding that ADT’s marketing materials were not misleading because they “neither promise to insure customers against all damages nor suggest that ADT accepts unlimited liability for customers’ losses ... The language on that page focuses on what happens once a fire or smoke alarm has been triggered, not how reliably the alarms are triggered.”[25] The court also noted that even “a deliberate or intentional breach of a valid contract, without more, does not constitute a violation of the Unfair Trade Practices Act.”[26]

Similarly, in Joy Systems v. ADT Security Services Inc., the plaintiff alleged that the security system did not detect a burglary at Joy Systems’ warehouse because the alarm system had not been connected to the central station.[27] Joy Systems argued that ADT violated New Jersey’s Consumer Fraud Act because ADT committed an affirmative misrepresentation by: (1) inducing the plaintiff to purchase its services in representing that it would provide central station signal and notification service as well as 24-hour monitoring; (2) providing the plaintiff with a certificate confirming this understanding; and (3) then failing to install those features.[28]

The District of New Jersey dismissed Joy Systems' Consumer Fraud Act claim because, "[I]n essence, [the p]laintiff again alleges that [ADT] failed to perform on the contract. It is well settled that something more than a breach of contract is required to make up a valid claim under the [Consumer Fraud Act]."^[29]

Scrutinize Claims to Ensure That Contract Cases Remain Contract Cases

Plaintiffs go to great lengths at the pleading stage to hold defendants to their end of the contractual bargain while simultaneously attempting to avoid their own. To defeat these attempts, carefully read each of the allegations to determine what the plaintiffs contend the defendants did wrong. If the alleged wrongful conduct boils down to the defendant merely breaching a contractual obligation, the sole adequately-pleaded claim is breach of contract. If that's the case, then plaintiffs are probably adding claims to enlarge their recoverable damages — such as treble damages under a consumer-fraud statute or punitive damages in a gross-negligence or fraud claim — or attempting to void an exculpatory provision.

A telltale sign of this tactic is that the facts supporting the tort, fraud or statutory claim are nearly identical to those supporting the breach-of-contract claim. Also, be mindful that conclusory phrases such as "fraudulent representations," "unconscionable conduct," "deceptive practices" or "grossly-negligent conduct" carry no weight with most courts unless they have factual support.

As the cases above demonstrate, courts often see through plaintiffs' transparent attempts to turn breaches of contracts into something more simply to void exculpatory provisions or expand their recoverable damages. Counsel should keep these rulings in mind when deciding whether to answer the complaint and proceed with costly and time-consuming discovery or pare down the complaint by moving to dismiss these contrived claims.

The cases above should embolden counsel to take plaintiffs to task by filing a dispositive motion at the pleading stage, asking the court to do what the plaintiff should have done from the outset — keep negligence and fraud claims out of what is a straightforward contract case.

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[1] See Charlie Eblen and Aaron Kirkland, Maximize Your Contract's Exculpatory Provisions, Law360, July 15, 2013.

[2] 475 Fed. App'x 115 (9th Cir. 2012).

[3] *Id.* at 117.

[4] 820 F. Supp. 2d 1061, 1070 (C.D. Cal. 2010), aff'd, 475 Fed. App'x 115 (9th Cir. 2012).

[5] 475 Fed. App'x at 117 (citing *Erlich v. Menezes*, 981 P.2d 978 (Cal. 1999)).

[6] 881 F. Supp. 2d 556 (S.D.N.Y. 2012), aff'd, No. 12-3445, 2013 WL 1982124 (2d Cir. May 15, 2013).

[7] 2013 WL 1982124, at *2.

[8] 881 F. Supp. 2d at 562.

[9] Id.; see also *Berman v. ADT LLC*, No. 12-7705, 2013 WL 6919891, at *6 (D.N.J. Dec. 13, 2013) (dismissing claims for gross negligence and willful and wanton misconduct, noting that "the law is clear that a plaintiff cannot maintain a tort claim against a defendant where the conduct complained of arises out of a contractual obligation, and does not implicate an extracontractual duty of care. Here, Plaintiffs have failed to allege – and cannot allege – that Defendant owed Plaintiff an extra-contractual duty to contact the authorities or other designated persons after receiving an alert signal from Plaintiffs' home."); *Brotherhood Mutual Insurance Co. v. ADT LLC*, __ F. Supp. 2d __, No. 13-1870, 2013 WL 5728211, at *1-2 (D. Minn. Oct. 22, 2013) (dismissing claim for willful and wanton negligence because "once an alarm company contracts to provide services, failure to provide those services is not redressable by a tort claim").

[10] No. 11-10259, 2011 WL 5244936, at *1-3 (E.D. Mich. Nov. 3, 2011); aff'd, No. 12-2023, 2014 WL 446824 (6th Cir. Feb. 4, 2014).

[11] Id. at *6.

[12] Id.

[13] Id. (emphasis in original).

[14] Id. at * 7 (quoting *Huron Tool & Eng'g Co. v. Precision Consulting Services Inc.*, 532 N.W.2d 541, 546 (Mich. 1995)).

[15] No. 2:11-cv-4426, 2012 WL 843315 (C.D. Cal. Mar. 6, 2012). The Central District of California's decision on ADT's motion for judgment on the pleading is currently on appeal to the Ninth Circuit. Notably, the Jhaveris did not appeal the court's decision on their fraud claim.

[16] Id. at *1.

[17] Id. at *4.

[18] Id.

[19] Id. at *5 (emphasis in original).

[20] Id. (quoting *Richardson v. Reliance Nat'l Indem. Co.*, No. 99-2952 (2000 WL 284211, at *4 (N.D. Cal. Mar. 9, 2000))).

[21] Id. at *7.

[22] No. 2:12-cv-1473, 2013 WL 1810659, *1 (D.S.C. Apr. 29, 2013).

[23] Id. at *5.

[24] Id.

[25] Id. at *6.

[26] Id. (quoting *Columbia E. Assoc. v. Bi-Lo, Inc.*, 386 S.E.2d 259, 263 (S.C. Ct. App. 1989)).

[27] No. 07-3579, 2008 WL 682232, at *1 (D.N.J. Mar. 7, 2008).

[28] Id. at *3.

[29] Id. at *4.

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