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Burden of Proof for a Legal Fraud Claim Is Confused and Unsettled

A strong argument can be made that a mere preponderance of the evidence, and not clear and convincing evidence, is required

Eight years ago I wrote an article for the *New Jersey Law Journal* examining a trend in case law apparently requiring a party to prove a claim for legal fraud by clear and convincing evidence rather than by a preponderance of the evidence. See, “Is a Higher Standard Needed for Proof of Fraud?” 138 N.J.L.J. 679 (Oct. 17, 1994). It is time to re-examine and update the case law and to suggest that a claim for legal fraud may require proof by a mere preponderance of the evidence.

Basic Elements and the Different Standards of Proof

Legal fraud consists of (1) a material representation of a presently existing or past fact, (2) made with knowledge of its

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falsity and (3) with the intention that the other party rely thereon, (4) resulting in reliance by that party (5) to his or her detriment.

Equitable fraud does not require proof of scienter, meaning knowledge of the falsity of the representation and an intention that the other party rely thereon (elements (2) and (3) above). See *Jewish Center of Sussex County v. Whale*, 86 N.J. 619 (1981).

A party sues on a claim for legal fraud when money damages are sought and on a claim for equitable fraud when equitable relief, such as rescission of a contract, is sought.

Two standards of proof exist in civil cases. The preponderance of the evidence standard requires “that amount of evidence that causes [the finder of fact] to conclude that the allegation is probably true. [That is,] ... that the allegation is more likely true than not true. If the evidence ... is equally balanced, that issue has not been proven by a preponderance of the evidence.” See *Model Jury Charges — Civil* §1.12(H), and Richard J. Biunno, *New Jersey Rules of Evidence* (Gann 2002), Comment 5 to N.J.R.E. 101(b)(1) at 76 (and cases cited therein).

The higher standard of clear and con-

vincing evidence requires “a firm belief or conviction that the allegations sought to be proved by the evidence are true. It is evidence so clear, direct, weighty in terms of quality, and convincing as to cause [the finder of fact] to come to a clear conviction of the truth of the precise facts in issue.” *Model Jury Charges — Civil* §1.19. It requires more than “a mere balancing of doubts or probabilities.” See *New Jersey Rules of Evidence* (Gann 2002), Comment 6 to N.J.R.E. 101(b)(1).

Differences Ignored

Until the mid-1980s, the case law had provided that a party’s burden of proof on a fraud claim was dependent on whether the claim was for legal fraud or equitable fraud. A party was required to prove legal fraud by a preponderance of the evidence and equitable fraud by the higher standard of clear and convincing evidence. See, for example, *Batka v. Liberty Mutual Fire Ins. Co.*, 704 F. 2d 684 (3d Cir. 1983) (and the cases cited therein).

In the mid-1980s, several cases held that the burden of proof for fraud — legal and equitable — was by clear and convincing evidence. As noted in this article, there was no explanation, analysis or rationale in these cases regarding how and why this change in the law was being made. These cases also ignored the differences between legal fraud and equitable fraud and the corresponding burdens of proof. This trend has continued in the state courts to the present day.

Indeed, in the state court, the standard to prove legal fraud by clear and convincing evidence appears to be a *fait accompli*.

In the federal courts, there is a split in authority, with the better reasoned cases honoring the dichotomy between legal fraud and equitable fraud and the differing burdens of proof.

Earlier Cases

In 1961, the Appellate Division noted the different standards for proving fraud in *Armel v. Crewick*, 71 N.J. Super. 213 (App. Div. 1961). There, the court examined prior case law and held that a party must prove legal fraud by a preponderance of the evidence and equitable fraud by clear and convincing evidence.

In 1983, in *Batka*, the Third U.S. Circuit Court of Appeals noted the distinction between the burdens of proof for legal fraud and equitable fraud claims, citing all of the state court decisions applying the standard of a preponderance of the evidence to legal fraud and clear and convincing evidence to equitable fraud, and held:

In a suit for money damages for fraud, the plaintiff need only prove a case by a preponderance of the evidence. In order to obtain equitable relief such as rescission, however, clear and convincing proof is required. A leading case recognizing the distinction is *Armel v. Crewick*. ... New Jersey authorities applying the clear and convincing proof standard in equity in fraud cases are legion. ...

On the other hand, the preponderance of the evidence standard is applied only when a remedy at law for fraud is sought. ... While none of these cases, with the exception of *Armel*, explicitly articulate the law/equity distinction, such an understanding is implicit in those cases which cite to *Armel*. Moreover, New Jersey's highest court applied a clear and convincing evidence standard in *Connelly v. Weisfeld*, [142 N.J. Eq. 406 (E. & A. 1948), which involved equitable fraud.] but a preponderance of the evidence standard in *Fischetto [Paper Mill Supply, Inc. v. Quigley Co.]*, 3 N.J. 149 (1949), which involved legal fraud]. Clearly, New Jersey has long rec-

ognized the distinction articulated in *Armel*.

Based on *Armel* and *Batka*, an argument can be made that legal fraud requires only proof by a preponderance of the evidence because a plaintiff already has the difficult burden of proving scienter; that is, a plaintiff has the difficult task of proving that the defendant knew that his representation was false when made and that the defendant intended that the plaintiff rely on the representation. With equitable fraud, a plaintiff is not required to prove scienter; therefore, he must prove equitable fraud by the higher standard of clear and convincing evidence. See *Jewish Center*.

One Standard To Prove All Fraud Claims

It appears that things started to change in 1986, when in *Albright v. Burns*, 206 N.J. Super. 625 (App. Div. 1986), the Appellate Division stated that "[f]raud of course is never presumed; it must be clearly and convincingly proven." (Citing *Williams v. Witt*, 98 N.J. Super. 1 (App. Div. 1967), and *Gerard v. DiStefano*, 84 N.J. Super. 396 (Ch. Div. 1964)).

It is not clear that *Albright* involved a claim for legal fraud. Indeed, the foregoing quote was made in the midst of addressing whether it was appropriate to dismiss a claim for punitive damages. In any event, the court relied on *Williams* and *Gerard* to support its proposition that fraud must be proven by clear and convincing evidence. Both *Williams* and *Gerard* involved claims for equitable fraud; specifically, the annulment of marriages.

Three years later, however, *Albright* was cited by the Appellate Division in *Stochastic Decisions v. DiDomenico*, 236 N.J. Super. 388 (App. Div. 1989), where it stated that "[f]raud is not presumed; it must be proven through clear and convincing evidence." *Stochastic* involved a claim for legal fraud; that is, the plaintiff sought money damages.

It is important to note that there was no analysis on why the higher standard of clear and convincing evidence was being required to prove legal fraud when existing case law required a preponderance of the evidence. Thus began the unfortunate trend requiring legal fraud to be proven by clear and convincing evidence.

In 1992, *Albright* was again cited by

the Appellate Division in *Baldassarre v. Butler*, 254 N.J. Super. 502 (App. Div. 1992), which set forth the elements of both legal fraud and equitable fraud and then stated that "[f]raud, of course, is never presumed; it must be established by clear and convincing evidence." (citing *Stochastic*).

Although the court addressed both legal fraud and equitable fraud, it made no distinction regarding the plaintiff's burden of proof on each fraud claim. The Supreme Court reviewed and modified the Appellate Division's decision but did not address the burden of proof issue. *Baldassarre v. Butler*, 132 N.J. 278 (1993).

Albright and *Stochastic* were also cited in *R.A. Intile Realty Co., Inc. v. Raho*, 259 N.J. Super. 438 (Law Div. 1992), where the court noted that "[w]ith respect to the common law fraud claim against the Raho defendants, plaintiff has the burden of proving that claim by clear and convincing evidence; fraud will not be presumed." The plaintiff in *R.A. Intile* was seeking money damages, thus the case involved a legal fraud claim.

In the following year, the legal/equitable fraud dichotomy was again noted by the Third Circuit in *Lightning Lube, Inc. v. Whitco Corp.*, 4 F. 3d 1153 (3d Cir. 1993) (citing *Batka* and *Jewish Center*):

Depending on the remedy sought, an action for fraud may be either legal or equitable in nature. A plaintiff asserting a claim of legal fraud must show that the defendant acted with scienter, but only need prove the elements of fraud by a preponderance of the evidence. In contrast, a plaintiff advancing a claim of equitable fraud need not demonstrate scienter, but must establish the other elements of fraud by clear and convincing evidence.

This is a persuasive explanation for the differing burdens of proof for legal fraud and equitable fraud. Interestingly, the Third Circuit did not even cite *Albright* or *Stochastic* in *Lightning Lube*.

Notwithstanding the effort in *Lightning Lube* to resuscitate the legal/equitable fraud dichotomy, federal and state court decisions continued to rely on *Stochastic* for the proposition that clear and convincing evidence is required to prove legal fraud claims. See *Diaz v. Johnson Matthey, Inc.*, 869 F. Supp. 1155

(D.N.J. 1994), and *Fox v. Mercedes-Benz Credit Corp.*, 281 N.J. Super. 476 (App. Div. 1995), both citing *Stochastic*.

Stochastic was also cited by the Appellate Division in *Gennari v. Weichert Co. Realtors*, 288 N.J. Super. 504 (App. Div. 1996), in which the court addressed the appropriate burden of proof for a claim under the Consumer Fraud Act. However, the court stated that “the party asserting [common law legal] fraud bears the burden of proving it by clear and convincing evidence.” (citing *Stochastic*).

When *Gennari* reached the Supreme Court, the standard for proving common law legal fraud or consumer fraud was not an issue. As a result, the Supreme Court merely noted the Law Division’s decision, which found that there was no clear and convincing evidence to support a finding of common law fraud.

In both *Gennari* and *Baldassarre*, an argument can be made that the Supreme Court (or the parties) would have addressed the burden of proof issue if the Appellate Division had erred. However, a counterargument can be made that the issue was not addressed because it was not necessary to resolve the appeals. In addition, it is not likely that such a change in the law would be made by the Supreme Court’s mere silence on the issue.

Except for one recent case, *Gennari* has not been cited for the proposition that clear and convincing evidence is required to prove legal fraud. Instead, it is *Stochastic* that continues overwhelmingly to be cited for the proposition.

A Split in Authority

The recent decisions in the federal court in New Jersey reflect a split in authority between requiring clear and convincing evidence and a preponderance of the evidence. Some federal courts follow the legal/equitable fraud dichotomy espoused by the Third Circuit in *Batka* and *Lightning Lube* and require only a preponderance of the evidence to prove legal fraud.

Other federal courts follow *Stochastic* and its progeny by requiring proof of legal fraud by clear and convincing evidence.

The standard of proof issue was most recently addressed in *Lithuanian Commerce Corp. v. Sara Lee Hosiery*, 214 F. Supp. 2d 453 (D.N.J. 2002). To its credit, the court noted that the standard of proof

for claims of legal fraud is not well-settled and collected all of the recent cases supporting each standard of proof. It noted the line of cases largely citing to *Lightning Lube* and requiring a preponderance of the evidence and the other line of cases largely citing to *Stochastic* and requiring clear and convincing evidence.

The court then concluded that the “weight of authority” supported the conclusion that legal fraud claims must be proven by clear and convincing evidence. Unfortunately, the court merely cited the cases and did not analyze them to determine why legal fraud should be proven by clear and convincing evidence.

The court also concluded that the holding of *Lightning Lube* was “undermined” by *Gennari* and *Resorts International*, 181 F.3d 505 (3d Cir. 1999). In this regard, the court stated that in *Gennari*, the Supreme Court “adopted the clear and convincing standard for claims of legal fraud,” and that it “clearly held that the clear and convincing standard of proof was applicable to claims of legal fraud.”

In light of my comments above on *Gennari*, I respectfully disagree with the court’s conclusion that the Supreme Court clearly held that a legal fraud claim must be proven by clear and convincing evidence.

Likewise, I disagree with the court’s conclusion that *Lightning Lube* was undermined by *Resorts International*, which merely cited to *Stochastic* in support of a statement made in passing that legal fraud must be proven by clear and convincing evidence with no analysis of the issue. As it turns out, *Lithuanian Commerce* is nothing more than another case espousing that legal fraud requires proof by clear and convincing evidence.

Definitive Ruling Required

An argument can be made that the law/equity distinction identified in *Armel*, *Batka* and *Lightning Lube* was abandoned in *Stochastic*. However, it is not a persuasive argument, especially due to the lack of analysis on the issue in *Stochastic*. It is hard to fathom that such a significant change in the standard of proof can be made in such a manner.

Another argument can be made that clear and convincing evidence was always required to prove legal fraud and that

Armel, *Batka* and *Lightning Lube* were mere aberrations. Again, this is not a persuasive argument in light of the many cases cited therein standing for the proposition that clear and convincing evidence is required for equitable fraud and that a preponderance of the evidence is required for legal fraud.

On the surface, one may conclude that the courts have moved away from the legal/equitable fraud distinction and now require a party to prove fraud — whether equitable or legal — by clear and convincing evidence.

However, a close review of the case law reveals that *Stochastic* incorrectly or inadvertently changed the standard to prove legal fraud by its unfortunate reliance on *Albright*, which in turn relied on two equitable fraud (that is, annulment) cases. Such a change in the burden of proving legal fraud cannot, and should not, be made in such a manner, especially in light of the substantial and well-reasoned case law espousing the legal/equitable fraud dichotomy and the corresponding burdens of proof.

Finally, it is noted that the model jury charge for fraud sets forth the elements of legal fraud and then requires proof by clear and convincing evidence. See *Model Jury Charges — Civil* §3.19. However, even the Supreme Court Committee on Model Civil Jury Charges has recognized that clear and convincing evidence may not be required to prove legal fraud.

In 1996, the committee added a note to the model jury charge taking notice of the “debate” over the proper standard of proof for legal fraud, the difference between the standards to prove legal fraud and equitable fraud, and the recent trend to require clear and convincing evidence for all claims of fraud. As a result, it recommends a review of the case law. See *Model Jury Charges — Civil* §3.19.

Accordingly, the burden of proof for a legal fraud claim is not entirely clear and convincing; it is confused and unsettled. Until a definitive ruling is made by the Supreme Court or the Appellate Division, the law will continue to be unsettled, and a strong argument can continue to be made that a mere preponderance of the evidence, and not clear and convincing evidence, is what is required to prove a legal fraud claim. ■